2008-2009

REVENUE LAWS STUDY COMMITTEE

MINUTES

Revenue Laws Study Committee
Membership List
2007-2008

President Pro Tem Appointments

Senator John Kerr, III, Cochair
PO Box 1616
Goldsboro, NC 27533
(919) 734-1841

Senator Pete Brunstetter
Room 522, LOB
Raleigh, NC 27603
(919) 733-7850

Senator Dan Clodfelter
100 N. Tyron St., 47th Floor
Charlotte, NC 28202
(704) 331-1000

Senator Walter Dalton
346 North Main Street
Rutherfordton, NC 28139
(828) 286-8222

Senator Fletcher Hartsell
PO Box 368
Concord, NC 28025
(704) 786-5161

Senator David Hoyle
PO Box 2567
Gastonia, NC 28053
(704) 867-0822

Mr. Leonard Jones
300 North 35th Street
Morehead, City, NC 28577

Mr. Micah Pate
615 Oberlin Road
Raleigh, NC 27605

Speaker of the House Appointments

Representative Paul Luebke, Cochair
PO Box 26170
Greensboro, NC 27402
(336) 334-5295

Representative Harold J. Brubaker
138 Scarboro Street
Asheboro, NC 27203
(336) 629-5218

Representative Pryor Gibson
PO Box 1010
Wadesboro, NC 28170
(919) 632-1700

Representative Dewey Hill
1622 S. Madison Street
Whiteville, NC 28472
(910) 642-6044

Representative Danny McComas
PO Box 2274
Wilmington, NC 28402
(910) 343-8372

Representative Bill McGee
PO Box 5
Clemmons, NC 27012
(336) 766-4481

Representative William L. Wainwright
PO Box 941
Havelock, NC 28532
(252) 633-2411

Representative Jennifer Weiss
532 Legislative Office Building
Raleigh, NC 27603
(919) 715-3010

<u>Advisory Member</u>

Representative Becky Carney
1221 Legislative Building
Raleigh, NC 27601
(919) 733-5827

Staff

Cindy Avrette
Research Division
Room 545, LOB
(919) 733-2578

Trina Griffin
Research Division
Room 545, LOB
(919) 733-2578

Heather Fennel
Research Division
Room 545, LOB
(919) 733-2578

Ryan Blackledge
Bill Drafting Division
Room 401, LOB
(919) 733-6660

DeAnne Mangum
Committee Assistant
Room 329, LOB
(919) 733-2405

Barry Boardman
Fiscal Research Division
Room 643, LOB
(919) 733-4910

Martha Walston
Fiscal Research Division
Room 643, LOB
(919) 733-4910

Dan Ettefagh
Bill Drafting Division
Room 401, LOB
(919) 733-6660

2005-2006 Revenue Laws Study Committee

Committee Membership & Staff Contact Information Listing

House Appointments

Representative Paul Luebke, Co-Chair
1507 Oakland Avenue
Durham, North Carolina 27705
Paull@ncleg.net
(919) 286-0269

Representative Harold J. Brubaker
138 Scarboro Street
Asheboro, North Carolina 27203
Brub@ncleg.net
(336) 629-5128 629-2603 (F)

Representative Becky Carney
P. O. Box 32873
Charlotte, North Carolina 28232
Beckyc@ncleg.net
(704) 332-1893 (H) 905-2449 (C)

Representative Walter G. Church, Sr.
P.O. Box 760
Valdese, North Carolina 28690
Waltc@ncleg.net
(828) 879-3761 (H) 879-2356 (F)
(828) 874-2141 (O)

Representative Dewey L. Hill
P.O. Box 723
Whiteville, North Carolina 28472
Deweyh@ncleg.net
(910) 646-4297 (H) 640-7085 (C)
(910) 642-6044 (O) 642-7004 (F)

Representative Daniel F. McComas
P.O. Box 2274
Wilmington, North Carolina 28402
Dannym@ncleg.net
(910) 392-3011 (H) 612-9393 (C)
(910) 343-8372 (O) 343-8003 (F)

Representative William Wainwright
P.O. Box 33
Havelock, North Carolina 28532
Williamw@ncleg.net
(252) 447-7379 (H) 670-4469 (C)
(252) 633-2422 (O) 672-4075 (F)

Representative W.A. (Winkie) Wilkins
210 Fair Oaks Drive
Roxboro, North Carolina 27574
winkiew@ncleg.net
(336) 599-7336

Senate Appointments

Senator John H. Kerr, III, Co-Chair
P.O. Box 1616
Goldsboro, North Carolina 27533-1616
Johnk@ncleg.net
(919) 734-2910 (H) 734-4215 (F)
(919) 734-1841 (O)

Senator Daniel G. Clodfelter
100 N. Tryon St., 47th Fl.
Charlotte, North Carolina 28202-4003
Danielc@ncleg.net or clodfleterd@mvalaw.com
(704) 334-3684 (H) 378-2041 (F)
(704) 331-1041 (O)

Senator Walter H. Dalton
560 North Main Street
Rutherfordton, North Carolina 28139
Walterd@ncleg.net or wdalton@ndmlaw.com
(828) 287-2908 (H) 286-8229 (F)
(828) 286-8222 (O)

Senator Fletcher L. Hartsell, Jr.
P.O. Box 368
Concord, North Carolina 28026-0368
Fletcherh@ncleg.net
(704) 786-8508 (H) 788-8058 (F)
(704) 786-5161 (O)

Senator David W. Hoyle
P.O. Box 2567
Gastonia, North Carolina 28053
Davidh@ncleg.net
(704) 922-4969 (H) 864-7468 (F)
(704) 867-0822 (O)

Senator Hugh Webster
1419 Legislative Building
Raleigh, North Carolina 27601-1096
Hughw@ncleg.net
(919) 658-6170 658-3637 (F)

Mr. Leonard W. Jones
300 North 35th Street
Morehead City, North Carolina 28577

Mr. J. Micah Pate, III
615 Oberlin Road
Raleigh, North Carolina 27605

Last Updated: 11-16-2005 at 7:06 pm

Committee Membership & Staff Contact Information Listing

Staff Members

Ms. Cindy Avrette, Research Division
Room 545, Legislative Office Building
Cindya@ncleg.net
(919) 733-2578 715-5460 (F)

Ms. Martha Walston, Fiscal Research Division
Room 643, Legislative Office Building
Marthaw@ncleg.net
(919) 733-4910 (F)

Committee Clerk

Ms. DeAnne Mangum
Room 329, Legislative Office Building
Deannem@ncleg.net
(919) 733-2405

REVENUE LAWS STUDY COMMITTEE
Wednesday, October 22, 2008
Room 544, Legislative Office Building
9:30 a.m.

MINUTES

The Revenue Laws Study Committee met at 9:30 a.m. on Wednesday, October 22, 2008, in room 544 of the Legislative Office Building. Twelve members of the committee were present. Representative Luebke presided as chair.

Overview of 2008 Finance Law Changes and Fate of the Revenue Laws Study Committee's Recommendations to the 2008 General Assembly

Cindy Avrette, a staff attorney with the Research Division, was recognized to explain the 2007-2009 biennium tax law changes and which committee recommendations were enacted. A copy of her presentation is attached.

Budget Outlook

Barry Boardman, a fiscal analyst with the Fiscal Research Division, was recognized to give an overview of the current condition of the General Fund and a 2008-2009 economic forecast. A copy of Mr. Boardman's presentation is attached.

Overview of Exemptions for Nonprofits

Trina Griffin, a staff attorney with the Research Division, and Rodney Bizzell and Lee Dixon, fiscal analysts with the Fiscal Research Division, were recognized to provide an overview of nonprofits and their tax treatments. This included property tax exemptions and hospital charity care. A copy of their presentations is attached.

Discussion of the Illinois *Provena Covenant Medical Center Case*

Stan Jenkins, Supervisor of Assessments, Champaign County, Illinois, was recognized to explain the case which questioned the tax exemption status of not-for-profit hospital corporations. Hugh Tilson, the lobbyist with the NC Hospital Association, was recognized for comments and will provide staff with North Carolina hospital information before the end of the year. A copy of Mr. Jenkins' presentation is attached.

Paul Luebke

Representative Paul Luebke, Presiding Chair
Revenue Laws Study Committee

DeAnne Mangum

DeAnne Mangum, Committee Clerk

order of agenda changed

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

① Weiss

Wednesday, October 22, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. Welcoming Remarks

II. Overview of 2008 Finance Law Changes and Fate of the Revenue Laws Study Committee's Recommendations to the 2008 General Assembly $18 m fy $19m 2010 fy > tax deductions
① – *Cindy Avrette, Research Division* – ↓3 income tax brackets down, repeal of ~~inheritance~~ Paul Meyer county commission 4 counties commented on sales tax

III. Budget Outlook listen to his presentation
② – *Barry Boardman, Fiscal Research Division* Recession · State Health Plan · Revenue shortfalls · Medicaid & other srvs will increase

IV. Overview of Issues Raised by Advancing the Reappraisal Schedule for Property Taxes (S.L. 2008-146 Property Tax Modifications)
– *Martha Walston, Fiscal Research Division*

V. Sales Tax Treatment of Food vs. Prepared Food
– *Sandra Johnson, Fiscal Research Division*

Overview of Exemptions for Nonprofits
③ – *Trina Griffin, Research Division* – overview of nonprofits & their tax treatments
– *Rodney Bizzell, Fiscal Research Division* ✓ Property tax exemptions
– *Lee Dixon, Fiscal Research Division* ✓ Hosp. Charity Care

IV.

V. Discussion of the Illinois *Provena Covenant Medical Center* Case
– *Stan Jenkins, Supervisor of Assessments – Champaign County, Illinois* Ill. enacted leg cost plus 30 % billed to patient (uninsured)

V.

VII. Adjournment Hugh Tolson NC Hosp. Association will get staff addl info by end of 2008

Next Meeting Date: Wednesday, November 19, 2008
All meetings in Room 544, LOB, at 9:30 a.m.

State debt
portion
satisfied & unsatisfied
debt

Debt Affordability
updated version
by Treasurer's
office

x Extensive

House Pages

Rev. Laws Study Comm

Name Of Committee: _____ Date: 10-22-08

1. Name: _____

   County: _____

   Sponsor: _____

2. Name: _____

   County: _____

   Sponsor: _____

3. Name: _____

   County: _____

   Sponsor: _____

4. Name: _____

   County: _____

   Sponsor: _____

5. Name: _____

   County: _____

   Sponsor: _____

	HOUSE	Sgt-At-Arms	SENATE
1. Name:	MARTH GADISON		MARY PERRY
2. Name:	Rusty Rhodes		GEORGE ROBINSON
3. Name:	MARVIN LEE		ROBERT YOUNG
4. Name:			CHARLES HARPER
5. Name:			

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — October 22, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Jim Ahler	NC. Assn of CPAs
Jamal Jones	NCHA
	JD, AL, PA
W. Daniel	Electric Cities of N.C. Inc
Matthew McKenzie	Carolinas Healthcare
	Commerce
Kathy Hawkins	Progress Energy
Pete Rodda	Forsyth County
Pat Goddard	Johnston County

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

October 22, 2008
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Christine Cruj	Wake Med
Jackie Ray	NCGA
Brad Phillips	TWC
Cam Cizer	BPMHL
Gene Ainsworth	A & A
DAVID BARNES	Poyner Spruill
Jennifer Willis	Wake County Govt.
Pam Melton	EMBARQ

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — October 22, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
David Hansen	NC Center for Nonprofits
Jim Johnson	Blount Street Advisors
Ken Melton	Ken Melton & Assoc.
Paul Meyer	NCACC
Dean Plunkett	NCBWWA
Kevin Leonard	WCSR
CS Hollis	K L Gates

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — October 22, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Bill Wilson	AARP
Janice Davidson	NCDOR
Donna Alderman	NCDOR
Andy Sasol	NCDOR
Grey Roney	NCDOJ
Terence Friedman	NCDOJ
Bill Spencer	NCDOR
Amy McConkey	Smith Anderson
Nathan Batts	NC Bankers Assoc
Bill Wilkes	NC DOR
Stan Durrum	Henderson County

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — October 22, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Michael Houser	NC Dept of Revenue
Sharon Miller	CUCA
Karl Knapp	NCLM
Lori Anne Harris	~~LAHA~~
Jake Cashion	WSCC
Michelle Frazier	MFS
David Baker	NCDOR
Susan Williamson	NCANPHA
Sandy Sands	WCSR

VISITOR REGISTRATION SHEET

Revenue Laws Study — Name of Committee

10-22-2008 — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

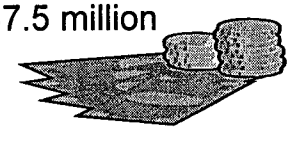
NAME	FIRM OR AGENCY AND ADDRESS
John Goodman	NC Chamber
R. Paul Wiles	NCHBA
Kelli Culver	NCLM
Martin Phagan	NC DJJDP
[signature]	WCPSS
Peggy Maynard	[signature]

NC Tax Law Changes: 2007-2009

Revenue Laws Study Committee
Cindy Avrette, Research Division, NCGA
October 22, 2008

Biennium at a Glance

- 2007 Fiscal Year
  - $1.54 billion surplus
  - 3rd year in a row
  - Net tax reductions for FY 07-08 = $87.5 million
  - Net tax reductions for FY 08-09 = $147.5 million
- 2008 Fiscal Year
  - Surplus < than last several years
  - $90 m ahead of forecast
  - Net tax reductions for FY 08-09 = $18.7 million
  - Net tax reductions for FY 09-10 = $79.1 million



General Trend Towards ...

- More income tax exemptions and deductions
- More sales tax exemptions and exceptions
- New tax credits
- Sunset extensions of credits and refunds
- New property tax exclusions

Structural Tax Changes 2007-2009

- Sales Tax
  - 6.75% sales tax rate
  - 4.75% State & 2% local (October 1, 2009)
  - County option sales tax of .25%
- Personal Taxes
  - Three income tax brackets (6% to 7.75%)
  - Refundable Earned Income Tax Credit (5%, 2009)
  - Gift tax repealed (1-1-09)

Income Tax Law Changes

- New Deductions
  - 529 Plan (2007)
    - Increased maximum amount
    - Removed income limitations until 2011
  - Firefighter/Rescue Squad (2007)
  - Manufactured Home Community sold to MHC Owners (2008)
- New Credits
  - WOTC (2007)
  - Adoption (2007)
  - Long Term Care Insurance (2007)
  - Donation of funds to a nonprofit (2007) or to a unit of government (2008) for use by it to obtain renewable energy property

Sales Tax Changes

- 2007 Exemptions
  - Commercial fishing
  - Baked goods sold in thrift stores
  - Baler twine
  - School instructional material included in holiday if $300 or less
  - Four-year phase-out of tax on electricity, piped natural gas, and fuel
    - 2007 – 2010
    - $40 million
- 2008 Changes
  - Sales Tax Holiday for Energy Star products
  - Lower tax rate on baked goods sold by artisan bakers
  - Exempt Interior design services
  - Sales tax refund for certain nonprofits affiliated with UNC
  - Clarify 501(c)(3) sales tax refunds

Sales Tax Changes

- 2007 Exemptions
  - Commercial fishing
  - Baked goods sold in thrift stores
  - Baler twine
  - School instructional material included in holiday if $300 or less
  - Four-year phase-out of tax on electricity, piped natural gas, and fuel
    - 2007 – 2010
    - $40 million
- 2008 Changes
  - **Sales Tax Holiday for Energy Star products**
  - Lower tax rate on baked goods sold by artisan bakers
  - Exempt Interior design services
  - **Clarify 501(c)(3) sales tax refunds**
  - **Sales tax refund for certain nonprofits affiliated with UNC**

Economic Incentives

- 2007 Changes
  - Analytical services
  - Software publishers
  - Railroad intermodal facilities
  - Datacenters
  - Aircraft manufacturers
  - R&D businesses
  - JDIG cap extended
- 2008 Changes
  - Extended sunsets
  - Increase QBV tax credit cap
  - Sales tax refund for solar electricity generating materials manufacturing
  - Machinery refurbishers
  - JDIG cap extended

Sunsets Extended

- Aviation Fuel Sales Tax Refunds
- Credit for R&D
- Credit for Low-Income Housing
- Credit for Mill Rehabilitation
- Credit for State Ports
- Credit for Small Business Employee Health Insurance Benefits
- Credit for Film Industry

2007 Property Tax Changes

- Increased income eligibility limit for homestead exclusion from $20,500 to $25,000, effective July 1, 2008
- Created homestead circuit breaker program for low-income elderly and disabled taxpayers, effective July 1, 2009
- Added working waterfront property & aquatic species farm to PUV program



2008 Property Tax Changes

- **More frequent revaluations**
- PUV program expanded to include wildlife conservation
- Exemption for leasehold interest in exempt property used for affordable housing
- Homestead exclusion for disabled veterans and spouses
- Exclusion for heavy equipment rentals (local option GR tax)
- Lower valuation of low-income housing developments
- Exemption for free samples of prescription drugs
- 80% reduction in valuation of solar energy electric systems

Most Notable Changes in 2008

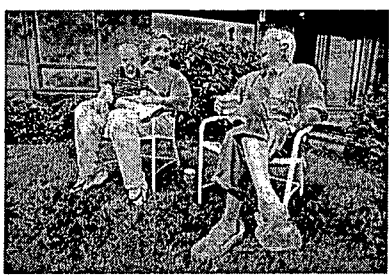
- Sales tax
  - New exemptions
  - New holiday
  - Small Business Protection Act
- Corporate tax
  - IRC update
  - Minor changes
    - Franchise Tax
    - PTP
  - Multiple sunsets extended
- Personal taxes
  - Increase in earned income tax credit
  - Miscellaneous credits and deductions
  - Repeal gift tax
- Property tax
  - Homestead exclusion for veterans
  - Wildlife conservation included in the PUV program

Earned Income Tax Credit

- Increase EITC
  - 3.5% to 5% of federal credit amount
  - $21 million
  - Effective 2009 taxable year
  - Federal credit amount varies by household size and income; indexed

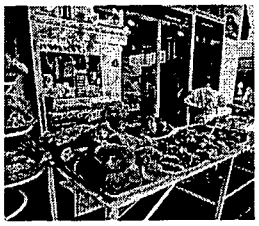


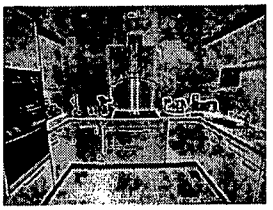
Gift Tax Repeal

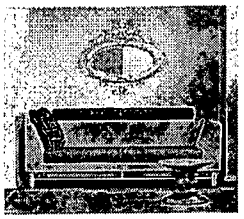


- Repeal gift tax
  - $17.5 million
  - Effective for gifts made on or after January 1, 2009
  - Supported by NCBA & NCACPA
  - CN & TN only states left with gift tax

Small Businesses Come to Raleigh







Resulted in Specific Legislation

- Sales tax exemption for baked goods sold by artisan bakeries
- Sales tax exemption for interior design services
- Small Business Protection Act
- Revenue Laws to study several sales tax specific issues

Small Business Protection Act

- Provided certain protections related to sales and use tax obligations
  - Reduction of assessment
  - Waiver of penalties
- Extended protection to verbal advice given by DOR
- Gave DOR additional flexibility w/ offers & compromise

SBPA: Qualifications

- Annual gross receipts < $1.8 million
- Remitted S&U taxes collected
- No prior audit on issue
- GF effort to comply with S&U tax law; Incorrect application of one or more:
  - Rate of tax that applies to food
  - Distinction between retailer and performance contractor
  - Distinction between incidental services and services necessary to complete sale of tpp
  - Determination of whether a person is a manufacturer

SBPA: Assessments

- Amount of reduction in assessment
  - Monthly GR up to $50,000, 98% reduction
  - Monthly GR up to $100,000, 95% reduction
  - Monthly GR up to $150,000, 90% reduction
- Limited retroactive application
  - Assessments pending 7-15-08
  - Assessments identified prior to 7-15-08
  - Assessments collectable but not paid as of 7-15-08
  - Paid w/in 6 months, timely refund claim filed

SBPA: Verbal Advice

- Protection of written advice from DOR extended to verbal advice from DOR
  - 7-16-08: DOR records establish erroneous advice given
  - 1-1-09: DOR must document conversations with taxpayers, whether in person or by phone, when specific advice requested
  - 7-1-09: DOR document certain sales tax questions
  - 7-1-10: Record calls at TAC

SBPA: Offer & Compromise

- Adjusted for inflation
- Eliminated requirement that DOR obtain approval from AG, unless in litigation
- Provided DOR the authority to settle tax liability for less than that asserted to be due *when the collection of an amount greater would produce an unjust result under the circumstances*

Revenue Laws Studies

- Taxation of services necessary to complete sale of tangible personal property
- Standards for distinguishing be/ performance contracts and retailers
- Distinction be/ food and prepared food and its taxation

Homestead Exclusion for Disabled Veterans and Spouses

- Property tax exclusion = $45,000 is assessed value of permanent residence
  (Homestead Exclusion = $25,000)
- No age requirement; disability requirement
  (Homestead Exclusion is age 65 or older or totally and permanently disabled)
- No income requirement
  (Homestead Exclusion = $25,000 for 2008; $25,600 for 2009)
- Effective July 1, 2009

Wildlife Conservation - PUV

- 20 acres, capped at 100 acres
- 5-year ownership
- Study 3-year fiscal impact on local governments – 2015 NCGA
- Wildlife habitat conservation agreement (WRC)
- Classified under PUV when agreement signed
- July 1, 2010



Other Legislation in 2008

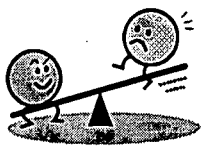
- Special assessments as revenue for purposes of local government revenue bonds (SL 2008-165)
- Procedure for Tax Class Actions (SL 2008-107)
- Home Inspector Privilege Tax (SL 2008-206)
- Resale of Tickets via Internet (SL 2008-158)
- Toll Enforcement Authority Changes (SL 2008-225)

2008 Revenue Laws Proposals

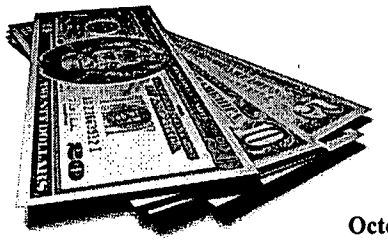
- Procedure for Tax Class Actions - ☑
- IRC Update - ☑
- Estate Tax Changes - ☑
- Modify Circuit Breaker Program - ☑
- Modify Reappraisal Schedules - ☑
- Exempt Disaster Assistance Debit Cards - ☑
- Corporate Tax Chg - ☑
  - Franchise Tax
  - PTP
- Technical Bill - ☑
- Supplemental PEG Support - ☑
- Short-Term Heavy Equipment Rentals - ☑
- Extend Sunsets on:
  - R&D - ☑
  - State Ports - ☑
  - Small Business Employee Health Insurance Benefits - ☑
  - Large Recycling Facility - ☒

What a Difference a Year Makes!

- 2007 Fiscal Year
  - $1.54 billion surplus
  - 3rd year in a row
- 2008 Fiscal Year
  - Surplus < than last several years
  - $90 m ahead of forecast
- 2009 Fiscal Year
  - Healthy surpluses of last several years will not be repeated



NORTH CAROLINA'S GENERAL FUND OUTLOOK



October 2008

Barry Boardman, Ph.D.
Economist, Fiscal Research Division
North Carolina General Assembly

FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Overview

- Revenues are 5% below target in first quarter
- Housing and financial upheaval push economy into recession
- State economic conditions deteriorate as housing, financial, and global downturns continue
- Budget pressures mount with slowdown in economy

How Do 2008-09 Revenues Look So Far?

- First quarter collections: $235 million below $4.6 billion target
  - Target growth 1.8%
  - less than total growth forecast for fiscal year
  - Forecast envisioned slowdown improves second-half of FY
- Important caveats
  - Continues previous months trends (sales & personal withholding)
  - Volatile collections second half of FY

2008-09 Forecast Assumptions and Risks

- Forecast assumed below normal growth in all economy-based taxes
  - 4.6% PIT withholding v. 6.4% trend
  - 3.1% SUT v. 5.5% trend (baseline)
  - 2.4% CIT v. 5.8% trend (baseline)
- General Fund revenue growth of 3.5% (baseline)
- May forecast cautioned of potential risks to State's economic well-being

2008-09 Forecast Assumptions and Risks

- Forecasts risks
  - Significant commodity price increases;
  - Continued decline in housing markets;
  - Tight consumer credit;
  - Financial market disruptions;
  - External shocks - war, natural disasters.
- ***4 out of 5 forecast risks have occurred***

Economic Outlook

- Economic headwinds have intensified
  - Housing recession continues
    - 26% decline in median price
  - Financial market turmoil
    - Tighter private and commercial credit
  - Rising commodity prices - energy and food
    - Food up 10.5%
    - Gas was up $1.30/ gal. (48.5% increase)

Economic Outlook

- Consumers hit hard by economic downturn
  - Falling employment
  - Lower inflation-adjusted wages
  - Loss of wealth from housing recession
  - 35-40% decline in equity markets
  - Tight credit conditions
  - High debt burden

Economic Outlook

- National recession indicators trend downward
  - Manufacturing & Trade Sales
  - Employment
  - Personal Income
  - Industrial Production
  - Consumer Confidence Index

Economic Outlook

- Improvements on the horizon?
  - Crude Oil Prices plummet
    - $72 v. $146
  - Housing prices close to stabilizing?
  - Mortgage rates decline
  - Core inflation low
  - Can Fed actions stabilize/loosen credit markets?

State's Economic Outlook

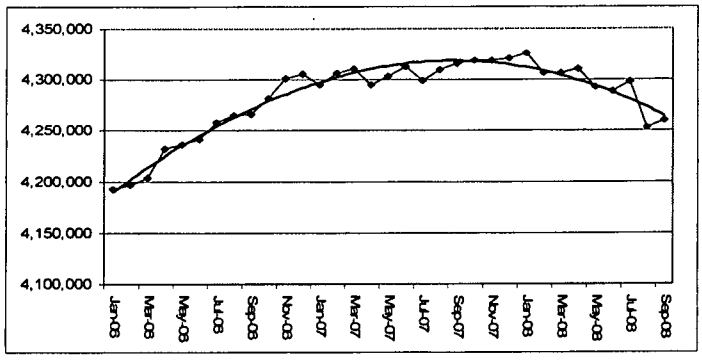
- Industries once thought resistant to housing and financial meltdown show signs of vulnerability
- Reduced consumer spending impacts the service and retail sectors
- Financial services sector hit hard by the financial markets troubles.
  - Job losses expected in this industry over the next 4 to 6 quarters

State's Economic Outlook

- Manufacturing sector continues to shed jobs (rate of 2% to 3% per year)
- Overall employment growth will stall in the State
  - No growth envisioned for this fiscal year and less than 2% in FY 2009-10.
- Moody's economy.com forecasters envision only 2.7% growth in the State's personal income for 2009

Key Revenue Collection Trends

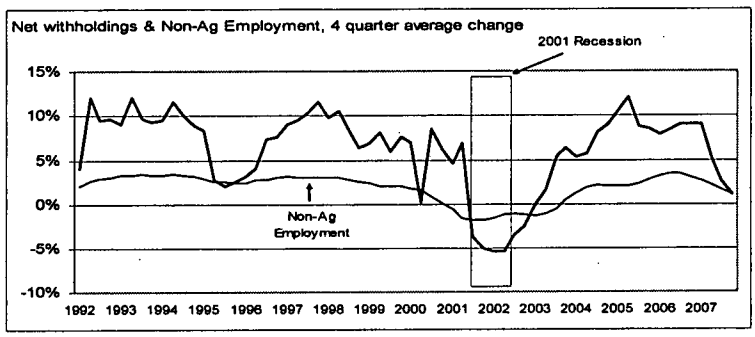
Non-Agricultural Employment, Seasonally Adjusted



Source: North Carolina Employment Security Commission

Key Revenue Collection Trends

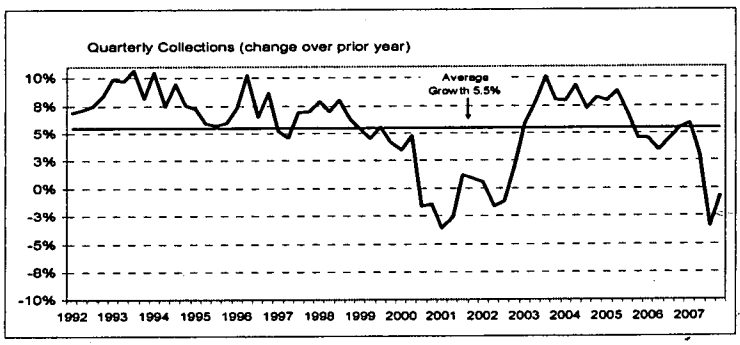
Withholding Tax Receipts



Withholding continues its downward trend coinciding with the slowdown in Non-Ag employment growth.

Key Revenue Collection Trends

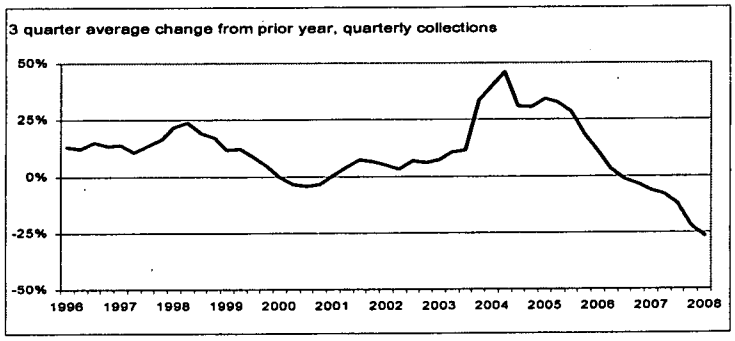
Sales & Use Tax Collections (adjusted for tax law changes)



Sales tax collections go negative the last quarter of FY 2007- 08 with only a modest rebound to start the new fiscal year.

Key Revenue Collection Trends

Real Estate Conveyance Collections



Real Estate Conveyance tax is not part of the General Fund, it does illustrate the impact of the housing slump on these collections and in turn the potential impact on other real estate related activity such as residential construction and retail furniture sales.

2008-09 State Budget Outlook

- **Budget pressures mount, with:**
  - Possible significant revenue shortfall
  - State Health Plan
    - Potential $200 - $300 million fix
  - Medicaid and other income assistance programs are counter-cyclical

ADVANCING REAPPRAISAL SCHEDULE FOR PROPERTY TAXES

Current Law

- Counties must reappraise real property at least every 8 years
- Counties are authorized to advance 8-year schedule
- Non-appraisal year revaluation allowed if value of property has changed for reasons other than economic conditions

4-year Schedule

Swain	Person	Stokes	Henderson,
Tyrrell	Davie	Northampton	Iredell,
Watauga	Forsyth	Wilkes	Rutherford
Orange	Gaston	New Hanover	Lee
Stanly	Moore	Alexander	Macon
Onslow	Burke	Rowan	Cleveland
Buncombe	Catawba	Brunswick	Cherokee
Haywood	Carteret	Surry	Lincoln
Yadkin	Pitt	Caswell	Jackson
Caldwell	Richmond	Cabarrus	Chatham

5-year schedule

Ashe

Robeson

Dare

6-year schedule

Hyde

Harnett

Rockingham

Randolph

Cumberland

Mecklenburg

Franklin

Method of revaluations

- In-house v. outsourcing
- Real property appraised at market or true value as of January 1
- Mass appraisal – assessor groups properties and prepares uniform schedules of values, standards and rules
- Three approaches to valuing real property: cost approach, sales comparison approach, and income approach

Sales Assessment (S/A) Ratio Studies

- S/A study used by assessor in general reappraisal year to ensure that tax values reflect fair market values
- S/A ratio study compares appraised value of parcels with sales price. The closer the comparison is to 100%, the closer the appraised value is to the fair market value of the parcel
- S/A ratio study for each county prepared yearly by Department, and county notified by April 15 following the study

S.L. 2008-146 history

- Revenue Laws Study Committee proposed a 4-year schedule to 2008 Session
- SB 1878 (Clodfelter) and HB 2476 (Brubaker and Hill) introduced proposal
- Senate version required advancing schedule if S/A ratio dropped below .90
- House version required advancing schedule if S/A ratio dropped below .70 or became greater than 1.10

Ratified

- Advanced schedule required only for county whose population is 75,000 or greater and whose S/A ratio dropped below .85 or became greater than 1.15
- New values must be implemented by January 1 of third year following notice of S/A ratio study by Department
- Other counties retain 8-year schedule

Counties with population of 75,000 or greater

Alamance
Brunswick
Buncombe
Burke
Cabarrus
Caldwell
Catawba
Cleveland
Craven
Cumberland
Davidson
Durham
Forsyth
Gaston
Guilford
Harnett
Henderson
Iredell
Johnston
Mecklenburg
Moore
Nash
New Hanover
Onslow
Orange
Pitt
Randolph
Robeson
Rockingham
Rowan
Union
Wake
Wayne
Wilson

Advantages of Advanced Schedule

- Appraised value is more equivalent to fair market value
- Not as much sticker shock because not as big a difference in values between revaluations
- More frequent revaluations would result in appraised values reflecting an economic downturn in the housing market

Disadvantages of Advanced Schedule

- Revaluations are expensive
- Smaller counties do not have manpower or revenue for more frequent revaluation

Schedules of other States

- Alabama - four year cycle
- Florida – annual cycle
- Georgia – based on level of assessment
- Kentucky – annual cycle
- West Virginia – three year cycle
- South Carolina – four year cycle
- Louisiana – four year cycle
- Tennessee – counties choose, four, five, or six year cycle
- Virginia – counties larger than 50,000 every four years, counties under 50,000 may delay until fifth or sixth year. Cities over 30,000 every two years, and cities under 30,000 may delay until fourth year

SALES RATIO (Shaded Counties are Impacted By 2008 Legislation)						
	2007 Population	2008 Sales	Parcel	Last	Current	Next
County	Estimates	Ratio	Count	Reval	Cycle Length	Reval
Gates	11,819	0.4350	9,000	2001	8	2009
Pamlico	12,947	0.4841	14,300	2004	8	2012
Graham	8,144	0.5164	8,675	2002	8	2010
Mitchell	15,950	0.5419	16,300	2001	8	2009
Clay	10,326	0.5549	15,500	2002	8	2010
Pender	50,430	0.5566	43,500	2003	8	2011
Warren	19,919	0.5996	22,200	2001	8	2009
Polk	19,040	0.6080	15,500	2001	8	2009
Madison	33,626	0.6546	20,000	2004	8	2012
Craven	96,406	0.6615	52,600	2002	8	2010
Swain	13,889	0.6629	11,250	2005	4	2009
Anson	25,332	0.6769	19,500	2002	8	2010
Beaufort	46,070	0.6802	43,000	2002	8	2010
Avery	18,292	0.7107	23,295	2006	8	2014
Montgomery	27,588	0.7200	30,500	2004	8	2012
Hyde	5,447	0.7243	8,500	2003	6	2009
Martin	20,495	0.7291	15,500	2001	8	2009
Edgecombe	51,813	0.7597	30,000	2001	8	2009
Duplin	53,133	0.7800	36,500	2001	8	2009
Tyrrell	4,290	0.7834	5,000	2005	4	2009
Watauga	44,696	0.7838	44,600	2006	4	2010
Ashe	26,003	0.7896	36,500	2006	5	2011
Orange	127,344	0.7933	52,500	2005	4	2009
Transylvania	30,758	0.7971	31,000	2002	7	2009
McDowell	23,906	0.8000	27,000	2003	8	2011
Sampson	64,522	0.8160	49,500	2003	8	2011
Cumberland	313,616	0.8172	129,000	2003	6	2009
Stanly	59,158	0.8191	37,500	2005	4	2009
Nash	92,915	0.8192	49,300	2001	8	2009
Harnett	106,506	0.8198	57,000	2003	6	2009
Onslow	169,302	0.8270	62,665	2006	4	2010
Wayne	115,225	0.8281	62,000	2003	8	2011
Mecklenburg	863,147	0.8290	322,000	2003	6	2009
Hertford	23,730	0.8324	15,500	2003	8	2011
Buncombe	225,609	0.8360	110,000	2006	4	2010
Haywood	57,031	0.8415	48,500	2006	4	2010
Robeson	129,425	0.8440	73,000	2005	5	2010
Columbus	54,460	0.8466	41,700	2005	8	2013
Currituck	23,731	0.8537	23,500	2005	8	2013
Yadkin	37,850	0.8542	28,000	2005	4	2009
Johnston	157,296	0.8555	81,000	2003	8	2011
Pasquotank	40,880	0.8578	20,113	2006	8	2014
Caldwell	79,376	0.8585	51,500	2005	4	2009
Washington	13,214	0.8607	9,800	2005	8	2013
Granville	55,667	0.8610	27,800	2002	8	2010
Halifax	55,352	0.8624	38,237	2007	8	2015
Alamance	143,154	0.8708	67,200	2001	8	2009
Jones	10,315	0.8744	8,500	2006	8	2014
Rockingham	91,646	0.8808	52,000	2003	6	2009
Bertie	19,971	0.8809	18,000	2004	8	2012
Scotland	36,830	0.8820	23,500	2003	8	2011
Chatham	59,168	0.8863	36,200	2005	4	2009
Person	37,640	0.8903	28,100	2005	4	2009

County	2007 Population Estimates	2008 Sales Ratio	Parcel Count	Last Reval	Current Cycle Length	Next Reval
Alleghany	11,088	0.8909	16,200	2007	8	2015
Stokes	46,257	0.8947	29,000	2005	4	2009
Greene	21,110	0.8981	11,000	2005	8	2013
Franklin	56,456	0.9013	37,500	2004	6	2010
Bladen	32,500	0.9069	31,213	2007	8	2015
Henderson	102,142	0.9075	72,000	2007	4	2011
Davie	40,447	0.9094	23,700	2005	4	2009
Lenoir	57,642	0.9105	34,500	2001	8	2009
Guilford	460,780	0.9160	200,000	2004	8	2012
Northampton	21,235	0.9180	19,700	2007	4	2011
Iredell	150,421	0.9210	89,000	2007	4	2011
Forsyth	338,679	0.9210	132,000	2005	4	2009
Randolph	139,422	0.9243	80,000	2007	6	2013
Dare	34,272	0.9246	41,700	2005	5	2010
Wilkes	67,182	0.9297	50,000	2007	4	2011
Rutherford	62,926	0.9324	53,500	2007	4	2011
Gaston	200,972	0.9327	102,523	2007	4	2011
New Hanover	189,922	0.9369	93,000	2007	4	2011
Lee	56,376	0.9394	30,531	2007	4	2011
Camden	9,519	0.9411	8,000	2007	8	2015
Moore	83,932	0.9412	66,654	2007	4	2011
Alexander	36,656	0.9474	23,000	2007	4	2011
Chowan	14,660	0.9516	12,100	2006	8	2014
Hoke	42,932	0.9556	22,000	2006	8	2014
Macon	44,064	0.9588	43,000	2007	4	2011
Burke	88,439	0.9641	55,000	2007	4	2011
Union	182,344	0.9645	86,500	2008	8	2016
Rowan	136,486	0.9672	81,200	2007	4	2011
Cleveland	97,144	0.9785	54,200	2008	4	2012
Catawba	153,404	0.9794	85,000	2007	4	2011
Brunswick	99,440	0.9807	130,000	2007	4	2011
Cherokee	27,026	0.9820	31,500	2008	4	2012
Carteret	63,294	0.9840	57,381	2007	4	2011
Surry	73,150	0.9878	39,800	2008	4	2012
Lincoln	72,776	0.9919	45,500	2008	4	2012
Pitt	151,970	0.9944	72,500	2008	4	2012
Yancey	18,550	0.9974	15,500	2008	8	2016
Wake	832,590	0.9991	314,000	2008	8	2016
Davidson	156,400	0.9998	92,000	2007	8	2015
Perquimans	12,722	1.0000	13,600	2008	8	2016
Caswell	23,508	1.0000	14,500	2008	4	2012
Jackson	36,815	1.0000	37,000	2008	4	2012
Vance	43,583	1.0000	25,000	2008	8	2016
Richmond	46,672	1.0000	30,500	2008	4	2012
Wilson	77,970	1.0000	36,500	2008	8	2016
Cabarrus	164,384	1.0000	77,500	2008	4	2012
Durham	254,740	1.0000	105,000	2008	8	2016

COUNTIES						
County	2007 Population Estimates	2008 Sales Ratio		County	2007 Population Estimates	2008 Sales Ratio
Alamance	143,154	0.8708		Lincoln	72,776	0.9919
Alexander	36,656	0.9474		Macon	44,064	0.9588
Alleghany	11,088	0.8909		Madison	33,626	0.6546
Anson	25,332	0.6769		Martin	20,495	0.7291
Ashe	26,003	0.7896		McDowell	23,906	0.8000
Avery	18,292	0.7107		Mecklenburg	863,147	0.8290
Beaufort	46,070	0.6802		Mitchell	15,950	0.5419
Bertie	19,971	0.8809		Montgomery	27,588	0.7200
Bladen	32,500	0.9069		Moore	83,932	0.9412
Brunswick	99,440	0.9807		Nash	92,915	0.8192
Buncombe	225,609	0.8360		New Hanover	189,922	0.9369
Burke	88,439	0.9641		Northampton	21,235	0.9180
Cabarrus	164,384	1.0000		Onslow	169,302	0.8270
Caldwell	79,376	0.8585		Orange	127,344	0.7933
Camden	9,519	0.9411		Pamlico	12,947	0.4841
Carteret	63,294	0.9840		Pasquotank	40,880	0.8578
Caswell	23,508	1.0000		Pender	50,430	0.5566
Catawba	153,404	0.9794		Perquimans	12,722	1.0000
Chatham	59,168	0.8863		Person	37,640	0.8903
Cherokee	27,026	0.9820		Pitt	151,970	0.9944
Chowan	14,660	0.9516		Polk	19,040	0.6080
Clay	10,326	0.5549		Randolph	139,422	0.9243
Cleveland	97,144	0.9785		Richmond	46,672	1.0000
Columbus	54,460	0.8466		Robeson	129,425	0.8440
Craven	96,406	0.6615		Rockingham	91,646	0.8808
Cumberland	313,616	0.8172		Rowan	136,486	0.9672
Currituck	23,731	0.8537		Rutherford	62,926	0.9324
Dare	34,272	0.9246		Sampson	64,522	0.8160
Davidson	156,400	0.9998		Scotland	36,830	0.8820
Davie	40,447	0.9094		Stanly	59,158	0.8191
Duplin	53,133	0.7800		Stokes	46,257	0.8947
Durham	254,740	1.0000		Surry	73,150	0.9878
Edgecombe	51,813	0.7597		Swain	13,889	0.6629
Forsyth	338,679	0.9210		Transylvania	30,758	0.7971
Franklin	56,456	0.9013		Tyrrell	4,290	0.7834
Gaston	200,972	0.9327		Union	182,344	0.9645
Gates	11,819	0.4350		Vance	43,583	1.0000
Graham	8,144	0.5164		Wake	832,590	0.9991
Granville	55,667	0.8610		Warren	19,919	0.5996
Greene	21,110	0.8981		Washington	13,214	0.8607
Guilford	460,780	0.9160		Watauga	44,696	0.7838
Halifax	55,352	0.8624		Wayne	115,225	0.8281
Harnett	106,506	0.8198		Wilkes	67,182	0.9297
Haywood	57,031	0.8415		Wilson	77,970	1.0000
Henderson	102,142	0.9075		Yadkin	37,850	0.8542
Hertford	23,730	0.8324		Yancey	18,550	0.9974
Hoke	42,932	0.9556				
Hyde	5,447	0.7243				
Iredell	150,421	0.9210				
Jackson	36,815	1.0000				
Johnston	157,296	0.8555				
Jones	10,315	0.8744				
Lee	56,376	0.9394				
Lenoir	57,642	0.9105				

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Wednesday, October 22, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. **Welcoming Remarks**

II. **Overview of 2008 Finance Law Changes and Fate of the Revenue Laws Study Committee's Recommendations to the 2008 General Assembly**
– *Cindy Avrette, Research Division*

III. **Budget Outlook**
– *Barry Boardman, Fiscal Research Division*

IV. **Overview of Issues Raised by Advancing the Reappraisal Schedule for Property Taxes (S.L. 2008-146 Property Tax Modifications)**
– *Martha Walston, Fiscal Research Division*

V. **Sales Tax Treatment of Food vs. Prepared Food**
– *Sandra Johnson, Fiscal Research Division*

VI. **Overview of Exemptions for Nonprofits**
– *Trina Griffin, Research Division*
– *Rodney Bizzell, Fiscal Research Division*
– *Lee Dixon, Fiscal Research Division*

Discussion of the Illinois *Provena Covenant Medical Center* Case
– *Stan Jenkins, Supervisor of Assessments*
Champaign County, Illinois

VII. **Adjournment**

Next Meeting Date: Wednesday, November 19, 2008
All meetings in Room 544, LOB, at 9:30 a.m.

Property Tax Exemptions and Sales Tax Refunds for Nonprofits

Revenue Laws Study Committee

Rodney Bizzell
NC General Assembly
Fiscal Research Division

Data Sources

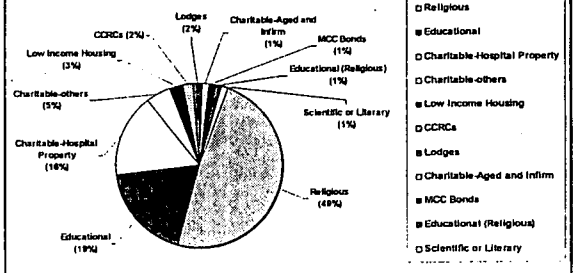
- **Value of Property Tax Exclusions**
  - As reported on Form AV-50
  - Increased emphasis placed on reported exclusion values
  - Does not include all personal property
  - Fiscal impact is estimated for counties only
- **Sales Tax Refunds**
  - DOR Statistical Abstract of NC Taxes
  - Distribution will not change significantly as a result of new clarification included in S.L. 2008-107

Nonprofit Tax Exemptions
Property Tax – FY 2007-08

Exemption / Exclusion	Value	County-Only Revenue Impact	Percentage
Religious	14,965,744,447	101,318,090	49%
Educational	5,798,331,003	39,254,701	19%
Charitable-Hospital Property	5,031,527,811	34,063,443	16%
Charitable-others	1,420,119,234	9,614,207	5%
Low Income Housing	868,328,943	5,878,587	3%
CCRCs	622,339,267	4,213,237	2%
Lodges	489,610,287	3,314,662	2%
Charitable-Aged and Infirm	434,438,587	2,941,149	1%
MCC Bonds	411,731,257	2,787,421	1%
Educational (Religious)	403,491,918	2,731,640	1%
Scientific or Literary	301,858,193	2,043,560	1%
Total	$ 30,747,520,947	$ 208,160,717	100%

Source: NC Dept. of Revenue Form AV50

Nonprofit Tax Exemptions
Property Tax – FY 2007-08



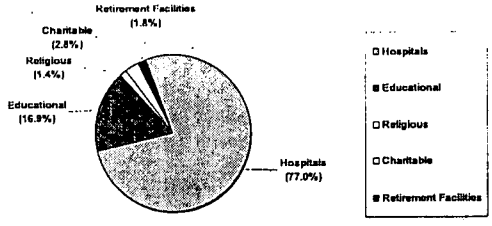
Source: NC Dept. of Revenue Form AV-50

Nonprofit Tax Exemptions
Sales Tax Refunds – FY 2006-07

Exemption / Exclusion	Refunds Issued	Percentage
Hospitals	213,586,366	77%
Educational	46,914,998	17%
Religious	3,904,682	1%
Charitable	7,854,695	3%
Retirement Facilities	5,072,427	2%
Total	$ 277,333,168	100%

Source: Statistical Abstract of North Carolina Taxes, NC DOR

Nonprofit Tax Exemptions
Sales Tax Refunds – FY 2006-07



Source: Statistical Abstract of North Carolina Taxes, NC DOR

Summary

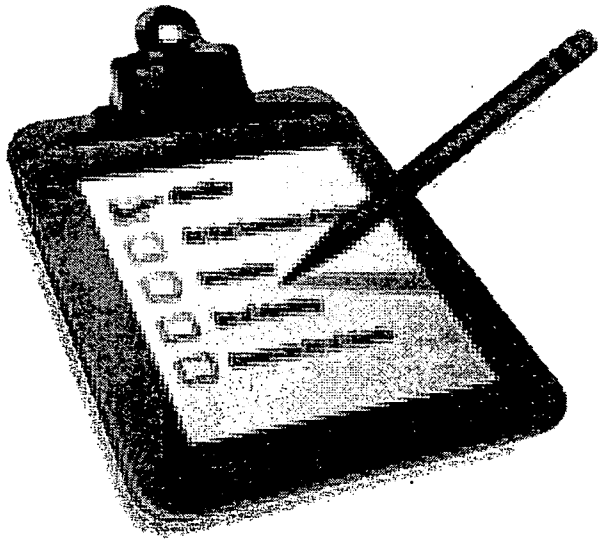
- Fiscal impact to counties of n onprofit property tax exemption is approxi mately $200 million (approximately 4% of total statewide levy).
- Fiscal impact of sales tax refund (state and local) is $277 million.
- Top 3 in total fiscal impact:
  - Nonprofit Hospitals $247 million
  - Religious Organizations $105 million
  - Educational Organizations $86 million

An Overview of the Tax Treatment of Nonprofits

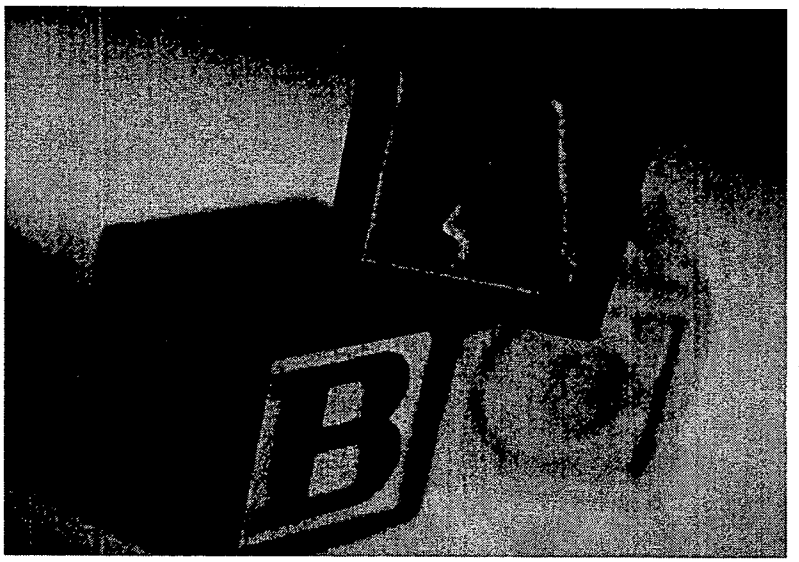
Trina Griffin
Research Division, NCGA
October 22, 2008

Outline

- Basics
- Statistics
- Tax Treatment
- Trends
- Issues



Nonprofit Basics



What Is A Nonprofit?

- An organization whose purpose is to provide a public or mutual benefit and that does not seek to accumulate profits for distribution to owners or investors.

For Profit vs. Nonprofit

Similarities

- Formation
- Governance
- Employees/wages
- Provision of goods and services
- Profit

Differences

- Goal or mission
- Profit distribution
- Ownership
- Distribution of assets upon dissolution
- Tax-exempt status

IRC 501(c)(3)

A corporation organized and operated exclusively for:

- Religious, charitable, scientific, testing for public safety, literary or educational purposes

  OR

- To foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

IRC 501(c)(3)

- No part of the net earnings may inure to the benefit of any private shareholder.
- No substantial part of the activities is carrying on propaganda or attempting to influence legislation.
- No participation in any political campaign on behalf of or in opposition to any political candidate.

IRC 501(c)(3)

- 3 basic categories:
  - Public charities
  - Private foundations
  - Other nonprofit organizations
- 501(c)(3)s with gross receipts over $25,000 must report financial activity annually to the IRS on Form 990.
- Churches and church-affiliated organizations are exempt from this requirement.



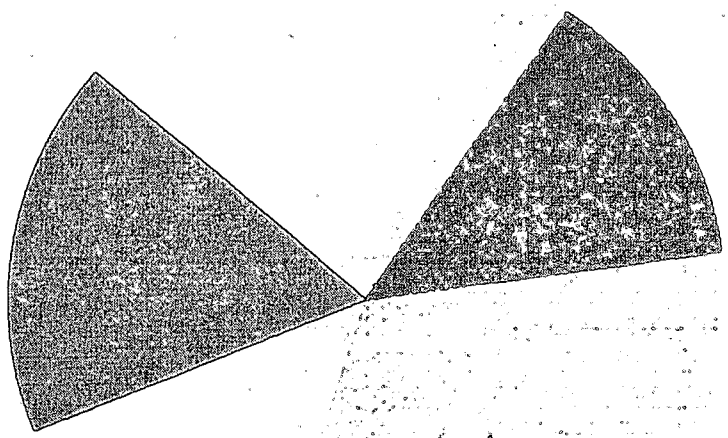
Statistics

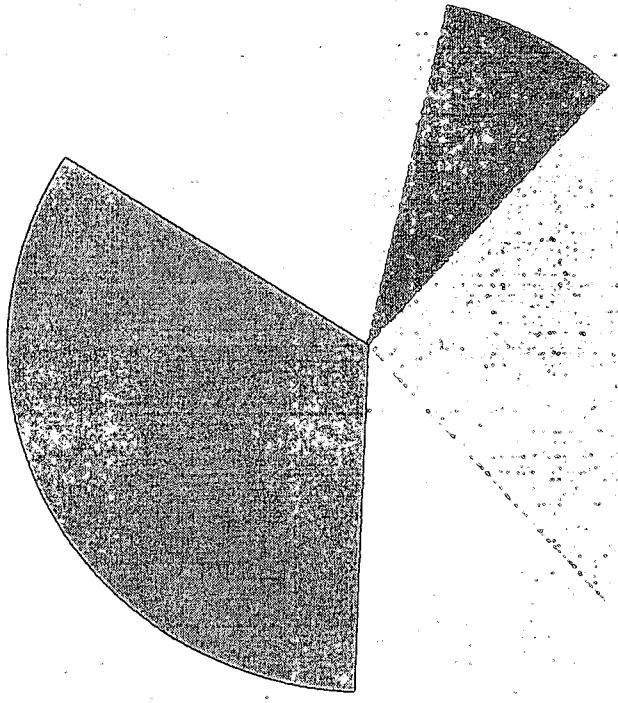
National
North Carolina

National Statistics

- Approx. 1.4 million nonprofits registered with IRS.
- Over 500,000 collected more than $25,000 in gross receipts.
- From 1995-2005, the number of reporting public charities grew 66% and revenues and assets increased 54%.
- Hospitals and higher education institutions account for more than half of total expenses and assets of all public charities ($1 trillion).

*Source: *Nonprofit Almanac*, National Center for Charitable Statistics (2008)





Comparison of Nonprofits by Category

NTEE Major Group	National	NC
Arts, Culture, Humanities	11.5%	8.9%
Education	18.7%	16.4%
Environment, animals	4.3%	3.3%
Health	13.3%	8.3%
Human services	32.3%	25.7%
International & foreign affairs	1.6%	1.0%
Public and societal benefit	12.1%	11%
Religious	**6.0%**	**24.2%**
Unknown	0.1%	1.0%

NC Statistics

501(c)(3) public charities	25,747
501(c)(3) private foundations	3,067
Other 501(c) nonprofit organizations	12,112
	40,926

- 62% of NC public charities are non-reporting
- Nonprofits put $29 billion into local economies in 2006 compared to $12 billion in 1996. Nonprofits provide 6% of the jobs in this State (*Source: NC Center for Nonprofits*).

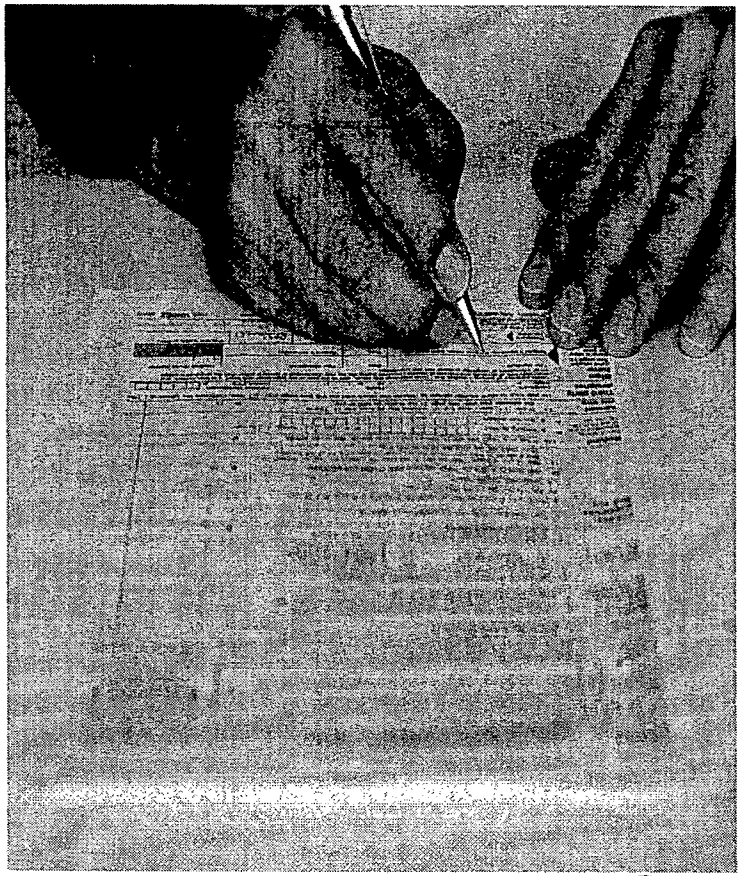
Source: National Center for Charitable Statistics, 2006.

NC Statistics

- The largest nonprofit landholders are:
  - Religious organizations – comprise 24% of total; not required to report assets
  - Educational organizations – comprise 16.4% of total and possess 41% of the total assets
  - Nonprofit hospitals - comprise 8.3% of total and possess 34% of the total assets
- 50% of reporting public charities are concentrated in 9 urban counties: Wake, Mecklenburg, Guilford, Forsyth, Durham, Buncombe, Cumberland, Orange, and New Hanover
- 80% of NC's total nonprofit assets are located in these same 9 urban counties.

Tax Treatment

Federal
State & Local



Federal Tax Treatment

- Exemption from federal income tax
- Deductibility of contributions by donors
- Subject to FICA (if they have employees)
- Subject to telephone and gasoline excise taxes
- Subject to "unrelated business income tax"
- Private foundations pay income tax on investment income
- Federal tax-exempt status does not guarantee exemption from state and local taxes.

State Tax Treatment

- No State income tax
- Sales tax refund
- Property tax exemption
- Deductibility of charitable contributions for donors
- Access to tax-exempt bond financing

Sales Tax Refund

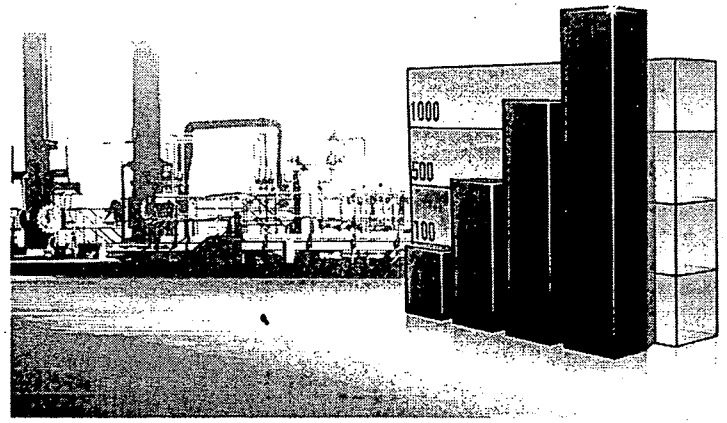
- **Nonprofit hospitals**, including hospitals and medical accommodations operated by a hospital authority.
- **Qualified retirement facilities**.
- **501(c)(3)s,** except for organizations classified under NTEE as follows *(Effective July 1, 2008)*:
  - Community Improvement and Capacity Building
  - Public and societal benefit
  - Mutual and membership benefit
- A **university-affiliated nonprofit organization** that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina.

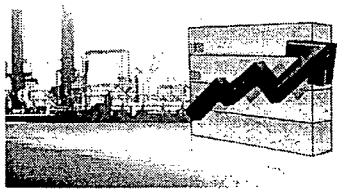
Property Tax Exemptions

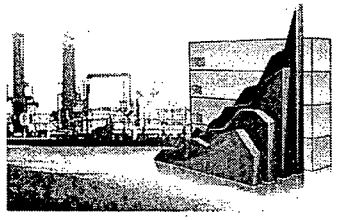
- Property owned by certain named entities
  - e.g. American Legion, VFW, Order of the Moose, Free Masons of NC, Goodwill
- Property used for educational, religious, scientific, literary, or charitable purposes
- Property used for charitable hospital purposes
- Cemeteries
- Qualified retirement facilities
- Health care facilities financed with MCC bonds

Property Tax Exemptions

- Not automatic; single application; 1/8 review
- Different statutes; varying standards for exemptions
  - "Wholly and exclusively used"
  - "Actually and exclusively used"
- "Charitable Purpose"
  - A purpose that has humane and philanthropic objectives.
  - It is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward.
- "Notwithstanding" provisions







Trends

Generally
National
State & Local

Generally

- Challenges to tax exemptions for nonprofits are not new.
- Revenue Laws has looked at this issue on more than one occasion.
- Factors contributing to increased examination and attention:
  - Rapid and significant growth: quantity and income
  - Increase in “commercial” activities
  - Fiscal crisis

National Trends

- Congress - Sen. Grassley considering legislation
- IRS – 2006 survey; revised 990 regulations (2008)
- GAO Report (September 2008)
- Lawsuits
  - Early 2000s – profiteering
  - More recently – denials of property tax exemptions
- Negative publicity; "scandals" – United Way; WSJ article

Wall Street Journal

- The top 50 nonprofit hospitals had an increase in net income from $500 million in 2001 to $4.6 billion in 2006.
- 77% of U.S. nonprofits hospitals are profitable compared to 61% of for profit hospitals.
- Cites strategies used by hospitals to increase profits.



State & Local Trends

- State legislatures and agencies studying issue
  - Washington - Joint Legislative and Audit Review Committee
  - California - Auditor's report
  - Ohio Attorney General
- Local governments denying property tax exemptions:
  - Minnesota – day care center
  - Illinois – nonprofit hospital
  - Oregon – residential substance abuse treatment center
  - Wisconsin – outpatient health care center
- So far, courts are backing up local governments.

Issues



Issues

- What is the public purpose or goal of the property tax exemption for charitable nonprofits?
- Is the law clear?
- Does the law fulfill its public purpose?

ADVANCING REAPPRAISAL SCHEDULE FOR PROPERTY TAXES

Current Law

- Counties must reappraise real property at least every 8 years
- Counties are authorized to advance 8-year schedule
- Non-appraisal year revaluation allowed if value of property has changed for reasons other than economic conditions

4-year Schedule

Swain	Person	Stokes	Henderson,
Tyrrell	Davie	Northampton	Iredell,
Watauga	Forsyth	Wilkes	Rutherford
Orange	Gaston	New Hanover	Lee
Stanly	Moore	Alexander	Macon
Onslow	Burke	Rowan	Cleveland
Buncombe	Catawba	Brunswick	Cherokee
Haywood	Carteret	Surry	Lincoln
Yadkin	Pitt	Caswell	Jackson
Caldwell	Richmond	Cabarrus	Chatham

5-year schedule

Ashe

Robeson

Dare

6-year schedule

Hyde
Harnett
Rockingham
Randolph

Cumberland
Mecklenburg
Franklin

Method of revaluations

- In-house v. outsourcing
- Real property appraised at market or true value as of January 1
- Mass appraisal – assessor groups properties and prepares uniform schedules of values, standards and rules
- Three approaches to valuing real property: cost approach, sales comparison approach, and income approach

Sales Assessment (S/A) Ratio Studies

- S/A study used by assessor in general reappraisal year to ensure that tax values reflect fair market values
- S/A ratio study compares appraised value of parcels with sales price. The closer the comparison is to 100%, the closer the appraised value is to the fair market value of the parcel
- S/A ratio study for each county prepared yearly by Department, and county notified by April 15 following the study

S.L. 2008-146 history

- Revenue Laws Study Committee proposed a 4-year schedule to 2008 Session
- SB 1878 (Clodfelter) and HB 2476 (Brubaker and Hill) introduced proposal
- Senate version required advancing schedule if S/A ratio dropped below .90
- House version required advancing schedule if S/A ratio dropped below .70 or became greater than 1.10

Ratified

- Advanced schedule required only for county whose population is 75,000 or greater and whose S/A ratio dropped below .85 or became greater than 1.15
- New values must be implemented by January 1 of third year following notice of S/A ratio study by Department
- Other counties retain 8-year schedule

Counties with population of 75,000 or greater

Alamance
Brunswick
Buncombe
Burke
Cabarrus
Caldwell
Catawba
Cleveland
Craven
Cumberland
Davidson
Durham
Forsyth
Gaston
Guilford
Harnett
Henderson
Iredell
Johnston
Mecklenburg
Moore
Nash
New Hanover
Onslow
Orange
Pitt
Randolph
Robeson
Rockingham
Rowan
Union
Wake
Wayne
Wilson

Advantages of Advanced Schedule

- Appraised value is more equivalent to fair market value
- Not as much sticker shock because not as big a difference in values between revaluations
- More frequent revaluations would result in appraised values reflecting an economic downturn in the housing market

Disadvantages of Advanced Schedule

- Revaluations are expensive
- Smaller counties do not have manpower or revenue for more frequent revaluation

Schedules of other States

- Alabama - four year cycle
- Florida – annual cycle
- Georgia – based on level of assessment
- Kentucky – annual cycle
- West Virginia – three year cycle
- South Carolina – four year cycle
- Louisiana – four year cycle
- Tennessee – counties choose, four, five, or six year cycle
- Virginia – counties larger than 50,000 every four years, counties under 50,000 may delay until fifth or sixth year. Cities over 30,000 every two years, and cities under 30,000 may delay until fourth year

Overview of Exemptions for Non-Profits

Hospital Charity Care

Revenue Laws Study Committee

Lee Dixon
Fiscal Research Division
North Carolina General Assembly
October 22, 2008

Charity Care

- Background
- National Perspective
- North Carolina Perspective
- Other States

Charity Care--Background

- Continuing increase in the number of uninsured
- Critical role of hospitals as safety net providers
- Increasing demand for uncompensated care
- Increasing scrutiny of hospitals' charity care and community benefits
- Evaluating the benefits compared to tax exemptions

Charity Care—National Perspective

2004

- Hospitals charging uninsured patients up to three times the cost of treatment
- Some hospitals aggressively pursuing collection
- State legislators and advocates point to the exemptions hospitals enjoy

Charity Care—National Perspective

2004

- 40 Class action lawsuits against some 400 hospitals
- State Legislators introduce legislation in 12 states
- No legislation is enacted
- Hospitals change their behavior

Charity Care—National Perspective

2005

- Government Accountability Office asked to conduct a study
- "Nonprofit, For-Profit, and Government Hospitals: Uncompensated Care and Other Community Benefits"
- California, Florida, Georgia, Indiana, and Texas

Charity Care—National Perspective

GAO Findings

- Government Hospitals Devoted Largest Share to Charity Care
- Non-Profits Devoted More to Charity Care Than Profit-Hospitals, but by a small margin
- The Burden of Charity Care was Concentrated in a Small Number of Hospitals

Charity Care—National Perspective

2006

- IRS Conducts a Study of 500 Non-Profit Hospitals

- IRS found:
  - Wide Variation in Eligibility for Charity Care
  - Wide Variation in Publicizing Opportunity for Charity Care
  - 45% of Hospitals Spent 3% or Less on Charity Care
  - Nearly 25% Spent 1% or Less

The IRS Findings were Consistent with GAO

Charity Care—National Perspective

2007

- IRS begins work to update Form 990

- Form by which all non-profit entities report their community activities to justify their tax exempt status.

- Had not been revised since 1969
  - IRS has not specified the need to provide charity care
  - Engage in community benefit, including charity care

Charity Care—National Perspective

2008

- GAO is asked to conduct a follow-up study
  - IRS and State requirements concerning community benefit
  - Guidelines hospitals use to define community benefit
  - How hospitals report community benefit
  - California, Indiana, Massachusetts, and Texas

Charity Care—National Perspective

Findings

- IRS allows hospitals broad latitude in defining community benefit
- Requirements hospitals must meet for community benefit, in 15 states with laws, vary widely

Alabama	Indiana	North Dakota
California	Maryland	Pennsylvania
Colorado	Mississippi	Texas
Idaho	New Hampshire	West Virginia
Illinois	New York	Wyoming

Charity Care—National Perspective

Findings—continued

- Broad latitude in defining community benefit results in wide variation in data reported
- There is agreement on the definition of charity care
- There is variance in the eligibility, the amount allowed, and the amount reported

Charity Care—Form 990

August 2008

- IRS Releases Final Redesign of Form 990
- Schedule H Pertains to Hospitals
  - Part 1 Charity Care and Other Community Benefits
  - Part 2 Community Building Activities
  - Part 3 Bad Debt, Medicare, & Collection Practices
  - Part 4 Management Companies & Joint Ventures
  - Part 5 Facility Information (Required for 2008)
  - Part 6 Supplemental Information

Charity Care—Form 990

Schedule H—Part 1 Charity Care

- Identify policies and other income-based criteria
  - Income
  - Medically indigent
- Charity Care is not to include
  - Bad Debt or uncollectible charges
  - The Difference Between the Cost of Care and Payment Received for Medicare or Medicaid
  - Contractual Adjustments with Other 3rd Party Payers
- Hospital must indicate if it denied assistance solely because Charity Care budget exceeded

Charity Care—Form 990

Schedule H—Part 1

- Community Benefit
  - Activities carried out to improve community health
    - Sponsoring health fairs
    - Involvement in immunization or prevention activities
    - Hospital staff volunteering in community activities
  - Activities involving health professions education
    - Medical Students, Interns, and Residents
    - Nursing and Allied Health Professions
    - Continuing Education
  - Activities associated with needs assessment, planning, fund raising or grant writing

Charity Care—NC Perspective

Currently

- Lack a standardized charity care database is available
- Lack a Standard Charity Care Policy
  - Ranges from 100% to 300% FPL
  - Charity care and Discounted care
- Lack a Standardized Calculation of Charity Care Costs

Charity Care—NC Perspective

Currently

- Lack a set policy for informing uninsured patients of the opportunity for Charity Care
- Difficult to evaluate tax exemption of hospitals without standardized, accurate information
- Hospital Charity Care is part of the equation in delivering care to the uninsured

Charity Care—NC Perspective

In the Future
North Carolina Hospital Association

- Use data from FY 2007
- Fill out the new Schedule H forms
- Information available by December 31, 2008

Charity Care—NC Perspective

In the Future

- Cost of providing charity care
- Un-reimbursable cost of treating Medicare and Medicaid patients
- Community health improvement
- Health professions education
- Subsidized health care services
- Research costs
- Cash donations
- Community building activities

Charity Care—Other States

Illinois

Uninsured patients are to be billed

- Cost, plus 35%

- Annual amount paid any single hospital is not to exceed 25% of gross income (First state)

- Eligibility
  - 600% FPL Urban areas--$127,200 for family of 4
  - 300% FPL Rural areas--$ 63,600 for family of 4
  - 775,000 Illinois families qualify

Charity Care—Other States

Texas

- Hospitals are Tax Exempt by:

  - Providing Charity Care at a level that is reasonable with a community's needs

  - Level of Charity Care must be equal to 100% of the tax-exempt benefit

  - Charity Care and Community Benefit must equal at least 5% of net patient revenue; and 4% of the 5% must be charity care or government sponsored indigent care

Charity Care—Other States

California

- As a Condition of Licensure Each Hospital Must:
  - Provide all eligible patients written materials explaining the hospital's charity care policy
  - Eligible Patients are Defined as Uninsured Patients, Those with High Medical Costs who have annual incomes at or below 350% FPL

Charity Care—Other States

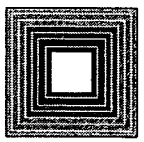
New York

- To Participate in the Indigent Care Pool Hospitals Must Institute the Following Policies:
  - For Patients with incomes up to 100% FPL
    - a nominal amount is to be collected
  - For Patients with incomes between 101% and 150%
    - a fee equal to 20% of what the highest volume payer would have been charged
  - For patients between 151% and 250% FPL
    - a fee beginning at 20% and up to what the highest volume payer would have received on a sliding scale
  - For patients between 251% and 300% PFL
    - a fee equal to what would have been paid under Medicare or Medicaid

Sales Tax Treatment of Food and Prepared Food

Revenue Laws Study Committee
October 22, 2008

Sandra Johnson – Fiscal Research



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

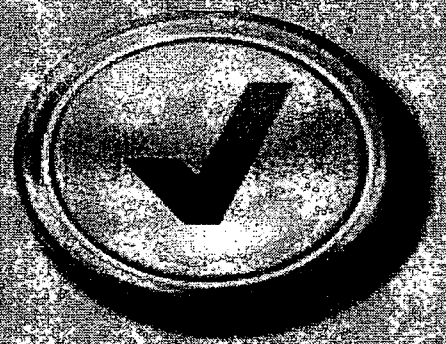
Overview

- The Small Business Protection Act (SBPA) S.L. 2008-107 (Section 28.16)
- History of Food and the Sales and Use Tax
- Recent Challenges
- Options

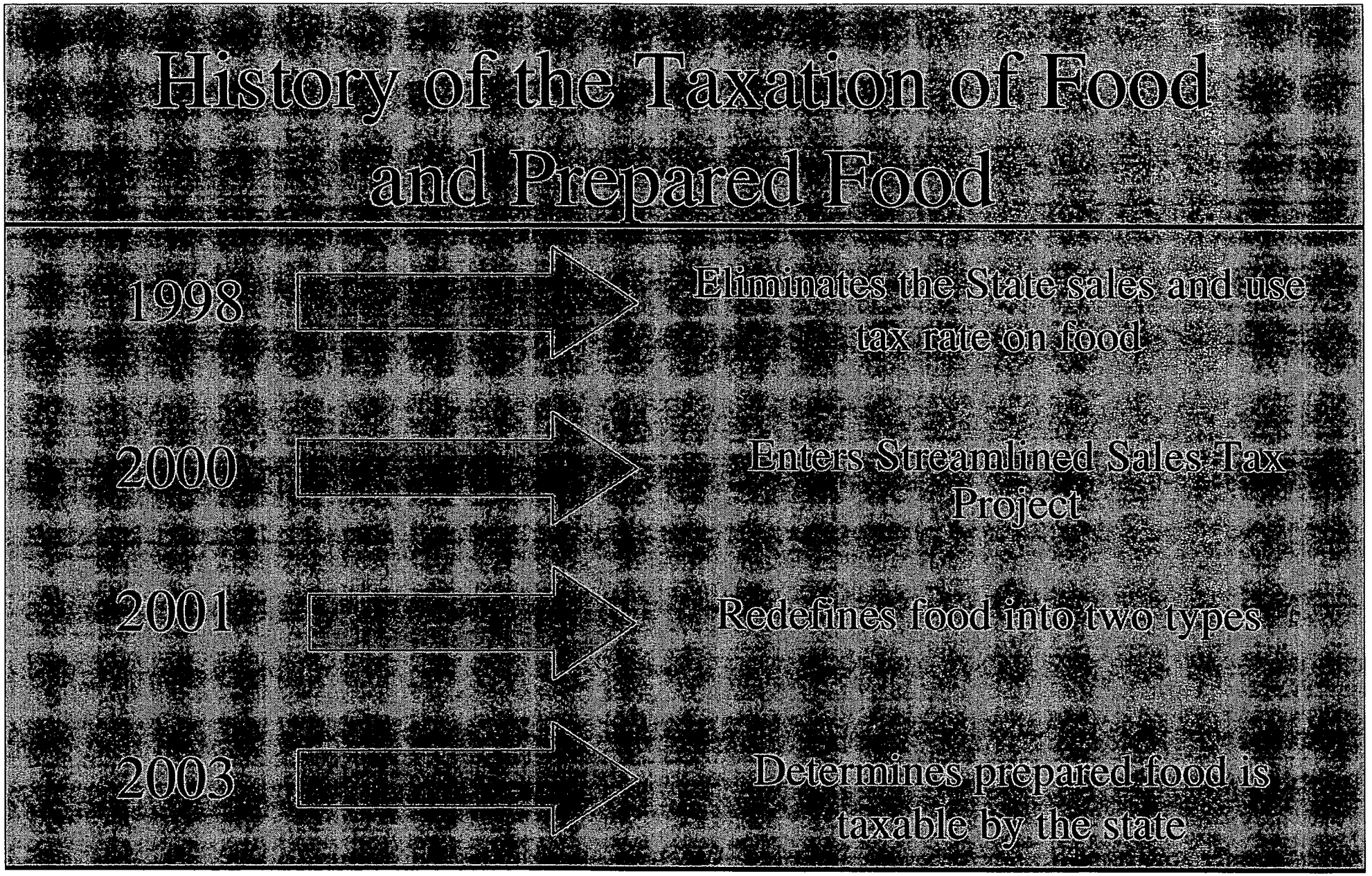


The Small Business Protection Act (SBPA)

- Revenue Laws Study Committee:
  - Taxation of services
  - Differentiation between retailers and performance contractors
  - Distinction between food and prepared food



History of the Taxation of Food and Prepared Food



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Food for Home Consumption

- Definition—G.S. 105-164.13B
- Exempt from State sales and use tax unless it is defined as:
  - Dietary supplements
  - Food sold through a vending machine
  - Prepared food
  - Soft drinks
  - Candy

Food for Home Consumption

Fiscal Year 07-08

- Sales and use tax rate
  - State rate 0%
  - Local rate 2%
- Local Revenue $210 M

Prepared Food

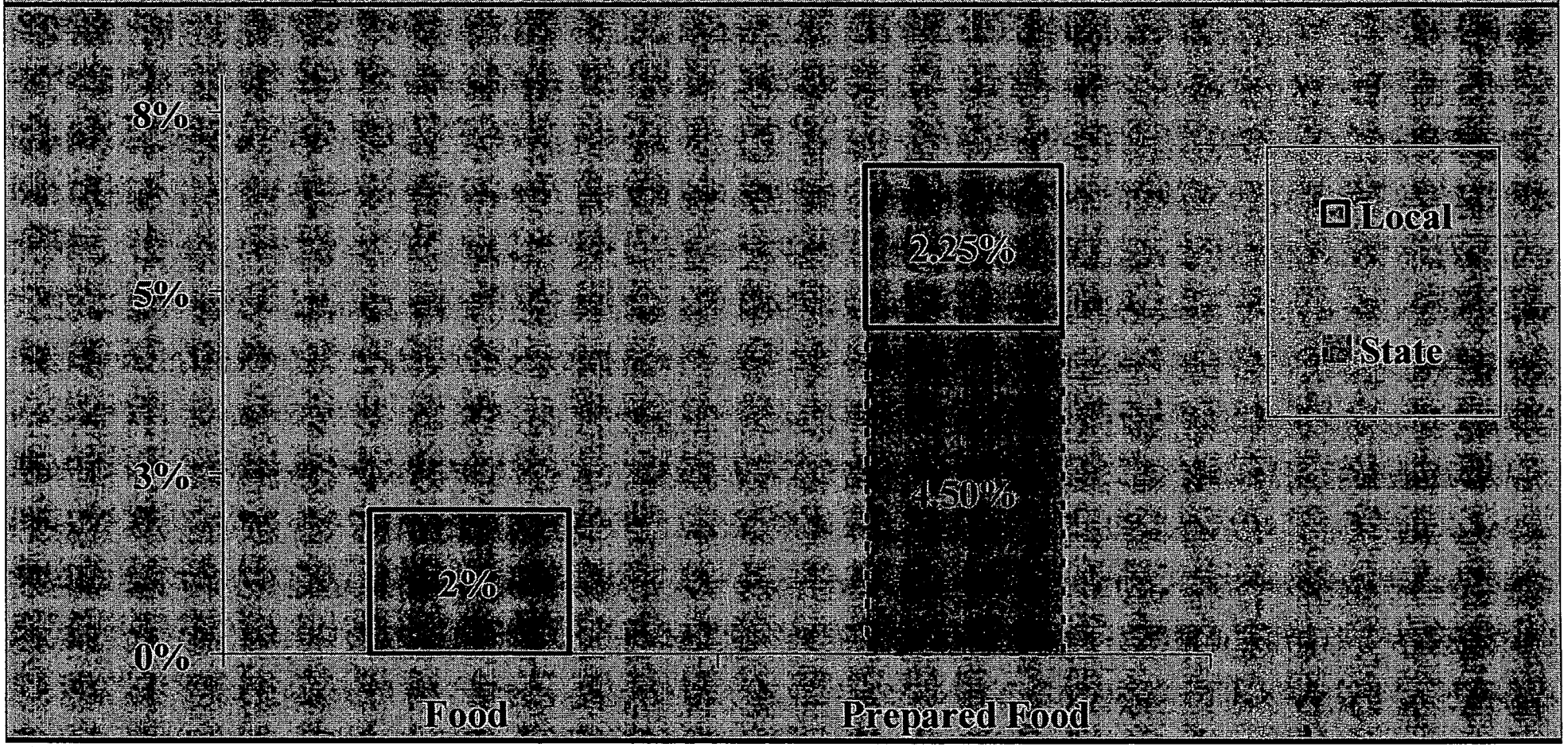
- Definition—G.S. 105-164.3(28)
- Subject to the State and local sales and use tax if:
  - It is sold in a heated state or it is heated by the retailer
  - It consists of two or more foods mixed or combined by the retailer for sale as a single item
  - It is sold with eating utensils provided by the retailer

Prepared Food

Fiscal Year 07-08

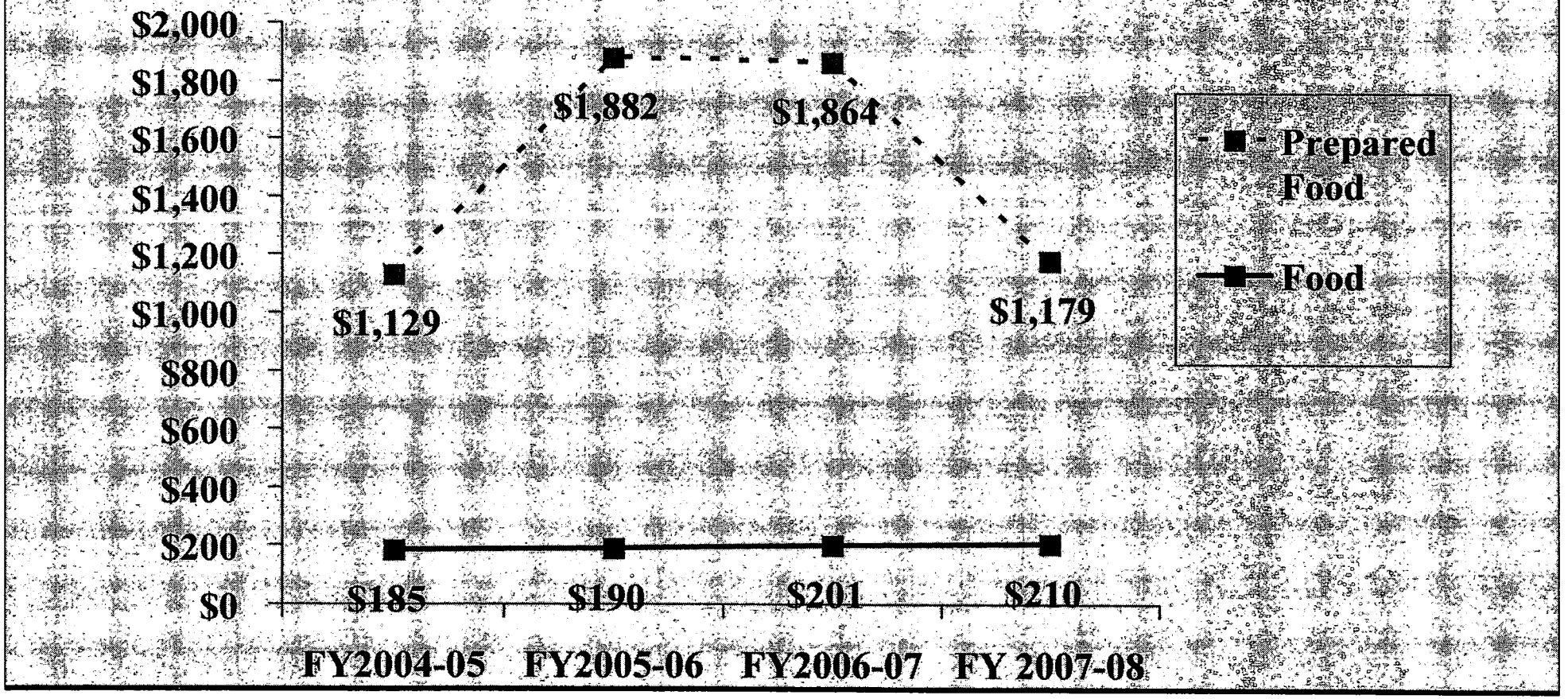
- Sales and use tax rate 6.75%
  - State 4.25%
  - Local 2.5%
- Revenue $1.2 Bill.
  - State $742 Mill.
  - Local $437 Mill.

Sales Tax Rate on Food and Prepared Food, as of Oct. 2008



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Sales Tax Collections on Food and Prepared Food ($ In Millions)



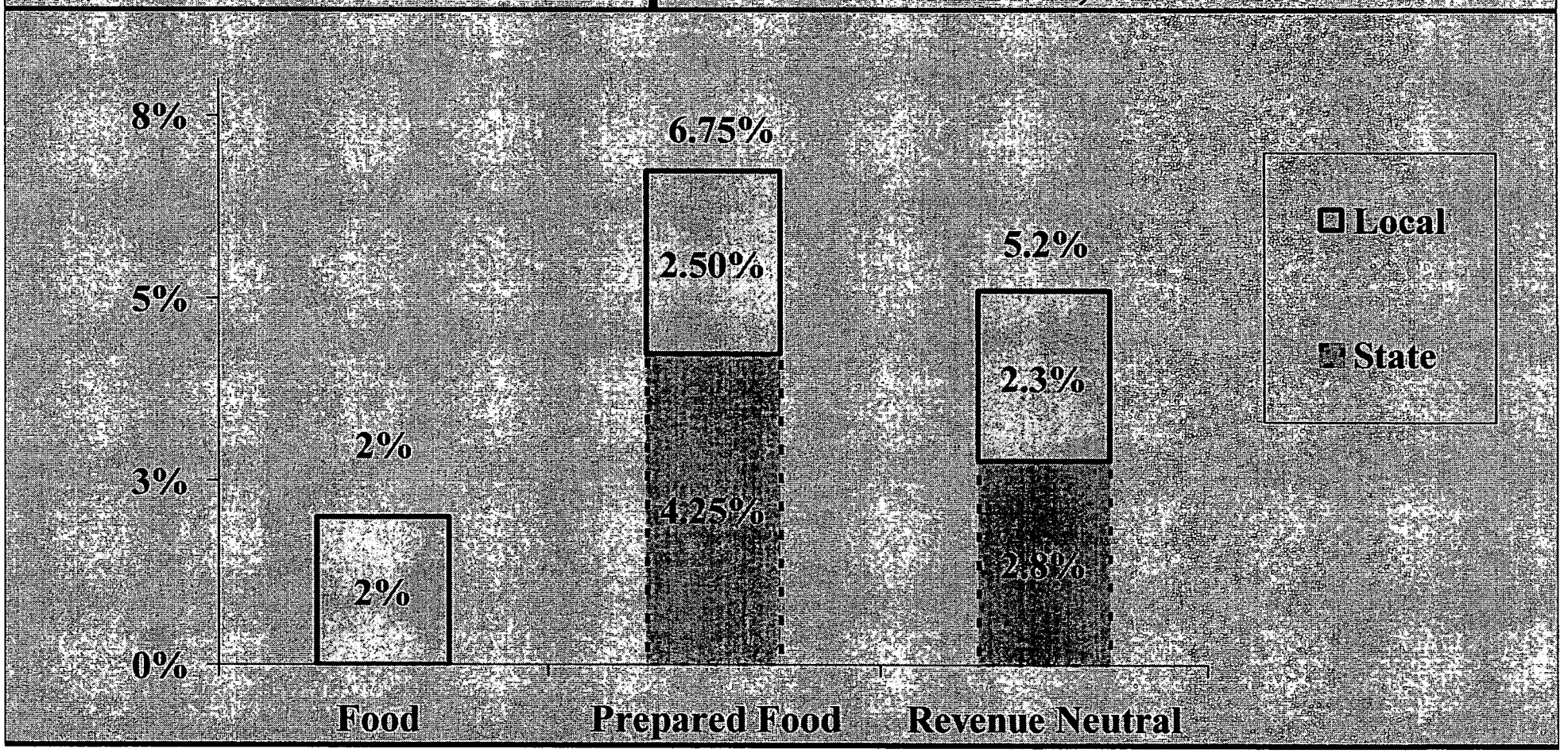
Challenges

- Blurred line between food and prepared food
- Difficulty in administering two different rates

Options

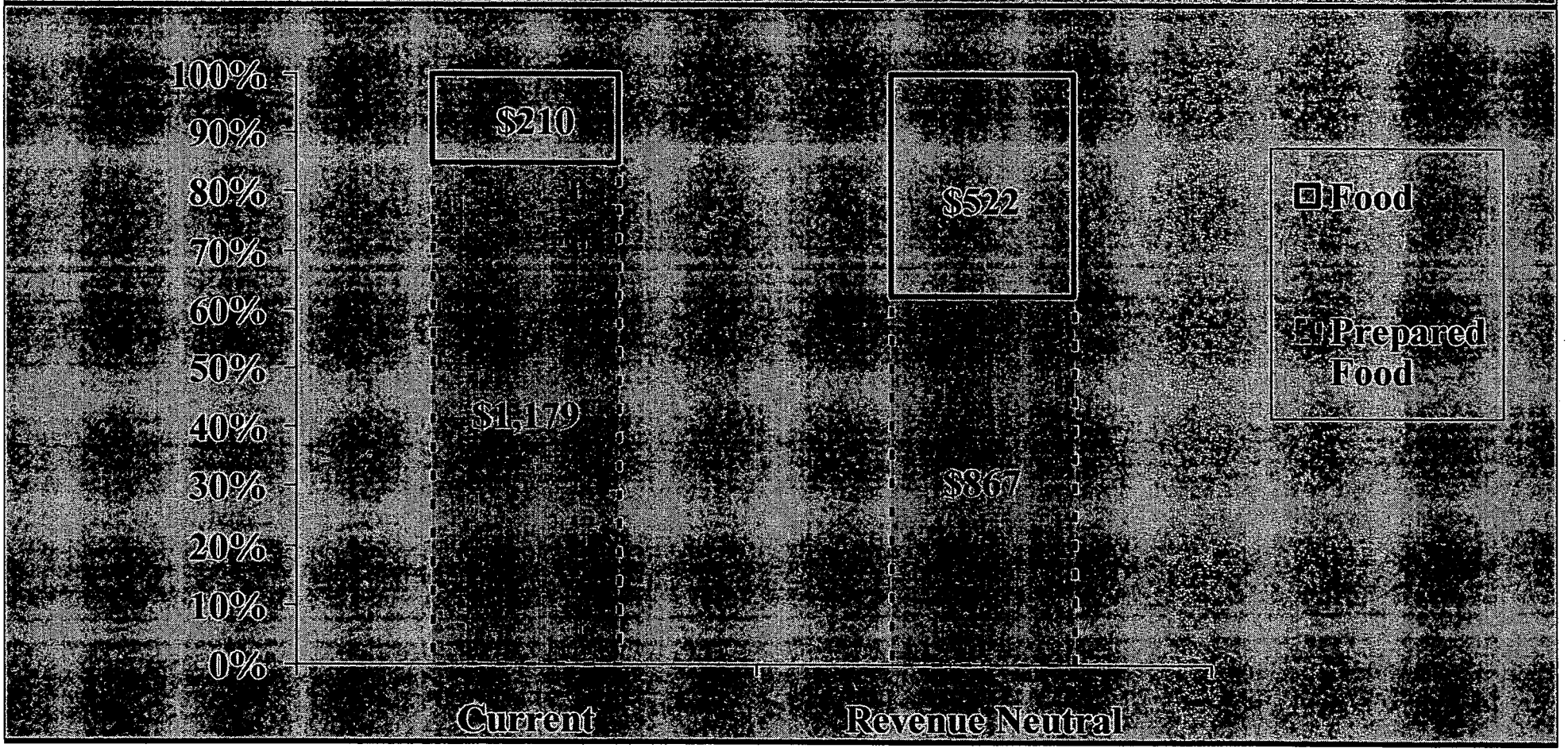
- Determine differences as they come
- Tax everything at the combined rate
- Eliminate State sales and use on prepared food
- Implement revenue neutral rate

Revenue Neutral Rate for Food and Prepared Food, FY07-08



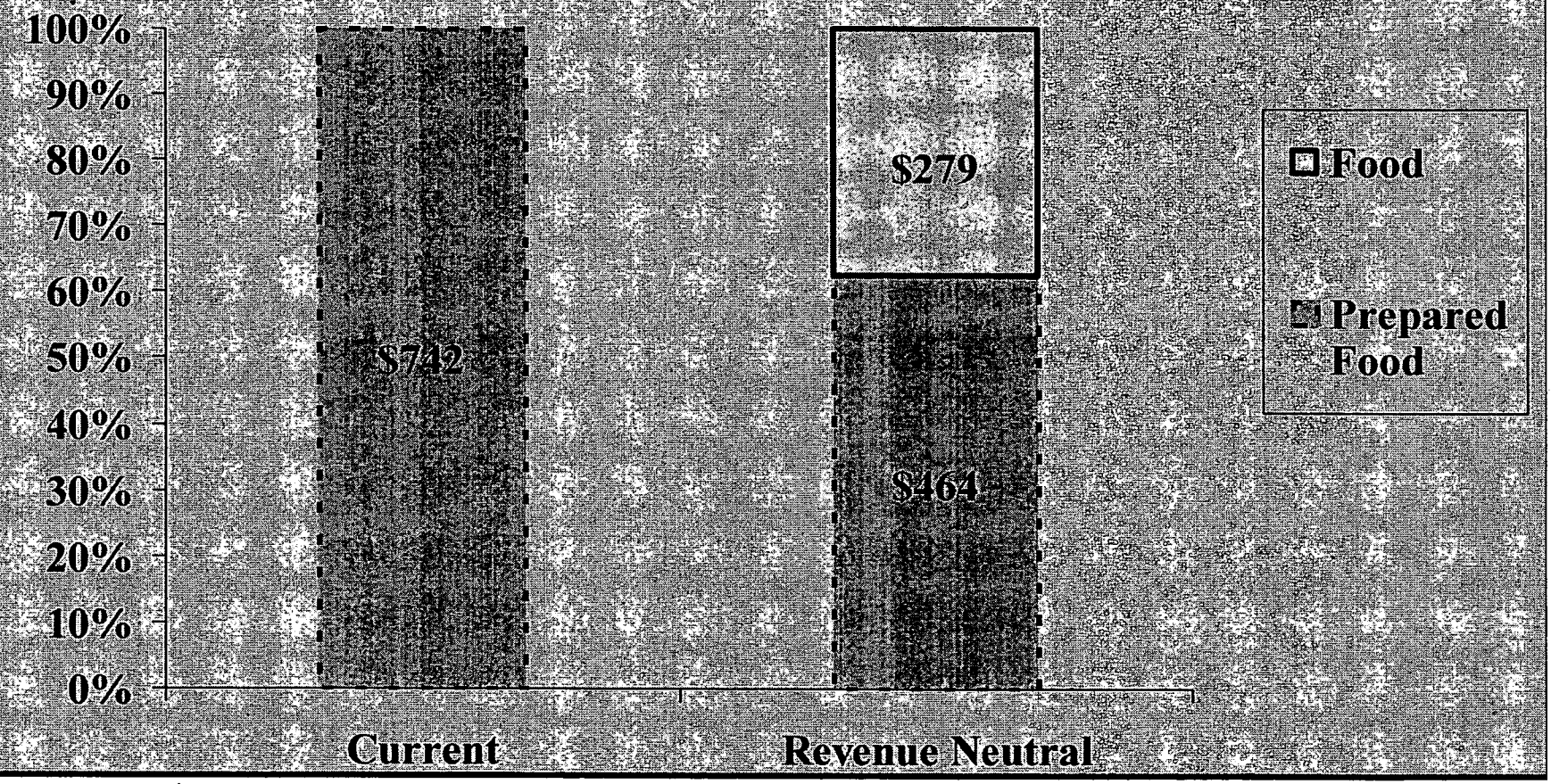
FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Tax Collections w/ Revenue Neutral Rate, FY07-08 ($ In Millions)



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

State Collections w/ Revenue Neutral Rate, FY07-08 ($ In Millions)



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Past Recommendations

- How other states tax food
  - U.S.
  - Streamlined Sales and Use Tax Project
- Past recommendations
  - State and Local Fiscal Modernization Study
  - Department of Revenue

Other States Tax Treatment of Food for Home Consumption

U.S.

- Ten levy the full rate
- Five levy reduced rates
- Three apply local tax
- 27 states exempt food
- Five levy full rate but w/ caveats
- Five no sales tax

Streamlined

- 21 states
- 13 states exempt food
- Six levy the full rate
- Two levy reduced rates

Past Recommendations Related to the Taxation of Food

State and Local Fiscal Modernization Study

- Eliminate differential sales tax rates
  - Establish a revenue neutral rate
  - Provide income tax relief for low-income families

2008

FINANCE LAW CHANGES

PREPARED BY
FINANCE TEAM LEGAL STAFF:
Cindy Avrette
Dan Ettefagh
Heather Fennell
Trina Griffin
Martha Walston

TABLE OF CONTENTS

(Sorted by Session Law #)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-35	SB 1876	Deferred Property Tax Programs Changes.	Senator Clodfelter	1
S.L. 2008-107	HB 2436	Modify Appropriations Act of 2007.	Rep. Michaux, Adams, Alexander, Crawford	4
S.L. 2008-118	HB 2438	2008 Budget Technical Corrections.	Rep. Michaux, Tolson, Yongue	37
S.L. 2008-134	SB 1704	Rev Laws Tech., Clarifying, & Admin Changes.	Senator Hartsell	38
S.L. 2008-144	SB 1852	Tax on Short-Term Heavy Equipment Rentals.	Senator Brunstetter	49
S.L. 2008-146, as amended by S.L. 2008-187	SB 1878	Property Tax Modifications.	Senator Clodfelter	51
S.L. 2008-147	SB 2075	Economic Development Modifications.	Senator Berger of Franklin	57
S.L. 2008-148	SB 1716	Supplemental PEG Support.	Senator Clodfelter	58
S.L. 2008-154	HB 2509	Sales Tax Refund for Certain Nonprofits.	Representative Gibson	60
S.L. 2008-158	SB 1407	Resale of Tickets via Internet.	Senator Hartsell	61

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-165, as amended by S.L. 2008-187	HB 1770	Future Conveyances/Special Assessments.	Representative McComas	63
S.L. 2008-171	HB 1889	Wildlife Land Property Tax Changes.	Rep. Harrison, Gibson, Hill, Brubaker	65
S.L. 2008-204	SB 1925	UNC Nonapp. Cap. Projects/Airport Authority.	Senator Kerr	70
S.L. 2008-206	HB 2558	Home Inspector Privilege License.	Representative Ross	76
S.L. 2008-207	HB 2530	Solid Waste Tax Changes/Unsalable OTP Refund.	Rep. Harrison, T. Harrell, Luebke, Thomas	77
S.L. 2008-225	SB 1697	Toll Enforcement Authority Changes.	Senator Jenkins	78
Appendices		*Appendix A - Table of Contents Sorted by Bill #*		
		Appendix B - Table of Contents Sorted by Short Title		
		Appendix C - Table of Contents Sorted by Sponsor		

2008 Finance Law Changes

Deferred Property Tax Programs Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-35	SB 1876	Senator Clodfelter

AN ACT TO MODIFY THE CIRCUIT BREAKER TAX BENEFIT, TO STANDARDIZE ADMINISTRATION OF ALL DEFERRED PROPERTY TAX PROGRAMS, AND TO CORRECT THE EFFECTIVE DATE OF CHANGES TO THE HOMESTEAD EXCLUSION.

OVERVIEW: This act does the following:

- It modifies the property tax homestead circuit breaker program to ease the administration and implementation of the program.
- It consolidates the administrative provisions of North Carolina's property tax deferral programs into one statute.
- It simplifies the collection remedies for delinquent property taxes.
- It clarifies the property tax homestead income eligibility amount.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

ANALYSIS:

Part I: Circuit Breaker Modifications

In 2007, the General Assembly enacted a new property tax deferral program[1] for North Carolina residents who have owned and occupied property located in the State as a permanent residence for at least five years, who are either 65 years of age or older or totally and permanently disabled, and whose income for the preceding year does not exceed 150% of the income eligibility limit for the property tax homestead exclusion.[2] The homestead circuit breaker program becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009. The amount of property tax an eligible owner may defer under the program varies depending upon the owner's income. An owner whose income is less than the income eligibility limit of the property tax homestead exclusion may defer the portion of taxes imposed on the permanent residence that exceeds four percent (4%) of the owner's income. An owner whose income is 100% to 150% of the income eligibility limit of the

[1] S.L. 2007-497.

[2] For taxable years beginning on or after July 1, 2008, the homestead exclusion income eligibility amount is $25,000. This amount is indexed annually. The amount for 2009 is $25,600.

property tax homestead exclusion may defer the portion of taxes imposed on the permanent residence that exceeds five percent (5%) of the owner's income.

The Revenue Laws Study Committee reviewed the homestead circuit breaker program during the interim. It proposed several changes to the program it received from the Department of Revenue, the School of Government, and county tax assessors and collectors. The act does the following:

- It transfers the responsibility for notifying qualifying owners of the cumulative amount of deferred taxes, including interest, from the tax assessor to the tax collector. The tax collector has all the information needed to make this notification, even in counties where the towns located in it have a separate tax collector. Also, the tax collector is able to include this information on the property tax bills.

- It eliminates the delay in using enforced collection remedies[3] for all disqualifying events other than the owner's death. Taxes deferred under the circuit breaker program become payable upon the occurrence of a disqualifying event: death of the owner, transfer of the residence by the owner, or cessation of use of the residence as a permanent residence by the owner other than a qualifying temporary absence.[4] Upon the occurrence of a disqualifying event, the amount of taxes for the year with no circuit breaker benefit plus those taxes deferred for the preceding three fiscal years, together with interest, become due. Under prior law, a tax collector could not enforce the collection of these taxes until nine months after the disqualifying event. This delay was unique among North Carolina's property tax deferral programs. The act eliminates the delay in using the enforced collection remedies for all disqualifying events other than the owner's death, where the nine-month delay remains.

- It converts the application process from a one-time application to an annual application. The application process for the property tax homestead circuit breaker was modeled after the homestead exclusion, which requires a single application. However, while eligibility for both programs is contingent on a taxpayer's income, the actual benefit received under the circuit breaker program is a function of different variables: the property value for the exclusion versus the taxpayer's income for the circuit breaker. Since the amount of the circuit breaker tax benefit is a function of the taxpayer's income, an annual reporting of income is necessary for the county to prepare the tax bill.

- It creates an exception to the tax secrecy provisions to allow agents of a county to disclose on a property tax receipt the amount of property taxes due and the amount of property taxes deferred under the homestead circuit breaker. Since the amount of taxes that can be deferred under the circuit breaker program is a function of income, and since counties make property tax records public, a person could use the amount of deferred taxes to calculate a qualifying owner's income. For this reason, the counties requested an exception to general rule that it cannot publish information about a taxpayer's income.

---

[3] An enforced collection remedy is one or more of the collection remedies provided in G.S. 105-266 through 105-375 for delinquent property taxes. The remedies include attachment and garnishment and foreclosure.

[4] An exception to this rule exists, allowing deferral to continue if the residence is transferred to a spouse or qualifying co-owner and that individual qualifies for deferral and elects to continue deferral.

- It synchronizes the income eligibility limit for the 4% benefit under the homestead circuit breaker with the income eligibility limit for the homestead exclusion. Under prior law, there was a one-penny discrepancy between these income limits.

Part II: Deferral Program Modifications

North Carolina has six property tax deferral programs: (i) historic district property held as future site of historic structures[5] (ii) the circuit breaker tax deferral program[6] (iii) nonprofit property held as future site of low- or moderate-income housing[7] (iv) present-use value (PUV) property[8] (v) working waterfront property[9] and (vi) historic property.[10] The act creates a set of uniform provisions, applicable to all six programs. The provisions, several of which existed under prior law but were scattered among various statutes, are now collected in G.S. 105-277.1D and are as follows:

- Deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event. This results in no change from prior law for any of the deferral programs.
- Interest accrues as of the date the taxes would have originally become due without the deferral program. This results in no change from prior law for any of the deferral programs.
- The tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program. This results in no change from prior law for any of the deferral programs.
- Liens resulting from deferred taxes are extinguished when the taxes are paid. This results in no change from prior law for any of the deferral programs.
- If part of a property on which taxes are deferred loses eligibility, the assessor determines the amount of deferred taxes that apply to that part and that amount is due and payable. Under prior law, the PUV, working waterfront property and historic property programs permitted partial loss of eligibility; the other programs[11] were an all-or-nothing system. The act permits partial loss of eligibility in all programs.
- All or part of taxes deferred may be paid at any time without affecting deferral eligibility, and partial payments are applied first to accrued interest, not the principal. The Department's construction of prior law was that a taxpayer could not make a partial payment of taxes deferred from previous years without withdrawing the property from the deferral program. This effectively forced a taxpayer to choose between paying down any accrued deferred taxes on eligible property and keeping the property in the deferral program. The act eliminates this disincentive and permits payment against accrued taxes and interest.

---

[5] G.S. 105-275(29a).
[6] G.S. 105-277.1B.
[7] G.S. 105-278.6(e).
[8] G.S. 105.277.4(c).
[9] G.S. 105-277.14.
[10] G.S. 105-278(b).
[11] Future historic site, future low- or moderate-income housing site, and the circuit breaker programs.

The act also consolidates the statutory provisions relevant to when and against whom a taxing unit may utilize enforced collection remedies. An enforced collection remedy is one or more of the collection remedies provided in G.S. 105-266 through 105-375 for delinquent property taxes. The remedies include attachment and garnishment and foreclosure. The act provides two sets of rules. The first set of rules provides that collection remedies may be enforced as of the date of delinquency. The date of delinquency is determined as follows:

- For normal taxes, the date of delinquency is the date the tax begins to accrue interest. Under G.S. 105-360, that date is January 6th.
- For deferred taxes other than the circuit breaker where the disqualifying event is the death of the owner, the date of delinquency is the date a disqualifying event occurs.
- For deferred taxes under the circuit breaker where the disqualifying event is the death of the owner, the date of delinquency is the first day of the ninth month following the date of death.

The second set of rules provides against whom enforced collection remedies may be used:

- For delinquent taxes on real property, the taxing unit may proceed against the owner of record as of the date of delinquency and any subsequent owner.
- For delinquent taxes on personal property, the taxing unit may proceed against the owner of record as of January 1 of the calendar year in which the fiscal year of taxation begins.
- For delinquent taxes on registered motor vehicles, the taxing unit may proceed against the owner of record as of the date on which a new registration is applied for or on which the current vehicle registration is renewed.

Part III: Technical Change

Last year, the General Assembly enacted legislation increasing the income eligibility limit for the property tax homestead exclusion from $20,500 to $25,000.[12] The increase was supposed to take effect for taxable years beginning on July 1, 2008. A drafting error provided a different result. This act corrects the error to accomplish the intent of the original act.

Modify Appropriations Act of 2007.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-107	**HB 2436**	**Rep. Michaux, Adams, Alexander, Crawford**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL APPROPRIATIONS ACT OF 2007.

[12] Prior to S.L. 2007-497, the income eligibility amount was statutorily set at $18,000. The statutory amount is indexed annually. In 2007, the indexed income eligibility amount was $20,500. S.L. 2007-497 changed the statutory amount from $18,000 to $25,000.

OVERVIEW, FISCAL IMPACT, AND EFFECTIVE DATES: *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

Section	Description & Effective Dates	Fiscal Impact
Part I: Special Indebtedness		
27.8	*Special Indebtedness Projects* – ***Authorizes the issuance of $709,034,944 of special indebtedness to finance various capital projects over the next four fiscal years. Of this amount, no more than $345,866,944 may be issued in fiscal year 2008-2009.***	***General fund debt service for this section and Section 27.9 is $17,500,000 for fiscal year 2008-2009.***
27.9	*Two-Thirds Bonds Act of 2008* – ***Authorizes the issuance of $107,000,000 of general obligation bonds for the Green Square Project.***	***General fund debt service for this section and Section 27.8 is $17,500,000 for fiscal year 2008-2009.***
Part II: Individual & Corporate Income Tax Changes		
28.1	*IRC Update* – ***Updates the reference to the Internal Revenue Code to May 1, 2008, but decouples from the 50% bonus depreciation provision under the Economic Stimulus Act of 2008. This section is effective for taxable years beginning on or after January 1, 2008.***	***The impact on General Fund revenues is as follows: FY 2008-09: No impact FY 2009-10: Loss of $1.2 million FY 2010-11: Loss of $0.8 million FY 2011-12: Gain of $4.3 million FY 2012-13: Gain of $4.0 million***
28.7	*Close Franchise Tax Loopholes* – ***Provides that limited liability companies that elect to be taxed as S corporations are subject to the franchise tax in the same manner as other S corporations and that captive REITS are subject to the franchise tax in the same manner as a corporation. This section of the act becomes effective for taxable years beginning on or after January 1, 2009.***	***Minimal impact.***

Section	Description & Effective Dates	Fiscal Impact
28.8	*Publicly Traded Partnerships* – Requires a publicly traded partnership (PTP) that qualifies as a PTP under section 7704(c) of the Internal Revenue Code to file an informational return with the Secretary of Revenue that lists the partners who received more than $500 of income from the partnership during the taxable year. This section becomes effective for taxable years beginning on or after January 1, 2008.	Minimal impact.
28.9	*Increase Earned Income Tax Credit to Five Percent* – Increases the State's refundable earned income tax credit from 3.5% to 5%, effective for taxable years beginning on or after January 1, 2009.	Reduces General Fund revenues by $20.9 million beginning in fiscal year 2009-2010.
28.25	*Expand Renewable Energy Tax Credit* – Allows an income tax credit for donating funds to a unit of State or local government for the purpose of enabling that unit to acquire renewable energy property. This section is effective for taxable years beginning on or after January 1, 2008.	Reduces General Fund revenues by $100,000 annually.
28.27	*Tax Deduction for the Sale of a Manufactured Home Community to Manufactured Homeowners* – Creates an income tax deduction equal to the taxable gain reported by a taxpayer from the qualified sale of a manufactured home community. This section is effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2015.	Reduces General Fund revenues by approximately $100,000 annually.
Part III: Sales Tax Changes		

Section	Description & Effective Dates	Fiscal Impact
28.6	*Exempt Disaster Assistance Debit Sales* – Exempts from sales tax tangible personal property purchased with a client assistance debit card issued for disaster assistance relief by a State agency or a federal agency or instrumentality. This section became effective August 1, 2008, and applies to purchases made on or after that date.	Reduces General Fund revenue by approximately $500,000 annually.
28.12	*Sales Tax Holiday for Certain Energy Star Rated Appliances* – Creates a sales tax holiday for energy efficient products for the first weekend of November. The holiday applies to the following Energy Star products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps and geothermal heat pumps, ceiling fans, dehumidifiers, and programmable thermostats. This section became effective July 16, 2008.	Reduces General Fund revenue by $1.4 million annually.
28.19	*State Sales Tax Exemption for Baked Goods Sold by Artisan Bakeries* – Exempts bakery items sold by an artisan bakery from State sales tax, effective January 1, 2009.	Reduces General Fund revenues by $1.6 million for fiscal year 2008-2009 and by approximately $3.5 million for each year thereafter.
28.20	*Prohibit Tax on Interior Design Services* – Exempts from sales tax interior design services provided in conjunction with the sale of tangible personal property. This section became effective August 1, 2008.	Reduces General Fund revenues by $100,000 annually.
28.21	*1%, $80 Cap on Excise Tax on Machinery Refurbishers* – Applies a 1% privilege tax, with an $80 cap, in lieu of sales tax on equipment purchased by an industrial machinery refurbishing company that is used in repairing or refurbishing tangible personal property. This section became effective July 1, 2008, and applies to purchases made on or after that date.	Reduces General Fund revenues by $300,000 for fiscal year 2008-2009 and by $500,000 annually each year thereafter.

Section	Description & Effective Dates	Fiscal Impact
28.22	*Clarify 501(c)(3) Sales Tax Refund* – **Provides a definitive category of the type of nonprofit entity entitled to a semiannual sales and use tax refund. This section became effective July 1, 2008, and applies to purchases made on or after that date**	*Minimal fiscal impact.*
Part IV: Economic Incentives		
28.2	*Extend Credit for Research & Development* – **Extends from 2009 to 2014 the sunset on the income tax credit for qualified North Carolina research expenses or North Carolina University research expenses.**	*Reduces General Fund revenues as follows:* *FY 2008-09: $1.0 million* *FY 2009-10: $2.1 million* *FY 2010-11: $2.3 million* *FY 2011-12: $2.5 million* *FY 2012-13: $2.6 million*
28.3	*Extend Low-Income Housing Credit* – **Extends from 2010 to 2015 the sunset on the income tax credit that may be allocated to developers of low-income housing projects by the North Carolina Housing Finance Agency.**	*Reduces General Fund revenues as follows:* *FY 2008-09: -0-* *FY 2009-10: -0-* *FY 2010-11: -0-* *FY 2011-12: $22.1 million* *FY 2012-13: $45.2 million*
28.4	*Extend Mill Rehabilitation Credit* – **Extends the sunset for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011. Under prior law, the credit expired for qualified rehabilitation expenses occurring on or after that date.**	*Reduces General Fund revenues as follows:* *FY 2008-09: -0-* *FY 2009-10: -0-* *FY 2010-11: $1.5 million* *FY 2011-12: $3.4 million* *FY 2012-13: $4.2 million*
28.5	*Extend Sunset for State Ports Tax Credit* – **Extends from 2009 to 2014 the sunset on the income tax credit allowed to a taxpayer who loads or unloads cargo at either of the State-owned port terminals.**	*Reduces General Fund revenues as follows:* *FY 2008-09: $1.0 million* *FY 2009-10: $2.0 million* *FY 2010-11: $2.0 million* *FY 2011-12: $2.0 million*
28.10	*Extend Sunset for Small Business Employee Health Benefits* – **Extends from 2009 to 2010 the sunset on the tax credit available to small businesses that provide health benefits to all of their full-time employees.**	*Reduces General Fund revenues as follows:* *FY 2008-09: $8.5 million* *FY 2009-10: $17.7 million* *FY 2010-11: $10.1 million*

Section	Description & Effective Dates	Fiscal Impact
28.23	*Extend Aviation Fuel Refunds* – Extends from January 1, 2009, to January 1, 2011, the sunset on the following two sales tax refund provisions: • Aviation fuel used by an interstate passenger air carrier. • Aviation fuel used by a motorsports racing team to travel to or from a motorsports.	Reduces General Fund revenues as follows: FY 2009-10: $1.6 million FY 2010-11: $3.2 million FY 2011-12: $1.6 million
28.24	*Expand Film Industry Credit* – Extends from 2009 to 2014 the sunset on the 15% tax credit available for productions over $250,000. The provision also expands the definition of qualifying expenses. This section is effective for taxable years beginning on or after January 1, 2008.	Reduces General Fund revenues as follows: FY 2008-09: $0.1 million FY 2009-10: $8.5 million FY 2010-11: $26.7 million FY 2011-12: $27.5 million FY 2012-13: $28.4 million
28.26	*Increase Qualified Business Venture Tax Credit Cap* – Increases from $7 to $7.5 million the total amount of all qualified business investments credits that may be taken each year. This section is effective for investments made on or after January 1, 2008.	Reduces General Fund revenues as follows: FY 2009-10: $0.5 million FY 2010-11: $0.5 million FY 2011-12: $0.5 million FY2012-13: $0.5 million
Part V: Estate & Gift Tax Changes		
28.17	*Modify Estate Tax Law* – Modifies the estate tax law to remove property from the estate tax base that the State cannot tax. This section became effective July 16, 2008, applies retroactively to the estates of decedents for which the statute of limitations for claiming a refund had not expired as of December 28, 2007.	Reduces General Fund revenues by $2 million in fiscal year 2008-2009; reduces revenues by approximately $500,000 annually thereafter.
28.18	*Repeal Gift Tax Law* – Repeals the gift tax, effective January 1, 2009, and applicable to gifts made on or after that date.	Reduces General Fund revenues by $17.5 million for fiscal year 2009-2010.
Part VI: Property Tax Changes		

Section	Description & Effective Dates	Fiscal Impact
28.9	*Provide a Property Tax Exclusion for Honorably Discharged Disabled Veterans and Their Surviving Spouses* – ***Establishes a property tax homestead exemption for disabled veterans equal to the first $45,000 of the property's appraised value, effective for property tax years beginning on or after July 1, 2009.***	***No impact on State General Fund revenues. Reduces local government revenues by approximately $4.3 million.***
Part VII: Administrative Changes		
28.16	*Small Business Protection Act* – ***Requires the Department to reduce an assessment for sales and use taxes imposed on a small retailer if certain circumstances exist and to document advice given to taxpayers in certain situations. The majority of this section became effective when the Governor signed the act into law on July 16, 2008. The requirement that the Department document advice given to taxpayers related to sales tax application becomes effective January 1, 2009. The requirement that the Department document advice related to whether a taxpayer must register as a retailer or wholesale merchant under Article 5 of Chapter 105 becomes effective July 1, 2009.***	***Reduces General Fund revenues by $2.2 million for fiscal year 2009-2010 and by $500,000 annually thereafter.***
28.28	*Procedure for Tax Class Actions* – ***Establishes a procedure for initiating or joining a tax class action in which a taxpayer is seeking the refund of a tax paid under an alleged unconstitutional statute. This section is effective October 1, 2008, and applies to actions filed on or after that date.***	***Indeterminable.***

ANALYSIS:

Part I: State Indebtedness

Special Indebtedness. – Section 27.8 authorizes the issuance of $709,034,944 of special indebtedness to finance a variety of State capital projects over the next four fiscal years. Of this amount, only $345,866,944 may be issued or incurred during fiscal year 2008-2009. This

amount of indebtedness is within the recommended guidelines of the NC Debt Affordability Advisory Committee.[13] The NC Debt Affordability General Fund Model Guidelines recommends that General Fund debt service should be targeted at no more than 4% of General Fund revenues and should not exceed 4.75% of General Fund revenues. Based on projected General Fund revenues, the model calculates that the State could annually authorize $479,700,000 of new tax-supported debt over the next five years and remain within its targeted ratio. This section became effective when the Governor signed the act into law on July 16, 2008.

Special indebtedness[14] is non-voted debt that is typically secured only by an interest in the State property being acquired or improved. The term 'special indebtedness' covers both financing contract indebtedness and limited obligation bond indebtedness. Financing contract indebtedness may take the form of a lease purchase, an installment purchase, or a certificate of participation.[15] The form of debt anticipated for these issuances is limited obligation bonds. Since 2000, the State has relied exclusively on the authorization of special indebtedness to finance capital projects.

The capital projects financed in this section through special indebtedness include the following:

- Facilities for the University of North Carolina.
- Additions to several correctional institutions.
- The purchase of State judicial facilities located at 901 Corporate Drive in Raleigh.
- The acquisition of State park lands and conservation areas for the Land for Tomorrow initiative.
- Various other State capital projects, such as the completion of an oyster hatchery, improvements at the State ports in Morehead City and Wilmington, expansion and renovation to the polar bear exhibit at the N.C. Zoo, and construction of a Southeastern North Carolina Agriculture Center Pavilion.

Two-Thirds Bonds Act of 2008. – Section 27.9 authorizes the issuance of $107,000,000 of non-voted general obligation bond indebtedness to finance the Green Square Project. This section became effective when the Governor signed the act into law on July 16, 2008.

---

[13] The 2008 Debt Affordability Study may be accessed at www.nctreasurer.com.

[14] Before any type of special indebtedness may be issued or incurred, the State Treasurer must certify that debt financing may be desirable for a specific project presented to it by the Department of Administration. Next, the Council of State must give preliminary approval. If preliminary approval is obtained, the Council of State must give final approval, setting out details such as the maximum amount to be financed, the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed 40 years. The State Treasurer must approve the details of the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any State revenues to provide for repayment, and that the special indebtedness can be incurred or issued on terms favorable to the State. Finally, the State Treasurer must report to the Joint Legislative Commission on Governmental Operations at least five days before any special indebtedness is issued or incurred.

[15] Certificate of participation indebtedness involves a plan of finance in which a special corporation obtains funds to pay the cost of a capital facility to be financed through the delivery by the special corporation of certificates of participation. Limited obligation bond indebtedness does not require the presence of a special corporation.

General obligation bond indebtedness is secured by the faith and credit and taxing power of the State. As a general rule, general obligation bond indebtedness must be approved by the voters. However, under Article V, Sec. 3(a)(f) of the North Carolina Constitution, the State may issue non-voted general obligation bonds in an amount not to exceed 2/3 of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. Based upon this formula, the State could have issued up to $125,000,000 of non-voted general obligation bonds for fiscal year 2008-2009.

The Green Square Project consists of an office building for the Department of Environment and Natural Resources, the construction of a Nature Research Center for the NC Museum of Natural Science, and an underground parking deck with 426 spaces. The project also consists of another parking deck, authorized in S.L. 2006-231, which will house up to 900 spaces. The total cost of the project, excluding the parking deck authorized in 2006, is $150,000,000. The General Assembly appropriated $25,000,000 for the project last year. Parking receipts will service the debt for parking construction and the Friends of the Museum of Natural Science have committed $27,500,000 towards the cost of the Nature Research Center and $15,500,000 towards the cost of the exhibits.

Part II: Individual and Corporate Income Tax Changes

IRC Update. – Section 28.1 updates from January 1, 2007, to May 1, 2008, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. However, this section also requires an 85% addback of the bonus depreciation allowed under the Economic Stimulus Act of 2008 in order to achieve revenue neutrality for fiscal year 2008-2009. The Revenue Laws Study Committee recommended this provision, and the Governor included it in his revenue recommendations. This section is effective for taxable years beginning on or after January 1, 2008.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[16] The General Assembly determines each year whether to update this reference.[17] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law tracks federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made. Changing the reference date to May 1, 2008, incorporates, with the one major exception mentioned above, the changes made by the following acts: the Economic Stimulus Act of 2008, the Mortgage Forgiveness Debt Relief Act of 2007, and the Small Business and Work Opportunity Tax Act of 2007.[18]

---

[16] 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.

[17] 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."

[18] A more detailed summary of recent amendments to the Code is available upon request.

Enacted on February 13, 2008, the Economic Stimulus Act of 2008[19] (ESA) was a $152 billion package designed to stimulate the economy through rebates for individual taxpayers and incentives for businesses.[20] Those incentives are the 50% bonus depreciation provision for qualifying property placed in service in 2008, the increased limits for section 179 expensing of qualified property in 2008, and increased depreciation limits for 'luxury' autos predominantly used for business. North Carolina is not conforming to the bonus depreciation provision but does conform to the other business incentives.

- **50% Bonus Depreciation Provision.**[21] Under this section, North Carolina decouples from the federal accelerated depreciation schedule allowed under the ESA. Over the life of an asset placed in service during 2008, taxpayers will be able to deduct the same amount of the asset's basis under both federal and State law; it is just that the timing of the deduction will differ. To accomplish this decoupling, the section does two things:

  - It requires a taxpayer to add back to federal taxable income 85% of the accelerated depreciation amount[22] in the year the accelerated depreciation is claimed for federal purposes.[23]
  - In tax years beginning on or after January 1, 2009, it allows a taxpayer to deduct from federal taxable income the total amount of the add-back required for either the 2007 or 2008 tax year, divided into five equal installments.

  This means that for State tax purposes, a taxpayer may deduct a greater depreciation amount in the outlying tax years, which will be the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back. The purpose of this recovery provision is to enable the taxpayer to have the same basis in assets for federal and State purposes. Without this deduction provision, a taxpayer would have a different basis in the depreciable asset for State and federal purposes and would have to keep separate books and records for State and federal purposes until the disposal of the asset. In effect, the add-back and subsequent deduction will affect the timing of the impact of bonus depreciation on the State but it will not increase or decrease the total amount of revenue the State receives over the affected years.

  Under the ESA, a taxpayer is entitled to depreciate in the first year 50% of the adjusted basis of certain qualified property placed in service during the 2008 calendar year.[24] To claim bonus depreciation, the property must be one of the following types:

---

[19] P.L. 110-185.

[20] The rebates, which are technically "advance credit payments," do not impact State revenues and are not discussed in this analysis.

[21] Bonus depreciation allows a business to claim more of a deduction up front and spread the remainder out over the normal depreciation schedule. However, over the life of the asset the taxpayer still receives the same benefit. Congress has authorized bonus depreciation several times to encourage business investment, specifically after September 11, 2001. The Jobs Creation and Worker Assistance Act of 2002 provided a 30% bonus depreciation allowance. The Jobs and Growth Tax Relief Reconciliation Act of 2003 extended the sunset and increased the amount to 50%.

[22] The accelerated depreciation amount for property placed in service in 2008 is 50%.

[23] The add-back means that for State tax purposes, a taxpayer deducts less in that tax year than the taxpayer would have deducted if the State conformed to the accelerated depreciation provision.

- Eligible for the modified accelerated cost recovery system (MACRS) with a depreciation of 20 years or less.
- Water utility property
- Off-the-shelf computer software
- Qualified leasehold property.

Generally speaking, bonus depreciation is available for every item of tangible personal property, except inventory, property used outside the U.S., and property depreciated under the alternative depreciation system. Other than computer software, it is not available for intangibles. Bonus depreciation is not allowed if property is sold in the same year that it is placed in service.

- **Increased Section 179 Expensing Limits.** – This section conforms to the increased expensing limits authorized under the ESA. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Code. To be eligible, the property must be tangible personal property that is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take the expensing deduction first and claim section 168(k) depreciation on any remaining basis.

  Prior to the ESA, the deduction was limited to $128,000 of the cost of the property with a phase-out at $510,000 for 2008. The new law temporarily doubles the limitation to $250,000.[25] The threshold for reducing the deduction is also increased to $800,000 with a complete phase-out once qualifying purchases exceed $1.05 million. These limitations apply only to property purchased and placed in service in tax years beginning in 2008. The limitations will return to the lower levels for tax years beginning in 2009.

- **Increased Depreciation Limits for 'Luxury' Autos.** – This section conforms to the increased the depreciation limits on luxury vehicles under the ESA.[26] A luxury vehicle is one that costs more than the 'luxury auto price floor', which is adjusted annually for inflation along with the depreciation limits. The first-year limit on depreciation for passenger vehicles placed in service in 2008 is projected to be $2,960 for automobiles and $3,160 for vans and trucks. The new law raises the cap by $8,000 for a maximum first-year depreciation of $10,960 for autos and $11,160 for vans and trucks.

Close Franchise Tax Loopholes. – Section 28.7 changes the franchise tax laws as follows to conform with changes the General Assembly made in 2006 and 2007 to the corporate income tax laws:

---

[24] The placed-in-service date is extended one year, through December 31, 2009, for property with a recovery period of 10 years or longer, for transportation property, and for certain aircraft.

[25] The new law does not alter the section 179 limitation imposed on sport utility vehicles, which have an expense limit of $25,000.

[26] These limits were increased when bonus depreciation was previously available.

- It provides that limited liability companies (LLCs) that elect to be taxed as S corporations for income tax purposes are subject to the franchise tax in the same manner as other S corporations
- It provides that captive real estate investment trusts (REITs) are subject to the franchise tax since they are treated as corporations for income tax purposes.

The Revenue Laws Study Committee recommended these changes, upon the suggestion of the Department of Revenue.[27] This section is effective for taxable years beginning on or after January 1, 2009.

Prior to 2006, a LLC did not pay franchise tax. In 2006, the General Assembly amended the definition of 'corporation', as it applies to the franchise tax statutes, to include a LLC that elects to be taxed as a C corporation for federal income tax purposes.[28] The Department of Revenue began to receive questions from S corporations as to whether they could convert to a LLC and elect to be treated as an S corporation for income tax purposes, thereby becoming exempt from franchise tax.[29] To curb this potential franchise tax loophole, this section makes a similar change to the one enacted in 2006; it provides that a LLC that elects to be treated as a corporation for income tax purposes, either a C corporation or a S corporation, is also considered a corporation for franchise tax purposes.

In 2007, the General Assembly limited a corporation's ability to use captive REITs to avoid State taxes by disallowing the dividend paid deduction when a REIT is a captive REIT.[30] The effect of this change is that a captive REIT is treated as a regular corporation for income tax purposes. This section provides that a captive REIT will also be treated as a regular corporation for franchise tax purposes. Under the current franchise tax law, a REIT may, in determining its value for franchise tax purposes, deduct the aggregate market value of its investments in the stocks, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments. This section changes the statute to provide that this deduction may only be used by a REIT that is not a captive REIT. A REIT is an organization that uses the pooled capital of many investors to purchase and manage real estate. A captive REIT is one that is owned or controlled by a single entity.

Publicly Traded Partnerships. – A partnership doing business in this State must file an information return with the Department of Revenue that gives the name and address of each person who would be entitled to share in the partnership's net income, if distributable, and the amount each person's distributive share would be. A partnership that files a report must also furnish to each partner the information needed by that partner to file a North Carolina income tax return. For nonresident members of a partnership, the partnership must pay income tax for that partner based on the partner's distributive share.

Section 28.8 changes the reporting and payment requirements that apply to a publicly traded partnership (PTP) that is described in section 7704(c) of the Internal Revenue Code. It requires a qualifying PTP to report annually to the Department the partners in the PTP who received more than $500 of income rather than report the income received by every partner.

---

[27] HB 2508 and SB 1755.

[28] S.L. 2006-66, Section 24A.2.

[29] In 2005, S corporations paid more than $50 million in franchise tax.

[30] S.L. 2007-323, Section 31.18.

It also exempts qualifying PTPs from the requirement to pay tax on the partnership income received by a nonresident. The Revenue Laws Study Committee recommended this tax law change.[31] In making this recommendation, the Committee sought to strike a balance between the costs and burden of compliance with the reporting requirements for both the PTPs and the Department and the benefits gained by compliance. This section is effective for taxable years beginning on or after January 1, 2008.

A PTP is a limited partnership the interests in which are traded on stock exchanges such as the New York, American, and NASDAQ exchanges. Unlike a traditional partnership, a PTP has tens of thousands, and sometimes hundreds of thousands, of unitholders. A PTP's unitholders can change daily in trades on public exchanges. A PTP determines who its unitholders are once a year so the PTP can send K-1s to the unitholders.

PTPs initially came into existence during the 1980s as a means for companies to raise large amounts of capital needed to build or buy capital-intensive assets, like pipelines. When initially created, PTPs were taxed as partnerships. Congress began reviewing the PTP structure and its use in 1986. Congress determined that the structure was needed for certain types of entities in energy related businesses and it enacted legislation allowing PTPs described in section 7704(c) of the Code to continue to be treated like a partnership for income tax purposes. All other types of PTPs are taxed as a corporation. A PTP described in section 7704(c) of the Code is one that generates 90% of its income from qualified sources. Qualified sources include real estate activities, mineral or natural resources activities like exploration, production, mining, refining, marketing, and transportation of oil, gas, minerals, geothermal energy, and timber. There are approximately 90 PTPs in the country that meet the description in section 7704(c) of the Code, and 10 of these PTPS are located in North Carolina.

The Multi-State Tax Commission (MTC) adopted a model statute in December 2003 that exempts PTPs described in section 7704(c) of the Code from paying tax on partnership income received by a nonresident member so long as the PTP agrees to file an annual information return reporting the name, address, and taxpayer identification number of each unitholder with an income in the state in excess of $500. This section adopts the substance of the MTC model statute. Twenty-six states have excluded PTPs from tax payment requirements for nonresident partners through either specific legislation or administrative action. Eight states exempt PTPs from reporting distributions to its partners except for distributions of income that exceed $1,000 during the taxable year.

Increase Earned Income Tax Credit to Five Percent. – Section 28.9 increases the amount of the State's refundable earned income tax credit from 3.5% of an individual's federal earned income tax credit amount to 5%, effective for taxable years beginning on or after January 1, 2009.[32] The General Assembly enacted a refundable State earned income tax credit in 2007, effective for taxable years beginning on or after January 1, 2008.

The Internal Revenue Code provides an earned income tax credit for individuals who work and whose adjusted gross income does not exceed a specified amount. The credit is intended to offset some of the increases in living expenses and social security taxes and provide an incentive for low-income families to work instead of collect welfare. The amount of the

---

[31] HB 2508 and SB 1755.

[32] HB 2642.

credit may exceed the amount of tax owed by the taxpayer. If the credit allowed exceeds the amount of tax imposed, the excess is refundable to the taxpayer.

The amount of the federal credit varies depending upon whether the taxpayer has children and the amount of earned income the taxpayer has. The credit is phased out as the taxpayer's earned income rises. The earned income amounts and the credit amounts are indexed annually to inflation.

Tax Deduction for the Sale of a Manufactured Home Community to Manufactured Homeowners.[33] – Section 28.27 allows a taxpayer to deduct from federal taxable income the taxable gain from a qualified sale of a manufactured home community. A 'qualified sale' is a sale of land comprising a manufactured home community that is transferred in a single purchase to a group composed of a majority of the manufactured home community leaseholders, or to a nonprofit organization representing such a group. To qualify for this deduction, the taxpayer must give notice of the sale to the North Carolina Housing Finance Agency.[34] The deduction becomes effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2015.

Part III: Sales Tax Changes

Exempt Disaster Assistance Debit Sales. – Section 28.6 exempts from sales tax tangible personal property purchased with a client assistance debit card issued for disaster assistance relief by a State agency or a federal agency or instrumentality. The American Red Cross (ARC) is an instrumentality of a federal agency. Another example of a federal agency or instrumentality that may utilize this exemption would be the Federal Emergency Management Agency (FEMA). This section became effective August 1, 2008, and applies to purchases made on or after that date.

A state may not impose its sales tax on purchases made by the federal government or an instrumentality of the federal government. G.S. 105-164.13(17) specifically exempts from North Carolina sales tax 'sales which a state would be without power to tax under the limitations of the Constitution or laws of the United States or under the Constitution of this State.' Sales made pursuant to a disbursing order issued by a federal governmental agency or instrumentality is considered a sale to the government that is exempt from taxation. However, for purposes of the sales tax exemption, there is a significant difference between a debit card and a disbursing order: the purchaser, for purposes of the sales tax exemption, is the disaster victim when a debit card is used and it is the disbursing entity when the disbursing order is used. This section extends the same sales tax treatment that exists for purchases made through a disbursing order issued by a federal agency or instrumentality to purchases made with a client assistance debit card issued by it. This section became effective August 1, 2008, and applies to purchases made on or after that date.

The Revenue Laws Study Committee recommended this tax law change after representatives of the ARC brought the issue to the Committee's attention.[35] Over the last few years, the ARC has begun giving disaster victims debit cards to purchase tangible personal property. The ARC began using debit cards because it believes they are more efficient, effective, and

---

[33] The House Finance Committee originally considered the tax deduction in House Bill 1700.

[34] G.S. 42-14.3 requires an owner of a manufactured home community to notify the owners of the homes in the community of intent to convert the property to another use.

[35] SB 1703 and HB 2336.

less bureaucratic for the victim and less administrative effort and expense for the organization. The ARC client assistance card clearly identifies itself as one issued by the ARC. The ARC has the ability to see from its reports of the card's use the amount purchased and the store from which the goods were purchased. Unlike the old disbursing order system, the ARC does not have a cash register receipt describing the specific items purchased. The client assistance card authorization form is a contract between the ARC and the disaster victim. The contract stipulates the types of items the card may be used to purchase. In the event of inappropriate purchases, the card can be suspended.

Sales Tax Holiday for Certain Energy Star-Rated Appliances. – Section 28.12 creates a State and local sales and use tax exemption, applicable during the first weekend in November,[36] for the following Energy Star-rated products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps and geothermal heat pumps, ceiling fans, dehumidifiers, and programmable thermostats.[37] An Energy Star-rated product is one that meets the energy efficient guidelines set by the United States Environmental Protection Agency (EPA) and the United States Department of Energy and is authorized to carry the Energy Star label. The exemption does not apply to the sale of a product for use in a trade or business or to the rental of a product. This section became effective when the Governor signed the act into law on July 16, 2008.

The EPA introduced Energy Star in 1992 as a voluntary labeling program designed to identify and promote energy-efficient products to reduce greenhouse gas emissions. Energy Star-labeled products deliver the same or better performance as comparable models while using less energy and saving money. The program delivers the technical information and tools that aid in choosing energy-efficient solutions and best management practices. In 1996, EPA began including major appliances, office equipment, lighting, home electronics, and more in its Energy Star program. In 2007, Energy Star products delivered energy and cost savings of about $16 billion, and, over the past decade, the program has encouraged such technological innovations as efficient fluorescent lighting, power management systems for office equipment, and low standby energy use.

North Carolina participates in the Streamlined Sales and Use Tax Agreement. Under that Agreement, a state may not have a sales tax holiday unless the items to be exempted during the holiday are specifically defined in the Agreement's provisions concerning sales tax holidays. Until recently, the Agreement did not have a definition in its provisions governing sales tax holidays for energy efficient products; therefore, North Carolina could not institute a sales tax holiday for these products and remain compliant with the Agreement. As of April 2, 2008, the necessary definitions have been added to the Agreement, thus permitting the establishment of a sales tax holiday for energy efficient products. North Carolina has had a sales tax holiday during the first weekend in August for certain qualifying school supplies and articles of clothing since 2001.[38]

State Sales Tax Exemption for Baked Goods Sold by Artisan Bakeries. – Section 28.19 reduces the sales tax applicable to bakery items sold by artisan bakeries by exempting them from the general State sales tax rate. Effective January 1, 2009, bakery items sold by an artisan bakery

---

[36] The holiday period begins 12:01 AM on the first Friday of November and ends 11:59 PM on the following Sunday.

[37] The House first considered the sales tax holiday for energy star products in HB 2605. The Governor included a similar provision in his budget recommendation to the 2008 General Assembly.

[38] G.S. 105-164.13C.

will be taxed at the applicable local sales tax rate, as opposed to the combined general rate applicable to prepared foods. An artisan bakery is one that meets both of the following requirements:

- It derives over 80% of its gross receipts from bakery items.
- Its annual gross receipts, combined with the gross receipts of all related persons, do not exceed $1,800,000.

For several years, North Carolina has grappled with the issue of the taxation of bakery items. The term 'bakery item' is a subset of the defined term 'prepared food'. North Carolina imposes a higher sales tax rate on prepared food than food.[39] The distinction between food and prepared food often becomes complex.[40] The Senate Finance Committee heard testimony from many small bakeries across the State that they received conflicting information about the applicable tax rate they should impose on their bakery items. The conflicting information resulted in many bakeries being assessed additional tax, along with interest and penalties, because they taxed their bakery items at the incorrect, lower rate. The bakeries also argued that the differential tax rates imposed an unfair economic burden on their goods.

North Carolina is one of the 17 member states that have modified their sales and use tax laws to comply with the uniform provisions of the Streamlined Sales and Use Tax Agreement (Agreement). The Agreement is a multistate agreement that seeks to simplify and modernize sales and use tax administration in the member states. The Agreement does not influence whether a state imposes sales and use tax on an item or exempts it from tax. However, if a member state chooses to tax an item or exempt an item, it must adhere to the provisions concerning the definition of an item as defined in the Agreement.

The Agreement, as it existed when North Carolina adopted the uniform definitions for food and prepared food in 2001, did not include a distinction among the types of prepared food. Therefore, the choice before the General Assembly was to either tax all prepared food or exempt all prepared food. The State chose to tax all prepared food.

Later versions of the Agreement included a carve-out for bakery items from the defined term 'prepared food' to address problems some states began encountering in this area. The carve-out provides that bakery items may be taxed differently than other types of prepared food if they are sold without eating utensils provided by the seller. The Agreement defines 'bakery items' as bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, Danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas.

---

[39] There is a local sales tax of 2% on food while prepared food is subject to the general State sales tax rate of 4.25% and applicable local rates, which range from 2.5% to 2.75%. Several cities and counties impose a prepared food tax, in addition to the State and local sales tax.

[40] Any food item prepared by a retailer and sold by the retailer to a consumer is a prepared food and is subject to the State and local sales tax rates. A similar product produced by someone else, but sold by the same retailer, is food and is exempt from State sales tax. For example, slaw prepared by Harris Teeter and sold in its deli section is prepared food. Slaw produced by someone else and sold at Harris Teeter is food. Likewise, the same product may be taxed differently depending upon where it is purchased. For example, a donut purchased at the place where it is made is prepared food. The same donut purchased at a grocery store is food.

This section provides that bakery items, as that term is defined in the Agreement, are taxed as food if the item is sold by an artisan bakery.[41] The section does not lower the tax rate on all bakery items.[42] It also does not change the application of the local meals taxes because the act does not change the definition of prepared food. Therefore, in the applicable jurisdictions, the meals tax will continue to apply to all bakery items, regardless of who sells them.

Prohibit Tax on Interior Design Services. – Section 28.20 eliminates the sales and use tax on interior design services provided in conjunction with the sale of tangible personal property. This section became effective August 1, 2008. Charges for interior design or consulting services by an interior designer or decorator are not subject to sales or use tax. However, charges for services made in conjunction with the sale of tangible personal property are subject to sales or use tax because they are considered part of the sales price of the property. The definition of 'sales price' is the total amount or consideration for which tangible personal property is sold, leased, or rented. The consideration may be in the form of cash, credit, property, or services necessary to complete the sale.[43]

Discerning when services constitute part of the sales price of a product is often difficult with respect to transactions in which the product transferred is largely the result of personal services. At the two extremes, there is no great difficulty. When an attorney draws a will, there is no difficulty in concluding that services have been rendered, even though the document the client receives embodying the services constitutes tangible personal property. At the other extreme, when an artist renders a painting, the sale of the painting is a sale of tangible personal property, even though the value of the painting is attributable to the talent of the artist and not the cost of the canvas and paint. The great difficulty lies with transactions in the middle. Determining the proper treatment of services rendered in connection with the sale of a product is among the most frequently litigated issues in the area of sales tax.

The rule a number of states use to help resolve the difficulty of determining when services rendered should constitute part of the sales price of a product is whether the 'true object' of the buyer was to acquire the finished product or the service rendered. If the true object sought by the buyer is to obtain the property produced by the service, then the services are necessary to complete the sale and should be included in the computation of the sales price of the product.

Over the past several months, the Department of Revenue audited some interior designers and decorators and assessed sales tax on services they found necessary to complete the sale of the tangible personal property sold by the designer or decorator. Many of the interior designers and decorators appealed the assessment of the tax and brought the issue to the attention of legislators.[44] This section does not affect the assessments imposed under the prior law.

This section also does not address other transactions in which the tangible personal property transferred is largely the result of personal services. The Department issued a technical

---

[41] Under the Agreement, a state may enact an entity-based exemption for a product defined in the Agreement so long as the state defines the product consistent with its definition in the Agreement.

[42] SB 1630 would have reduced the sales tax rate applicable to all bakery items, regardless of who sold them.

[43] G.S. 105-164.3(37).

[44] SB 1657 passed the Senate Finance Committee and became the basis for this section in the budget.

bulletin on May 1, 2008, that provides guidance as to when services and sales are subject to sales or use tax. The bulletin provides the following guidelines:

- Charges for services rendered before the sale of tangible personal property are not subject to sales or use tax. A taxpayer's records must clearly establish that an agreement to sell tangible personal property was made after the completion of interior design services.
- Charges for services unrelated to the sale of tangible personal property are not subject to sales or use tax.
- Charges for services with incidental sales of property are not subject to sales or use tax. An incidental sale is defined as a sale where the charges for the tangible personal property equal 20% or less of the total combined charges for the tangible personal property.

1%, $80 Cap on Excise Tax on Machinery Refurbishers. – Section 28.21 expands Article 5F of Chapter 105 of the General Statutes to provide that the 1% privilege tax, with a cap of $80, applies to an industrial machinery refurbishing company that purchases equipment or an attachment or repair part for equipment used by the company in repairing or refurbishing tangible personal property owned by a third party. Property subject to the excise tax under Article 5F is exempt from sales and use tax. The change from a sales tax to a privilege tax not only means a lower tax rate for the property purchased but also means that retailers are not responsible for collecting and remitting the tax. The change became effective July 1, 2008, and applies to purchases made on or after that date.[45]

The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Sales and Use Tax Agreement that states must simplify their sales tax rates. The 2001 legislation, which became effective January 1, 2006, repealed the 1% sales tax rate, with an $80 cap, imposed on mill machinery purchased by a manufacturing industry or plant and replaced it with a privilege tax having the same rate. The Article has been expanded since its enactment to apply to purchases of fuel and equipment and machinery by a number of different industries, including:

- Fuel, other than electricity or piped natural gas, purchased by a manufacturing industry or plant to operate the industry or plant.
- Certain personal property purchased by a major recycling facility.
- Equipment purchased by a research and development company in the physical, engineering, and life sciences and used by that company in the research and development of tangible personal property.
- Equipment purchased by a software publishing company that is used in the research and development of tangible personal property.
- Equipment purchased by an eligible datacenter.

[45] SB 1745, as passed by the Senate, would have made this provision effective July 1, 2006, and applicable to purchases made on or after that date and to assessments made on or after that date for prior purchases. This bill became the basis for this provision. However, the retroactive effective date was not retained.

The Senate Finance Committee originally considered the issue of whether purchases of machinery and equipment by a machine refurbisher should be treated similarly to mill machinery purchased by a manufacturing industry in Senate Bill 1745.[46] For purposes of the mill machinery provision in Article 5F, a "manufacturing industry or plant" is an entity which manufactures articles for sale or some equivalent commercial purpose. The Department of Revenue held in both private letter rulings and at least two final decisions that a business that refurbishes or refinishes items of tangible personal property owned by a third party performs a service and is not engaged in manufacturing. Consequently, the machinery and equipment used in the refurbishing process was not eligible for the 1% privilege tax rate prior to the passage of this legislation. Instead, the purchases were subject to the combined general rate of sales and use tax.

Clarify 501(c)(3) Sales Tax Refund.[47] – Section 28.22 provides objective criteria to determine whether an organization is a nonprofit charitable institution eligible to receive a semiannual refund of sales and use taxes paid by it on direct purchases of tangible personal property and services used to carry on the work of the nonprofit entity. This section became effective July 1, 2008.

Prior to this change, the Department of Revenue had to determine whether a nonprofit entity requesting a sales and use tax refund qualified as a 'charitable institution'.[48] To make its determination, the Department relied on past determinations and court decisions. Under *Southmister, Inc. v. Justice*, the court defined a charitable organization as one "engaged in the relief or aid to a certain class of persons, a corporate body established for public use, or a private institution created and maintained for the purposes of dispensing some public good or benevolence to those who require it." In May of 2008, the North Carolina Court of Appeals appeared to expand the definition of charitable organization in *The Lynnwood Foundation v. N.C. Department of Revenue* when it affirmed a trial court's ruling that the Department erred in denying a sales and use tax refund to The Lynnwood Foundation. In 2004, the Department determined that the Lynnwood Foundation[49] no longer qualified[50] as a charitable organization for purposes of the sales and use tax refund for the following reasons: it did not engage in relief or aid to a charitable class; it operated for profit; and it did not use the taxed property for a charitable purpose. The Lynnwood Foundation appealed the decision and the trial court granted summary judgment in the Lynnwood Foundation's favor. The trial court found that the preservation of historic sites was a charitable purpose; that the Lynnwood Foundation's overall expenses exceeded its overall income; and that the

---

[46] Under SB 1743, the change in the law would have become effective July 1, 2006, and applied to purchases made on or after that date and to assessments made on or after that date for prior purchases. The provision enacted in this act did not retain the retroactive effective date.

[47] The Senate Finance Committee originally considered this issue in Senate Bill 2106.

[48] Under prior law, the refund applied to educational institutions, churches, orphanages, and *other charitable or religious institutions* not operated for profit. It continues to apply to nonprofit hospitals and qualified retirement facilities.

[49] The Lynnwood Foundation was incorporated in 1996 as a charitable organization to preserve and restore the Duke Mansion. In 1997 the Department determined that the Lynnwood Foundation was entitled to a refund of a portion of sales and use tax paid.

[50] The Lynnwood Foundation began operating the Duke Mansion as a conference and lodging facility in 1998. The Department reexamined the Lynnwood Foundation's status as a charitable organization within the meaning of the sales and use tax refund statute in 2002.

Lynnwood Foundation only sought a refund for the sales and use taxes it paid on items that it used in carrying out its charitable work.[51]

This section seeks to clarify the prior law, not to expand it. It provides a bright line test for determining whether a nonprofit entity is a charitable one by relying upon section 501(c)(3) of the Internal Revenue Code (Code) and the National Taxonomy of Exempt Entities (NTEE). The NTEE is a classification system categorizing charitable organizations with 501(c)(3) status by organizational mission into 26 subgroups based on Internal Revenue Service (IRS) activity codes. The activity codes provide detail on the operational activities of an organization that has been granted 501(c)(3) status. The IRS assigns an activity code to a charitable organization based on information provided by the organization at the time of application for 501(c)(3) status.

Effective July 1, 2008, a nonprofit entity may receive a sales tax refund if it is exempt from income tax under section 501(c)(3) of the Code but not designated as one of the following organizations under the NTEE:

- Community improvement, capacity building organization.
- Public, society benefit, multipurpose organization.
- Mutual/membership benefits organization.
- Organization whose mission or purpose is unknown.

According to the National Center for Charitable Statistics, as of November 2006 there were 11,901 active North Carolina based organizations with IRS 501(c)(3) status.[52] Of these 11,901 active organizations, 599 are classified within one of the four NTEE classifications excluded from receiving a sales tax refund. It is not known how many of these organizations received a sales tax refund under the prior law. Likewise, an organization that may have been determined by the Department to be ineligible for a sales tax refund in the past may be eligible under the new law. The Fiscal Research Division expects that the number of organizations and quantity of refunds affected by the change will be minimal.

Expand Renewable Energy Tax Credit. – Section 28.25 expands the income tax credit available to a taxpayer who donates funds to a tax-exempt nonprofit organization for the purpose of providing fund for the organization to invest in renewable energy property[53] to include similar donations made to a unit of State or local government. A taxpayer who claims this credit may not also claim the donation as a charitable contribution. This section became effective for taxable years beginning on or after January 1, 2008.

---

[51] The Foundation paid more than $239,000 in sales and use taxes from July 2004 through December 2005. It sought to recover $14,700. During the same period, the Foundation expended over $2 million towards preserving the property.

[52] An active organization is one that filed a federal 990 Form with the IRS between November 2004 and November 2006.

[53] Renewable energy property includes biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; commercial thermal or electrical generation from renewable energy crops or wood waste materials; hydroelectric generators; solar energy equipment; and wind equipment. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals.

The amount of the credit is equal to the taxpayer's share of the credit the governmental entity could claim under G.S. 105-129.16A[54] if it was subject to tax. The credit under G.S. 105-129.16A is equal to 35% of the cost of the property placed in service. The taxpayer's share of the credit is equal to the following calculation: (taxpayer's donation / cost of the renewable energy property of governmental entity placed in service that year as a result of the donation) X (the amount of the credit the governmental entity could claim if it were subject to tax). The credit must be taken in the year in which the property is placed in service.[55] The credit may be taken against either the income tax or the franchise tax and it may not exceed 50% of the taxpayer's of the tax against which it is claimed.

A governmental entity must keep a record of all donations it receives for renewable energy property and the amount of the donations used for this purpose. If the entity places renewable energy property in service, it must give each taxpayer who made a donation a statement setting out the amount of the credit the taxpayer qualifies for, a description of the renewable energy property placed in service, the cost of the property, the amount of the credit the entity could claim under G.S. 105-129.16A if it were subject to tax, and the taxpayer's share of the credit allowed. If the donations made for the renewable energy property exceed the cost of the property, the entity must prorate each taxpayer's share of the credit.

Part IV: Economic Incentives

This act extends the sunsets on and, in some instances, expands the scope of several tax credits. Tax credits are one of many economic incentives offered by the State designed to attract and maintain businesses in North Carolina. In 1998, the Revenue Laws Study Committee recommended that sunsets be placed on virtually all of the tax credits as a means to review and reevaluate those credits to determine whether they are accomplishing their intended goal. The Committee engaged in this review process during the 2007 interim and recommended extensions for the following three credits: the credit for research and development, the credit for the State Ports Authority, and the credit for small business employee health benefits. During the 2008 Session, the General Assembly extended or modified the sunset on three additional credits: the credit for low-income housing, the credit for mill rehabilitation, and the film industry credit. In addition to the extension of these credits, the General Assembly expanded the scope of the film industry and renewable energy tax credit and increased the cap on the qualified business venture tax credit.

These economic incentives are described more fully as follows and appear in the order in which they appear in the budget.

Extend Credit for Research & Development. – Section 28.2 extends for five years, until the year 2014, the sunset on this tax credit. Prior to the enactment of this section, the credit was scheduled to expire for taxable years beginning on or after January 1, 2009. This section became effective when the Governor signed the act into law on July 16, 2008.

In 2004, the General Assembly enacted this credit as an alternative to the Bill Lee research and development credit, which was set to expire along with the entire Bill Lee Act on January 1, 2006. A taxpayer that has qualified North Carolina research expenses or North

[54] G.S. 105-129.16A is repealed effective for renewable energy property placed into service on or after January 1, 2011.

[55] The installment requirements in G.S. 105-129.16A for nonresidential property do not apply to this credit.

Carolina university research expenses is allowed a credit. The taxpayer must satisfy Bill Lee Act requirements related to employee wages, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, and the taxpayer's environmental record. A taxpayer with overdue tax debts is not prohibited from taking this credit.

The credit amount varies. For North Carolina university research expenses, the credit amount is equal to 20% of the amount the taxpayer paid to the university for the research and development. For all other qualified research expenses, the credit is equal to a percentage of the expenses. Specifically, the rate is 3.25% for small businesses[56] and for research and development conducted in a development tier one area. For other research and development expenditures, the rate ranges from 1.25% to 3.25% as the amount of those expenditures increases.

Extend Low-Income Housing Credit. – Section 28.3 extends the sunset on the low-income housing tax credit from January 1, 2010, until January 1, 2015. Although the sunset was not scheduled to expire for two more years, developers of low-income housing begin their work months in advance and need to know what financing will be available as they secure options on sites. This section became effective when the Governor signed the act into law on July 16, 2008.

Congress enacted the federal Low Income Housing Tax Credit in 1986 to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The Internal Revenue Service (IRS) allocates the per capita low-income housing tax credit to state housing agencies such as the North Carolina Housing Finance Agency (HFA), which in turn allocate the credit to project developers who agree to lower project rents for low-income tenants.

In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit.[57] Under current law, a taxpayer may elect to receive the credit in the form of either a credit against tax liability or a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount. Historically, project developers have almost always elected the loan option. Neither a tax refund generated by the credit, nor a loan received as a result of the transfer of the credit is considered taxable income by the State. Although a State tax refund is considered taxable income by the IRS if the taxpayer itemizes deductions, a private letter ruling from the IRS provides that the loan proceeds are not.

Extend Mill Rehabilitation Tax Credit. – Section 28.4 extends the sunset for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011. Under prior law, the credit expired for qualified rehabilitation expenses occurring on or after that date. This section also makes clarifying and stylistic changes. This section is effective for taxable years beginning on or after January 1, 2008.

---

[56] A small business is a business whose annual receipts, combined with the annual receipts of all related persons, does not exceed $1,000,000.

[57] Under the original version of the State credit, a project developer had to sell the tax credits to receive funds to finance the project. Developers indicated that the process of selling the credits was complex and that they sold for no more than 45 cents on the dollar. In 2002, the General Assembly modified the way in which developers benefited from the credit to promote efficiency and cost savings while providing the same level of incentives.

North Carolina allows a tax credit for rehabilitating vacant historic manufacturing sites if the taxpayer spends at least $3 million to rehabilitate the site. To qualify for the credit, the site must satisfy all of the following conditions:

- The site was used as a manufacturing facility or for purposes ancillary to manufacturing, as a warehouse for selling agricultural products, or as a public or private utility.
- The site is a certified historic structure or a State-certified historic structure.
- The site has been at least 80% vacant for a period of at least two years immediately preceding the date the eligibility certification is made.

The amount of the credit is a percentage of the qualified rehabilitation expenditures, and the percentage varies depending on the enterprise tier location of the site and the eligibility for the federal credit as follows:

- Development tier one or two area – 40% of qualified rehabilitation expenditures or rehabilitation expenses, regardless of whether the taxpayer is allowed a federal credit.
- Development tier three area – 30% of qualified rehabilitation expenditures and the taxpayer is allowed a federal credit. No credit is allowed if the site is located in a development tier three and the taxpayer is not allowed a federal credit.

The credit may be claimed against the franchise tax, the income tax, or the gross premiums tax. If the credit is taken for income-producing property, it may be taken in the year the property is placed in service. If the credit is taken for non-income-producing property, the credit must be taken in five equal installments beginning with the taxable year in which the property is placed in service. The credit may not exceed the amount of the tax against which the credit is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by the taxpayer. Any unused portion of the credit may be carried forward for the succeeding nine years. This credit may be taken in place of the credit for historic rehabilitation, not in addition to it.

A pass-through entity may allocate the credit among any of its owners without limitation as long as the owner's adjusted basis in the pass-through entity is at least 40% of the amount of credit allocated to the owner.[58] An owner of a pass–through entity that qualifies for the credit will forfeit a portion of any credit the owner has received if both of the following conditions are met:

- The owner disposed of the interest within five years from the date the eligible site is placed into service.
- The owner's interest in the pass-through entity is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the eligible site was placed into service.

The forfeiture of an owner's interest is not required if the change in ownership is the result of the owner's death or the merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the entity, to the extent the entity does not

[58] A pass-through entity may also allocate the credit for rehabilitating an historic structure among its owners in the same manner as provided in this provision.

receive cash or tangible property in the transaction. A taxpayer or owner of a pass-through entity that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest computed from the date the taxes would have been due if the credit had not been allowed.

Extend Sunset for State Ports Tax Credit. – Section 28.5 of the act extends for five years, until the year 2014, the sunset on this tax credit. Prior to the enactment of this section, the credit was scheduled to expire for taxable years beginning on or after January 1, 2009. This section became effective when the Governor signed the act into law on July 16, 2008.

In 1992, the General Assembly enacted the State Ports tax credit to encourage exporters to use the two State-owned port terminals in Wilmington and Morehead City. At that time, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. Over the years, the credit has been expanded and the sunset has been extended four times.

Currently, the State Ports tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual or a corporation. The amount of the tax credit is equal to the amount of wharfage, handling, and throughput charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is $2 million.

Extend Sunset for Small Business Employee Health Benefits. – Section 28.10 extends from January 1, 2009, to January 1, 2010, the sunset on this tax credit. This section became effective when the Governor signed the act into law on July 16, 2008.

Effective for taxable years beginning on or after January 1, 2007, a small business[59] that provides health benefits to all of its full-time employees[60] is eligible for a tax credit. 'Providing health benefits' means one or more of the following:

- The taxpayer pays at least 50% of the premiums for health insurance coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee.
- The employee has existing coverage under one or more of the following: Medicare; Medicaid; a government funded program; a health insurance or benefit arrangement that provides benefits similar to or in excess of benefits provided under the basic health care plan.

The credit amount is equal to $250 per employee for whom the taxpayer pays the health insurance premium, not to exceed the taxpayer's cost of providing the health insurance benefit. The taxpayer may use the credit against either its income tax or its franchise tax liability. The credit may not exceed 50% of the taxpayer's tax liability. Any unused portions of the credit may be carried forward for five years.

---

[59] A 'small business' is a taxpayer that employs no more than 25 full-time employees.

[60] An 'eligible employee' is one that works a normal workweek of 30 or more hours and whose total wages or salary received from the business does not exceed $40,000 on annual basis.

Under the Internal Revenue Code, an employer may deduct premiums paid for health insurance cost of its employees as a business expense. The credit is in addition to any expense deduction the taxpayer claimed on its income tax return for the health insurance costs.

Extend Aviation Fuel Refunds.[61] – Section 28.23 extends the sunset for refunds of the State sales and use tax paid on fuel used by interstate passenger air carriers and on aviation fuel used by a professional motorsports racing team or a motorsports sanctioning body from January 1, 2009, to January 1, 2011.[62] To receive a refund, a taxpayer must submit a refund request in writing and include any information and documentation required by the Secretary of Revenue. The request is due within six months after the end of the calendar year for which the refund is claimed.

In 2005, the General Assembly allowed a sales and use tax refund to an interstate passenger air carrier for the net amount of sales and use tax paid by it on fuel during a calendar year in excess of $2,500,000.[63] The 'net amount of sales and use taxes paid' is the amount of sales tax paid by the interstate passenger air carrier less the refund of that tax allowed to all interstate carriers under subsection (a) of G.S. 105-164.14.[64] The refund for which the sunset provision is being extended is in addition to the refund allowed under G.S. 105-164.14(a).

In that same year, the General Assembly enacted a refund of sales and use taxes paid on aviation fuel by a motorsports racing team or motorsports sanctioning body. In order to qualify for the refund, the fuel must have been used to travel to or from a motorsports event in this State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State. For the purposes of the refund, a 'motorsports event' includes a motorsports race, a motorsports sponsor event, and motorsports testing.

Expand Film Industry Credit and Extend Sunset. – Section 28.24 extends for four years, until January 1, 2014, the sunset on this tax credit and makes several other changes to the credit. This section became effective for taxable years beginning on or after January 1, 2008.

This credit is a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production. However, the amount of the credit with respect to a feature film production is capped at $7.5 million. In order to obtain the credit, the taxpayer must have qualifying expenses in excess of $250,000. Qualifying expenses are the total amount spent in North Carolina for the following:

- Goods and services purchased by a production company in connection with a production.
- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. Under prior law, any amount paid to an individual who receives in excess of $1 million with respect to a single

---

[61] The Senate Finance Committee originally considered the sunset extension in Senate Bill 2113.

[62] S.L. 2006-66 extended the sunset on these two sales tax refund provisions from January 1, 2007, to January 1, 2009.

[63] S.L. 2005-435.

[64] Under subsection (a), an interstate carrier is allowed a refund of a portion of the sales and use taxes paid by the carrier on fuel, lubricants, repair parts, and accessories purchased in this State. The refund is equal to a proportion of the sales and use taxes paid by the carrier in this State. The proportion is equal to the proportion of the miles traveled by the carrier in this State to the total miles traveled by the carrier.

production may not be included in a qualifying expense. The section modifies this limitation by allowing a production company to include in its qualifying expenses up to $1 million in compensation paid to a highly compensated individual.[65] Any amount paid in excess of $1 million continues to be disallowed.

This section makes three additional changes to the credit. First, it allows a production company to include in its qualifying expenses the cost of insurance coverage for production-related insurance that is obtained on the production. The expenses do not qualify if the insurance coverage is purchased from a related member, which is defined in the current law. Second, it requires a taxpayer who claims the credit to file an intent-to-film notice with the North Carolina Film Office. The notice must include the name of the production, the name of the production company, the name of a financial contact for the production company, the proposed dates on which the production company plans to begin filing the production, and any other information required by the NC Film Office. This provision codifies current administrative practice.[66] Finally, it requires a taxpayer to acknowledge in the production credits both the North Carolina Film Office and the regional film office responsible for the geographic area in which the filming of the production occurred.

Increase Qualified Business Venture Tax Credit Cap. – Section 28.26 increases from $7 to $7.5 million the total amount of all qualified business investment credits that may be taken each year.[67] Demand for the credit exceeded $7 million in 2006 and totaled more than $6.5 million in 2007. This section is effective for investments made on or after January 1, 2008.

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture, a qualified grantee business, or a qualified licensee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by pass-through entities of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer files an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total amount of credits allowed in proportion to the size of the credit claimed by each taxpayer. In general, a taxpayer forfeits the credit if the taxpayer transfers the securities within one year or the qualified business redeems the securities purchased by the taxpayer within five years after the

---

[65] 'Highly compensated individual' is defined as 'An individual who directly or indirectly receives compensation in excess of one million dollars ($1,000,000) for personal services with respect to a single production. An individual receives compensation indirectly when a production company pays a personal service company or an employee leasing company that pays the individual.'

[66] A production may not claim the credit until the production is complete. As written, the notification and acknowledgement requirements are conditions to receiving the credit. It would be possible for a company that has begun production to be denied a credit because it failed to meet these requirements, even though the requirements did not exist at the time the company began, or possibly completed, its production.

[67] The Senate considered this issue in Senate Bill 1628.

investment was made. This credit is currently set to expire for investments made on or after January 1, 2011.

Part V: Estate & Gift Tax Changes

Modify Estate Tax Law. – Section 28.17 modifies the formula for calculating North Carolina estate tax on estates that include property located in another state by excluding the value of that property from the estate tax payable to North Carolina, as recommended by the Revenue Laws Study Committee.[68] The section became effective July 16, 2008, and applies retroactively to the estates of decedents for which the statute of limitations for claiming a refund had not expired on December 27, 2007.[69] A personal representative of an estate for which the statute of limitations had not expired may file a claim for refund under G.S. 105-241.6. The statute provides that the general statute of limitations for obtaining a refund of an overpayment of tax is the later of the following:

- Three years after the due date of the return. – A North Carolina estate tax return is due on the date a federal estate tax return is due. A federal estate tax return is due nine months from the date of death. An extension of time to file a federal estate tax return is an automatic extension of the time to file a State tax return.
- Two years after payment of the tax.

For estates with property only in North Carolina, the North Carolina estate tax equals the amount of the credit allowed on the federal estate tax return for state estate tax paid, as the federal law provided in 2001. If an estate has property in more than one state, the federal credit amount must be prorated between North Carolina and the other states in which the estate has property. In 2002, the Estate Tax Section of the North Carolina Bar Association recommended a change in the calculation formula from a net value ratio to a gross value ratio. The recommended change also provided that when the estate of a North Carolina decedent included out-of-state property, the North Carolina estate tax would be calculated as the amount of the 2001 tax credit reduced by the lesser of the amount of estate tax paid to the other state or the amount of the 2001 tax credit times the value of the out-of-state property divided by the value of the gross estate.

In calculating the estate tax payable in North Carolina for an estate that includes property located in a state that does not impose an estate tax, the formula, prior to its modification by this section, provided that the North Carolina estate tax would be reduced by zero, because that is the lesser of the amount paid to the state that does not impose an estate tax. This calculation resulted in North Carolina's estate tax being imposed on property that is not located within its taxing jurisdiction. The application of the formula was especially problematic for North Carolina because the states surrounding North Carolina do not have an estate tax. Virginia repealed its estate tax, effective July 1, 2007. Georgia, South Carolina, and Tennessee have not had an estate tax since January 1, 2005, because their estate tax equals the amount of the state estate tax credit allowed on the federal estate tax return. In

---

[68] SB 1756.

[69] A case has been filed in Mecklenburg County, *Stowe v. Department of Revenue*, to recover North Carolina estate taxes imposed on property located in South Carolina. The plaintiffs argue in their complaint that the formula for calculating North Carolina estate tax due when property is located in more than one state is unconstitutional because it provides less than a full reduction of the tax attributable to the out of state property when the other state does not impose an estate tax, or imposes an estate tax less than the prorated federal credit amount. The plaintiffs filed the complaint on December 27, 2007.

2001, Congress phased out the state estate tax credit over four years by reducing it 25% in 2002, 50% in 2003, 75% in 2004, and by repealing it entirely in 2005.[70]

This section modifies the formula for calculating North Carolina estate tax on estates that include property located in another state by prorating the federal credit amount between North Carolina and the other states in which the estate has property. It does so by eliminating the 'lesser of" language that sometimes results in North Carolina's estate tax being imposed on property located in another state.

Repeal Gift Tax Law. – Section 28.18 repeals North Carolina's gift tax law, effective January 1, 2009. The nuances of North Carolina's gift tax laws make the transfer of property through gifts difficult and complicate estate planning. The North Carolina Association of CPAs and the Estate and Gift Tax Section of the North Carolina Bar Association have consistently recommended that North Carolina eliminate or simplify its gift tax law. The Revenue Laws Study Committee recommended legislation to the 2007 General Assembly to reform the State's gift tax to more closely conform to the federal tax, but the General Assembly did not enact the bill. Although the Committee did not recommend legislation on this issue this session, it recognized the need to simplify the State's gift tax laws.

With the repeal of the gift tax in North Carolina, Connecticut and Tennessee remain the only two states in the nation to impose a tax on gifts. Some of the reasons for repealing North Carolina's gift tax law included:

- North Carolina taxes gifts at varying graduated rates based on the relationship between the donor and the donee.[71] It favors transfers between spouses by exempting those transfers from tax. It favors transfers to children and parents by giving those transfers the lowest rates as well as a cumulative exemption amount of $100,000. Transfers to other close family members are taxed at higher rates and do not enjoy the benefit of an exemption. Transfers to more distant relatives or to persons who are not related are taxed at the highest rate.

- North Carolina's gift tax structure does not conform well to the federal gift tax structure.[72] The federal gift tax is part of a somewhat unified gift-estate tax system at the federal level. As part of that system, the federal gift tax has a lifetime exemption amount of $1,000,000. This amount is much larger than the State exemption amount and is available regardless of the relationship between the donor and donee. One result of this difference is that some transfers made while the donor is alive are

[70] The federal estate tax changes were part of the Economic Growth and Tax Relief Reconciliation Act of 2001. Under the provisions of that Act, the state estate tax credit phased-out, the federal estate tax exclusion amounts increased gradually, and the top rates decreased gradually until 2010 when the tax is repealed. However, the provisions are currently set to expire for estates of decedents dying after December 31, 2010. Effective January 1, 2011, the federal estate tax law will return to the provisions that existed in the year 2000 unless Congress enacts new legislation. Therefore, effective 2011, the state estate tax credit will exist again and the applicable exclusion amounts and tax rates will return to the amounts that existed in 2000.

[71] North Carolina is the only state whose gift tax rate structure differs depending on the relationship between the donor and the donee.

[72] Connecticut's gift tax structure conforms to the federal gift tax system. North Carolina and Tennessee's does not.

taxable in North Carolina, although the same transfer made by a decedent would not be taxable.[73]

- There are sometimes differences in the valuation of a gift for State and federal tax purposes. This discrepancy most commonly occurs with respect to the valuation of annuities. For State purposes, statutes mandate an interest rate of 6% be used in determining the value of the annuity; for federal purposes, the current prevailing interest rate is used.
- A donee assumes the donor's basis when property is transferred by gift. A donee assumes a stepped-up basis when the property is transferred through an estate.

Part VI: Property Tax Exclusion for Honorably Discharged Disabled Veterans and their Surviving Spouses.

Section 28.11 repeals the property tax exclusion for the first $38,000 in assessed value of housing for disabled veterans receiving benefits under 38 U.S.C. § 2101 and, in its place, creates a property tax homestead exclusion equal to the first $45,000 in assessed value of a permanent residence owned by an honorably discharged veteran or the unmarried surviving spouse of an honorably discharged veteran. This exclusion does not have an age requirement or an income requirement. The exclusion becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009.

To receive the exclusion, a property owner must file an application[74] with the county tax assessor. To qualify for the exclusion, the property owner must meet one of the following requirements, or be the unmarried surviving spouse of a person who met one of these requirements:

- A disabled veteran who receives benefits under 38 U.S.C. § 2101.
- A disabled veteran certified by the U.S. Government or the U.S. Department of Veterans Affairs as a person with a permanent total disability that is service-connected.

A taxpayer who receives the disabled veteran property tax exclusion may not benefit from any other homestead property tax exclusion. However, if the permanent residence is owned by more than one person who is not the taxpayer's spouse, and a co-owner qualifies for a property tax relief program, then the co-owner may receive the benefits of that program.[75] The exclusion allowed to either co-owner may not exceed the co-owner's proportionate share of the valuation of the property and the amount of the exclusion allowed to all co-owners may not exceed the greater of two applicable exclusion amounts.

North Carolina also provides the following property tax exclusions for disabled veterans:

---

[73] Accountants and estate planning attorneys found that the consequences of the gift tax affects the estate planning of middle-income citizens in that it discourages them from transferring a farm or small business to their natural heirs during their lifetime because they cannot afford to pay the applicable State gift tax.

[74] The application need be filed only once.

[75] G.S. 105-277.1 provides a property tax exclusion for elderly or disabled taxpayers who meet an income eligibility limit.

- A property tax exclusion for a motor vehicle given by the U.S. Government to veterans on account of disabilities they suffered in WWII, the Korean, Conflict, or the Vietnam War.
- A property tax exclusion for a motor vehicle owned by a disabled veteran if the vehicle has been altered with special equipment to accommodate a service-connected disability. A service-connected disability is an injury incurred or disease contracted in or aggravated by active service. The disability must be loss of one or both hands or feet, permanent loss of use of one or both hands or feet, or permanent impairment of vision of both eyes.

Part VII: Administrative Changes

Small Business Protection Act. – Section 28.16 provides small businesses with certain protections related to their sales and use tax obligations, it requires the Department of Revenue to establish and implement procedures for improving customer service and quality control measures with regard to advice given to taxpayers in certain areas of the tax law, and it directs the Revenue Laws Study Committee to study issues related to the interpretation and application of certain areas of the sales and use tax law.

Under this section, the Secretary is required to reduce an assessment for sales and use taxes made against a small business as the result of an audit and waive any associated penalties if all of the following conditions are met:

- The annual gross receipts of the business and all related persons for the calendar year preceding the year in which the audit period begins do not exceed $1.8 million dollars.
- The business remitted all the sales and use taxes it collected during the audit period.
- The business had not been told by the Department in a prior audit to collect sales and use taxes in the circumstance that is the basis of the assessment.
- The business made a good faith effort to comply with the sales and use tax laws and the assessment is based on the incorrect application of one of the following complex areas of these laws:
  - The rate of tax that applies to prepared food.
  - The distinction between a retailer and a performance contractor.
  - The distinction between a service that is necessary to complete the sale of tangible personal property, which is taxable, and a service that is incidental to the sale of tangible personal property, which is not taxable.
  - The determination of whether a person is a manufacturer.

The amount of the reduction is a percentage of the assessment and varies depending on the average monthly gross receipts of the business:

Avg. Monthly Gross Receipts	Reduction of Assessment
$0-50,000	98%
$50,001-100,000	95%
$100,001-150,000	90%

In addition to applying prospectively to future assessments and claims for the refund of an assessment, this section also has limited retroactive application. Specifically, it applies to assessments that are pending as of July 15, 2008, to assessments that have been identified in a notice of final assessment under former G.S. 105-241.1 prior to July 15, 2008, or to assessments that became collectible but have not been paid as of July 15, 2008. If, however, an assessment was paid within six months after it became collectible, then the taxpayer may also be eligible for a reduction if a timely claim for refund could be filed.

During the 2008 Session, the Senate and House Finance Committees heard from a number of small business owners who expressed concern and confusion regarding the application to their particular businesses of certain sales and use tax provisions and, in some instances, verbal information provided by the Department of Revenue that they believed to be erroneous or unclear. This section attempts to address either the actual or perceived issues of quality control within the Department with respect to verbal advice given to taxpayers. Specifically, this section requires the Department to document certain conversations with taxpayers, regardless of whether the conversation is conducted by phone or in person. Effective January 1, 2009, the Department must document advice given to a taxpayer when the taxpayer provides identifying information, asks about the application of a tax to the taxpayer in specific circumstances, and requests that the Secretary document the advice in the taxpayer's records. The documentation must set out the date of the conversation, the question asked, and the advice given. This requirement does not apply in a conference or presentation-type setting. Effective July 1, 2009, the Department must document in a similar manner a conversation with a taxpayer who is not registered as a retailer or a wholesale merchant under Article 5 of Chapter 105 of the General Statutes when the taxpayer identifies himself, describes the business in which he is engaged, and asks if he is required to be registered under Article 5.

Under current law, a taxpayer may request in writing specific advice from the Department. If the Department furnishes erroneous written advice in response, and the taxpayer reasonably relies on that advice, the taxpayer is not liable for any penalty or additional assessment attributable to the erroneous advice. However, the same protection does not apply with regard to verbal advice. Effective July 16, 2008, when the act became law, this same protection is extended to taxpayers with regard to erroneous verbal advice provided that Departmental records establish that the erroneous advice was given.

This section rewrites the offer and compromise statute so that it more accurately reflects current practice, is adjusted for inflation, and eliminates the requirement that the Department obtain approval from the Attorney General unless the matter is in litigation. It also adds a new condition under which the Department may settle a tax liability for less than that asserted to be due; that is, when the collection of an amount greater than the amount offered would produce an unjust result under the circumstances. The rewrite of this statute is intended, in part, to provide the Department with additional flexibility with regard to offers and compromise.

This section requires the Department to do two things. First, the Department must establish and implement by July 1, 2010, a plan to record telephone calls received at the Taxpayer Assistance Center for training, customer service, and quality control purposes. Second, the Department must report to the Revenue Laws Study Committee, prior to the convening of the 2009 General Assembly, on customer service improvement initiatives.

Finally, it directs the Revenue Laws Study Committee to study the following issues related to the interpretation and application of certain areas of the sales and use tax law that frequently cause confusion among taxpayers and often result in inadvertent noncompliance:

- The taxation of services necessary to complete the sale of tangible personal property and standards for distinguishing between a service that is taxable as one that is necessary to complete the sale and a service that is incidental to the sale of tangible personal property.
- The applicability of the sales and use tax to performance contracts and standards for distinguishing between performance contractors and retailers.
- The distinction between food and prepared food under the sales and use tax laws and whether to eliminate this distinction by applying a uniform, revenue-neutral rate to all food.

Procedure for Tax Class Actions. – Section 28.28, which was a recommendation of the Revenue Laws Study Committee, establishes a procedure for taxpayers seeking to initiate or join a class action in order to obtain a refund of tax paid due to an alleged unconstitutional statute. This section became effective October 1, 2008, and applies to civil actions filed on or after that date.

The Revenue Laws Study Committee spent a significant amount of time examining this issue. Prompted by requests from both the North Carolina Bar Association and the North Carolina Association of Certified Public Accountants, the Committee first examined the issue in 2002. The Committee revisited the issue in 2006 as part of its broader, in-depth study of the procedures related to the review of disputed tax matters. Most recently, in its report to the 2008 Regular Session of the 2007 General Assembly, the Committee determined that the existing law needed to be clarified because of ambiguity surrounding recent judicial interpretations of the 'protest statute', which was the prior mechanism for bringing a civil suit for a refund of tax. The purpose of this legislation is to identify and protect the potential liability of the State for tax refunds and to give taxpayers, the Department, and practitioners clear guidance as to the proper procedure governing tax-related class actions.

- **Authority.** – Neither the law prior to 2007, nor the law in place prior to the effective date of this act expressly allows for a class action for the refund of a tax. However, the North Carolina courts have allowed civil actions brought under the former protest statute[76] to be certified as class actions. Effective January 1, 2008, a new statute governs the conditions under which a civil action may be initiated by a taxpayer for the refund of a tax based on the alleged unconstitutionality of a statute.[77] However, the statute is silent with regard to class actions. This section provides specific statutory authority for tax class actions, which may be brought only on the grounds of an alleged unconstitutional statute.
- **Bringing a Tax Class Action.** – A taxpayer who wishes to commence a class action challenging the constitutionality of a tax statute and who seeks to represent the class must meet certain requirements. First, the taxpayer must meet the same requirements

[76] G.S. 105-267.
[77] G.S. 105-241.17.

that any other taxpayer is required to meet in order to bring a civil action. Those requirements are as follows:

- The taxpayer must receive a final determination from the Department after a review and conference.
- The taxpayer must commence a contested case at the Office of Administrative Hearings (OAH).
- OAH subsequently dismissed the case for lack of jurisdiction because the sole issue in the case is the facial constitutionality of a statute.
- The taxpayer has paid the tax, penalties, and interest due in the final determination.
- The civil action is filed within two years of the dismissal from OAH.

Second, the taxpayer must also comply with any requirements under Rule 23 of the North Carolina Rules of Civil Procedure. North Carolina courts have required compliance with Rule 23 in prior tax class actions, so the requirement is not new, but this section sets out the requirement explicitly in statute.

Finally, this section adds a new requirement for bringing a tax class action. The taxpayer's claims must be typical of the claims of the class members in order for the taxpayer to serve as the class representative. This language mirrors language in Rule 23 of the Federal Rules of Civil Procedure. Whether a claim is 'typical' is an issue for the court to determine when approving the class representative.

- **Joining a Tax Class Action.** – In order to become a member of a tax class action, a taxpayer must be eligible and must affirmatively elect to participate as a member of the class.
  - Eligibility. – A taxpayer is eligible to become a member of the class if the taxpayer could have filed a claim for refund as of the date the class action was commenced or as of a subsequent date set by the court, whether or not the person actually filed a claim. For purposes of determining this eligibility, a class action 'commences' upon the later of the date a complaint is filed alleging the existence of a class or the date a complaint is amended to allege the existence of a class.
  - Affirmative Election. – An eligible taxpayer becomes a member of a class by affirmatively indicating a desire to be included in the class in response to a notice of the class action. A taxpayer who joins a class is not required to exhaust the administrative review process; only the class representative must do so.
- **Procedure.** – The procedure for notifying potential class members, the content of the notice, and the method by which potential class members indicate a desire to be included in the class in response to the notice must be approved by the court. This procedure may include ordering the Department of Revenue to provide the class representative with a list of names and last known addresses of all taxpayers who are readily determinable by the Department and are eligible to become a member of the class. The class representative must advance the costs of notification.

- **Statute of Limitations.** – The general statute of limitations for obtaining a refund of overpayment of tax is the later of three years after the due date of the return or two years after payment of the tax. Without a class action mechanism, each taxpayer seeking a refund of a tax paid under an alleged unconstitutional statute would have to file a claim for refund within the statute of limitations period and exhaust the administrative and judicial review process.

  One general principle of class actions is that the filing of a suit tolls the statute of limitations for all prospective class members until class certification is denied. If certification is denied, the limitations period begins to run again and plaintiffs may file their own individual claims. This same principle applies to tax class actions. The statute of limitations for filing a claim for refund on the grounds of an unconstitutional statute is tolled for a taxpayer who is eligible to become a member of a class action. The tolling begins on the date the class action is commenced. For a taxpayer who does not join the class, the tolling ends when the taxpayer does not affirmatively indicate a desire to be included in the class as provided by the court. For a taxpayer who does join the class, the tolling ends when the court enters any of the following:

  - A final order denying certification of the class.
  - A final order decertifying the class.
  - A final order dismissing the class action without an adjudication on the merits.
  - A final judgment on the merits.

- **Effect on Nonparticipating Taxpayers.** – Class actions are designed to adjudicate, in a single action, the claims of numerous parties with similar claims. One objective of a class action judgment is to prevent future litigation of claims that were, or could have been, litigated in the class action. Thus, the legal principles of 'claim preclusion' and 'issue preclusion' arise in the class action context. Claim preclusion means that a final judgment on the merits in a case is conclusive as to the rights of the parties to that case and bars them from bringing a subsequent action involving the same claim. In the class action context, the application of claim preclusion means that the judgment applies to the entire certified class. In certain instances, it can also bind nonparties. It does not, however, bar an individual who elects not to participate in the class action from bringing his or her own claim. Issue preclusion bars the same parties from relitigating in a subsequent action an issue that was litigated in a prior action. Courts have generally held that a successful defendant in a prior class action suit may not assert issue preclusion in a subsequent suit against a plaintiff who opted out of the earlier class action. Similarly, when a class prevails in an earlier action, an individual who opted out of that class who now chooses to bring his or her own individual claim against the same defendant may not assert issue preclusion in that case.

  This section provides that the principles of claim preclusion and issue preclusion apply to tax class actions in the same manner in which they apply to class actions generally. It further specifies that if a final judgment on the merits is entered in a class action in favor of the class, the following applies to an eligible taxpayer who did not become a member of the class:

- The taxpayer is not entitled to share in any monetary relief awarded to the class.
- If the taxpayer has been assessed for failure to pay the tax at issue in the class action and the taxpayer has not paid the assessment, then the assessment is abated.
- The taxpayer is relieved of any future liability for the tax that is the subject of the class action.

2008 Budget Technical Corrections.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-118	**HB 2438**	**Rep. Michaux, Tolson, Yongue**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER MODIFICATIONS TO THE STATE BUDGET.

OVERVIEW: Section 3.10 of this act allows an annual sales and use tax refund for materials used to build a facility that manufactures solar electricity generating materials. The remainder of this act does not impact the tax laws and is not discussed below.

FISCAL IMPACT: This section is expected to reduce General Fund revenues by $348,813 in fiscal year 2010-2011.

EFFECTIVE DATE: Section 3.10 of this act became effective July 1, 2008, applies to purchases made on or after that date, and expires for purchases made on or after January 1, 2013.

ANALYSIS: Section 3.10 of this act adds 'solar electricity generating materials manufacturing' to the list of industries entitled to an annual refund of the sales and use tax paid by the owner of the industry on building materials and supplies, fixtures, and equipment used to construct a facility that will be used primarily to manufacture solar electricity generating materials. Solar electricity generating materials manufacturing is defined as the development and production of one or more of the following:

- Photovoltaic materials or modules used in producing electricity.
- Polymers or polymer film primarily intended for incorporation into photovoltaic materials or modules used in producing electricity.

The industries currently eligible for the refund include the following: air courier services; aircraft manufacturing; bioprocessing; computer manufacturing; financial services, securities operations, and related systems development; motor vehicle manufacturing; pharmaceutical and medicine manufacturing and distribution of pharmaceuticals and medicines; and semiconductor manufacturing.

Photovoltaics (PV) are solar cells made and composed of semiconductor materials that are used to convert sunlight directly into electricity. The current solar industry in the United States employs some 20,000 employees in high value, high tech jobs and is expected to grow

toward a workforce of 150,000 by the year 2020.[78] DuPont is a materials and technology supplier to the PV industry. It offers products needed for PV module production, such as polymer films, resins, sheets, and conductive pastes. DuPont has one facility in Bladen County and another in Kentucky that produce polymers needed to manufacture polymer film. The company is looking to expand this industry. United Solar Ovonic is a company headquartered in Michigan that specializes in thin film solar technologies and the manufacture of thin film solar electric modules and laminates. It, too, is looking to expand its operations.

To be eligible for this refund, the Secretary of Commerce must certify that the owner of the facility will invest at least $50 million of private funds in the construction of the facility, if the facility is located in a development tier one area, and at least $100 million if the facility is located elsewhere in the State. In addition to the investment requirement, a solar electricity generating materials manufacturing business must also meet a wage standard in order to qualify for the sales tax refund. A business meets the wage standard if it pays the lesser of an average weekly wage that is equal to or greater than 110% of the average weekly wage for the State or the average weekly wage for the county.

If the owner does not make the required minimum investment within 5 years after the first refund is received, the owner forfeits all refunds already received. Upon forfeiture, the owner is liable for not only the tax due, but also interest computed from the date each refund was received. A person that fails to pay the tax and interest due within 30 days after the date of forfeiture is subject to the penalties provided in G.S. 105-236. A request for a refund must be in writing and must be submitted within six months after the end of the State's fiscal year. A refund applied for after the due date is barred. The refund provision expires for purchases made on or after January 1, 2013.

Rev Laws Tech., Clarifying, & Admin Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-134	**SB 1704**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

OVERVIEW: This act makes technical, clarifying, and administrative changes to the revenue laws, the motor fuel tax laws, and related statutes, as recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Except as otherwise provided, these changes became effective when the act was signed into law by the Governor on July 28, 2008.

ANALYSIS:

[78] "Energy Alternatives and Jobs." 2000. Renewable Energy World, 3(6): November/December, pp. 26 32.

Part I: 911 Technical Changes

Section	Explanation
1.(a)	Allows the 911 Board to adjust allocations to ensure local governments receive, at a minimum, the same revenues the local government collected in 911 fees for the fiscal year ending June 30, 2007.
1.(b)	Changes from calendar year to fiscal year the time frame in which the Board can make changes in allocation percentages to conform to the Board's accounting practices.
1.(c)	Clarifies that the Eastern Band of the Cherokee Nation is an eligible PSAP and can receive disbursements from the 911 Fund, even though the Nation is exempt from Chapter 159, the Local Government Finance Act. Its per capita distribution amount will be based upon the most recent federal census estimates of the population living on the Qualla Boundary.
1.(d)	Extends the moratorium on the collection of the 911 fee from prepaid wireless providers from the 2008 calendar year to the first nine months of the 2009 calendar year.

Part II: Work Opportunity Tax Credit (WOTC) Changes

2.(a)	Clarifies that the WOTC is limited to 6% of the federal credit for wages paid in the same taxable year for positions located in North Carolina. Places a sunset on the credit effective for taxable years beginning on or after January 1, 2012. These changes are effective for taxable years beginning on or after January 1, 2008.
2.(b) &(c)	Clarifies that an employer cannot deduct the wages paid as a business expense from state taxable income if the employer takes the WOTC for those wages.

Part III: Reform Tax Appeal Changes

3	Conforms the due date of the franchise tax return and the corporate tax return. Section 10 of S.L. 2007-491 extended by one month the due date for filing a franchise tax return. Section 14 of that act made a corresponding change for corporate income tax returns. Since franchise tax and corporate income tax are reported on the same form, the effective dates must conform. However, the way the act was drafted, the one-month extension for franchise tax would occur in 2008 while the one-month extension for corporate income would take place in 2009. This section corrects the inconsistency by repealing Section 10, effective retroactively to January 1, 2008, and by reenacting the provision, effective January 1, 2009. With this change, the one-month extension will take effect for both taxes beginning in 2009.

	Inserts language inadvertently omitted in a rewrite of the franchise tax statute in 2007. Section 10 of S.L. 2007-491 rewrote for clarity the subsection imposing the franchise tax. The rewrite inadvertently omitted existing language requiring a corporation to determine its tax liability based on "the books and records of the corporation at the close of the income year." This section puts this language back in the statute.
4	Conforms the corporate tax return to the franchise tax return. S.L. 2007-491 added chief financial officers to the list of corporate officers authorized to sign franchise tax returns and deleted the secretary, the assistant secretary, and the assistant treasurer. However, similar changes were not made in the corresponding corporate income tax statute. Since the franchise tax return and the corporate income tax return are on the same form, the statutes need to match. This section makes that conforming change to the corporate tax statute.
5	Provides that a taxpayer may file a request for review of the Department of Revenue's proposed denial of a refund at any time by the date that inaction by the Department is considered a proposed denial of the refund but within 45 days of receiving actual notice of a proposed denial by the Department. This section addresses that concern, as recommended by the Department, and is effective for taxable years on or after January 1, 2008. Under the new administrative review process, the Department of Revenue is required to take action on a request for a refund within six months after the request has been filed. If the Department denies the request, it must send a notice to the taxpayer, and the taxpayer has 45 days to request a review of the proposed denial. However, if the Department fails to take any action within six months, the request is considered denied, and the taxpayer has 45 days from that point to request review. The purpose of this provision is to allow a taxpayer to move forward in the administrative review process despite inaction by the Department. However, concerns have been raised that the running of this 45-day period without actual notice from the Department may create a potential trap that bars taxpayers from appealing the denial.
6	Clarifies that the validity of a proposed denial of refund is not affected by the Department's failure to timely issue a notice of final determination. The Department must issue a final determination within nine months after the taxpayer requests a review of a proposed denial of a refund or a proposed assessment of tax. The relevant statute specifically provides that failure to timely issue a notice of final determination does not affect the validity of a proposed assessment but is silent as to the impact on a proposed denial of refund.
7	Replaces the word 'tax,' which is a defined term, with the word 'amount' for consistency. The purpose of this change is to clarify that if a taxpayer does not send in the amount shown due with a return, the Department can collect the principal amount of the tax, any applicable penalties, such as failure to pay, and interest.

8	Makes a conforming change in the motor fuel tax law regarding the new administrative review process.
9	Allows government agency lab reports to be admitted into evidence in a contested tax case hearing without requiring agency personnel testimony. S.L. 2007-491 made special provisions for contested tax cases heard at the Office of Administrative Hearings. Among them, a law enforcement report may be admitted into evidence without the testimony of personnel from the law enforcement agency. The Motor Fuels Tax Division of the Department requested a similar provision for government agency lab reports used in the enforcement of the motor fuel tax laws.

Part IV: Collection Changes

10	Adds partners and managers of a partnership (who may or may not be a partner) to the list of officers or, as rewritten, 'responsible persons' whom the Department may assess. The Department requested this change. This section also rewrites the section for clarity and style and places the statute in a more logical location within the Article. Individual officers and directors of a corporation are usually not liable for corporate debts or obligations. This is in contrast to partnership debts and liabilities, which are chargeable personally to the individual partners. However, by statute, a 'responsible officer' of a corporation or a limited liability company may be held personally liable for certain unpaid trust taxes owed by the business entity. These taxes include sales and use, motor fuels, and income withholding taxes. A 'responsible officer' is defined as the president, treasurer, and the CFO of a corporation, the manager of a LLC, and any other officer of a corporation or a member of a LLC who has a duty to pay taxes on behalf of the entity. The Department is authorized to enforce collection by proposing an assessment against the officer. Under prior law, there was no similar statutory authorization to assess partners for these taxes. Instead, the Department, like any other creditor of a partnership, would be required to sue in order to collect this liability. Once a judgment was obtained, the Department could seek to execute the judgment. This section became effective July 1, 2008, and applies to taxes that become collectible on or after that date.

Part V: Sales Tax Changes

11	Specifies how the tax on gross receipts from periodic payments made pursuant to agreements entered into before the effective date of the sales tax rate changes is to be reported. This section is a transitional provision for the 'Medicaid swap' enacted in the 2007 Session by S.L. 2007-323. Under the swap, the local sales and use

	tax rate decreases by ¼ cent in 2008-09 and again in 2009-10, and the State sales and use tax rate increases by the same amount. The combined State and local rates do not change; instead, the allocation of the combined rate between the State and the counties changes. Periodic payments consist of lease and rental payments and installment sale payments. Sales and use tax is due on lease and rental payments when the payments are billed. For installment sales, the tax application differs depending on whether the retailer reports on an accrual basis or a cash basis. A retailer on an accrual basis reports all the sales tax due on an installment sale when the sale is made. A retailer on a cash basis reports sales tax when each installment payment is received. This provision requires retailers who receive periodic payments from existing contracts to report them at the current State and local rates. This eliminates confusion about what to report and how to report it. Without this provision, a retailer who receives periodic payments will have receipts from existing contracts that are reportable at State and local rates that differ from the State and local rates that apply to periodic payments from new contracts.

Part VI: Occupancy Tax Changes

12.(a)	Provides that an interpretation by the Department of Revenue of a State sales tax law provision applies to a local law that references that provision. As the result of an independent audit by at least one county, questions arose among local governments and within the tourism industry regarding what constitutes 'gross receipts' for occupancy tax purposes. Most local occupancy tax acts state that a county or city may levy a room occupancy tax on "the gross receipts derived from the rental of any room...that is subject to sales tax imposed by the State under G.S. 105-164.4(a)(3)." Therefore, if an item of tangible personal property or a fee associated with the rental of an accommodation is subject to sales tax under G.S. 105-164.4(a)(3), then it is also subject to the local occupancy tax. While the Department can offer an interpretation of the State sales tax laws, it does not have statutory authority to offer an interpretation of the application of local occupancy tax laws, which it does not administer.
12.(b) & (c)	Provides that collectors of occupancy tax may allocate revenues for vacation packages that do not otherwise meet the definition of a bundled transaction. In January of 2008, the Department issued a technical bulletin related to the rentals of accommodations. In that bulletin, the Department clarified that the bundling provisions in G.S. 105-164.4D apply to vacation packages. For example, a vacation package may include lodging, meals, and greens fees for one price. The lodging is subject to sales and local occupancy tax, the meals are subject only to sales tax, and the greens fees are not subject to either sales or occupancy tax. The bundling provisions

	allow a hotel operator to allocate the revenues between taxable and exempt portions of the package. The allocation may be part of a hotel's internal records and is not required to appear on the customer's bill. A 'bundled transaction' is defined as a sale that includes at least one taxable item and at least one exempt item. Since the release of the bulletin, the tourism industry has sought clarification of whether the allocation rules apply to vacation packages consisting only of taxable items, since those packages do not otherwise meet the definition of a bundled transaction. The clarification is needed because although the entire vacation package may be subject to sales tax, not all items may be subject to occupancy tax. The collectors would like the ability to allocate those revenues.

Part VII: Medicaid Technical Changes

13	Ensures that counties spend as much on public school capital outlay as they would have in the absence of the Medicaid swap. Part of the swap changes the distribution of taxes imposed under Article 42 from a per capita basis to a point of collection basis. A county whose sales tax revenue decreases as a result of this conversion is required to continue to fund public school capital outlay at the amount that would be required in the absence of the conversion.
14	Makes two clarifying changes to the hold harmless calculation. The first is a technical change that describes the hold harmless calculation in a way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. The second change eliminates a potentially circular calculation of the amount of local sales and use tax revenue to be distributed. It does not change the amount of any tax or hold harmless payment. The prior law could be construed to calculate the amount of various hold harmless payments on the basis of an amount that includes a deduction for the payment that is attempted to be calculated, which is circular. The hold harmless payments are now both pegged, in part, on amounts distributed under Article 39 of Chapter 105 of the General Statutes and deducted from those amounts. This section resolves the problem by making it clear that the hold harmless payments are calculated on the basis of amounts allocated for distribution before any subtraction for the hold harmless payments. References in Article 39 and Chapter 1096 of the 1967 Session Laws are replaced with a direction in G.S. 105-522(b) to deduct the city hold harmless payment from the amount of local sales and use tax revenue otherwise allocated under those provisions for distribution to a county. Subsection (a) adds an

	instruction in G.S. 105-522(b) to deduct the payment. Subsection (b) removes the instruction from Article 39 of Chapter 105. Subsection (c) removes the instruction from Chapter 1096.
15	Makes three changes to the hold harmless calculation. First, it inserts the city hold harmless amount into the calculation of the county hold harmless payment, thereby ensuring that the intent of the General Assembly is fulfilled. G.S. 105-523(a) states that each county is to benefit from the Medicaid swap by at least $500,000. The current calculation for determining a county's hold harmless payment, however, does not include the amount a county is required to give to its cities in order to hold them harmless from the repealed local sales taxes. Subsection (a) adds the cost of the city hold harmless to the calculation of the county hold harmless payment. Subsections (d) and (f) repeal changes to G.S. 105-523 that were to take effect in 2009, and subsection (h) reinserts those same changes into the amended G.S. 105-523 while preserving the amendments added by subsection (a). Second, it makes the same technical change to G.S. 105-523(b)(3) that Section 14 makes to G.S. 105-522(a)(2). The technical change describes the hold harmless calculation in a simpler way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. Third, it changes the city hold harmless formula and the county hold harmless formula that apply to fiscal years beginning in 2009-2010 to match these formulas to the ones used in the tables that calculated the impact of the swap. The prior law incorrectly included a ¼% tax distributed on the basis of point of origin as one of the elements of the formulas. The Medicaid swap is based on the repeal of ½% local sales and use taxes distributed on a per capita basis and the conversion of a ¼% per capita tax to a ¼% point of origin tax. To reflect this, the reimbursement formula needed to be changed to delete the reference to a ¼% point of origin tax and replace it with a ¼% per capita tax. Subsections (c), (d), and (f) of this section repeal the provisions that contain the incorrect reference and subsections (g) and (h) insert the correct reference in the formulas. Subsections (b), (e), and (i) make conforming changes; they repeal sections that use terminology that does not match the revised reimbursement sections and replace them with a provision that uses terminology that is consistent with the revised sections.

Part VIII: Motor Fuel Tax Law Changes

The changes made by this part are effective January 1, 2009.

16 Makes clarifying and conforming changes and numbers the definitions sequentially. Adds definitions for terms used in the motor fuel tax statutes.

Under IFTA, a 'qualified motor vehicle' is one used, designed, or maintained for transportation of persons or property that meets one or more of the following conditions: has two axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds; has three or more axles regardless of weight; or has a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds when it is combined with another vehicle

17 Corrects a punctuation error.

18 Changes the statute to reflect current practice. Provides that the Department may include information received from the State Highway Patrol when determining the potential liability of a motor carrier. The SHP used to be located within the DMV. Incorporates defined terms.

19 Incorporates defined terms. Clarifies that recreational vehicles that are qualified motor vehicles under the IFTA would need to be registered. Also, the use of the defined term 'qualified motor vehicle' means that special mobile equipment would need to be registered. Although the law's definition of 'motor vehicle' arguably included special mobile equipment, the Department has not been requiring the registration of special mobile equipment. However, other IFTA states do require the registration of special mobile equipment.

20 Incorporates the commonly used term 'decal' for 'identification marker'.

21 Repeals an unnecessary statute. G.S. 105-252 and G.S. 105-254 give the Secretary the authority to prepare the appropriate forms and require the necessary information on those forms.

22 Incorporates the commonly used term 'decal' for 'identification marker'. Modernizes the language.

23 Incorporates the commonly used term 'decal' for 'identification marker'.

24 Revises the definitional statute to define commonly used terms, to incorporate definitions from other statutes, and to refer to federal regulations. It numbers the definitions sequentially.

25 Incorporates into the licensing statute the requirement that a for hire transporter have a license and specifies that a biodiesel provider is not required to have a separate license as a blender.

---

26 Makes conforming and grammatical changes. It removes definitions that have been incorporated into the definitional statute and it corrects the spelling of the term 'bulk end-user'.

27 Corrects the spelling of the term 'bulk end-user'.

28 Incorporates the defined term 'supplier'.

29 Incorporates the defined term 'in-State supplier'.

30 Provides that an importer's license must indicate the category of the importer, just like a supplier's license must indicate the category of the

supplier.

31 Clarifies the payment responsibilities of all license holders.

32 Specifies when the tax is payable on fuel grade ethanol. Effective January 1, 2009, the tax is payable when it is removed from a terminal or is produced in the State or imported to the State and not delivered to a terminal. Under law, it is taxable when it is blended. Specifies that a tax is payable when motor fuel is transferred 'behind-the-rack' to a person who is not licensed as a supplier, as required by law.

33 Provides that the supplier who sold motor fuel to an unlicensed exporter is jointly and severally liable for the tax imposed on that fuel. The statute provides similar joint and several liability for motor fuel sold to an unlicensed distributor; for motor fuel sold by an unlicensed supplier; and for dyed diesel fuel.

34 Makes a conforming change to the change made in Section 32 concerning taxation of fuel grade ethanol.

35 Makes a conforming change to the change made in Section 32 concerning transfers to unlicensed persons.

36 Corrects a grammatical error.

37 Corrects the spelling of the term 'bulk end-user'.

38 Corrects the spelling of the term 'bulk end-user' and 'end-seller'.

39 Corrects the spelling of the term 'bulk end-user'. Prohibits a supplier from transferring motor fuel from a terminal to a marine vessel unless the person to whom the fuel is transferred is a licensed supplier.

40 Identifies the tax responsibility of purchasers to the supplier.

41 Removes the requirement to sort the fuel by type on the reporting form; the requirement is not longer necessary due to electronic filing. It provides the Department with the ability to sort.

42 Corrects the spelling of the term 'bulk end-user'.

43 Makes a conforming change to administrative practice. It provides that terminal operators who are required to be licensed in this State must report transactions from out-of-state terminals with this State as its destination. It also changes the structure of the statute for uniformity purposes.

44 Requires only motor fuel transporters who transport motor fuel for hire to file reports of fuel movements. This reverses a change made last year that required all distributors and others who transport motor fuel for themselves and not for hire to file the reports.

45 Changes the structure of the statute for uniformity purposes.

46 Changes the catchline of the statute to more accurately reflect the contents of the statute. It specifies that the refunds are monthly refunds; this change reflects current practice. It also provides that an out-of-state bulk end-user

	must be registered as an exporter if requesting a refund for exports from a North Carolina bulk plant.
47	Specifies that the refund is a monthly refund; this change reflects current practice.
48	Corrects the spelling of the term 'end-user'.
49	Deletes the provisions for refunds filed upon application because all refunds are filed on an annual basis, a quarterly basis, or a monthly basis.
50	Clarifies the content of the shipping document.
51	Makes a conforming change to administrative practice and terminology.
52	Uses the defined term 'person'; that term incorporates a distributor.
53	Corrects the spelling of the term 'bulk end-user'. Cross-references the definition of highway to the defined term in the definitional statute.
54-58	Corrects the spelling of the term 'bulk end-user'.
59	Cross-references the defined terms in the definitional statute and renumbers the subdivisions sequentially.
60	Makes a conforming change to add the defined terms of aviation gasoline and jet fuel to the statute that imposes the ¼-cent inspection tax and provides that the tax on these two types of fuel are payable as specified by the Secretary of Revenue.

Part IX: Combined Motor Vehicle and Property Tax Registration System

61	Repeals current statutory provisions on the required memorandum of understanding because they are recodified in G.S. 105-330.11 as enacted by § 64 of this act.
62	Clarifies that an application for property tax exemption or exclusion is not required for vehicles qualifying for an exemption or exclusion listed in G.S. 105-282.1(a)(1). This change prevents the need to apply for an exemption for government owned vehicles and vehicles listed as inventory.
63	Clarifies the statute. Directs the Treasurer to report to Revenue Laws annually instead of semiannually.
64	Recodifies the provisions on the memorandum of understanding required between the Departments of Revenue and Transportation with respect to implementation of the combined collection system for vehicle registrations and property taxes.
65, 66	Delays the effective date of the combined system from July 1, 2010, to July 1, 2011.

Part X: Other Changes

67	Removes a provision that refers to a repealed statute for subdivision.
68	Allows an unauthorized substance tax officer to testify in court concerning an offense committed against that individual in the course of administering the Article. Currently, information obtained under Article 2D (Unauthorized Substance Taxes) is confidential and may not be disclosed, unless the disclosure is made to exchange information with certain law enforcement agencies concerning a tax imposed by the Article. The information may also not be used in a criminal prosecution, other than for a prosecution for a violation of the Article or unless the information is independently obtained. The Department requested this change due to a specific incident involving an officer who was assaulted but was prohibited from testifying about the incident.
69	Corrects an incorrect citation.
70	Clarifies a reference to a 'year' in a tax credit statute is a reference to a 'taxable year.'
71	Codifies the long-standing practice of the Department that it is able to correct errors concerning a taxpayer's liability whenever they are brought to the Department's attention.
72	Makes a clarifying change to the property tax exemption for historic preservation property.
73	Repeals the North Carolina Rural Redevelopment Authority (NCRRA). The NCRRA is an inactive entity. It was created by S.L. 2000-148 but was never appointed or funded. Creation of the Authority was a recommendation of the 1999 North Carolina Rural Prosperity Task Force, which was established by Governor Jim Hunt and chaired by Erskine Bowles. As envisioned by the Task Force, the Authority would administer a revolving loan fund, the Rural Investment Fund, as well as an investment fund, the Long-Term Rural Development Fund. No money was ever appropriated to these funds. Subsection (a) repeals the statutes that create the Authority and set out its duties. Subsections (b) through (e) make conforming changes. Specifically, subsection (b) repeals the Authority's exemption from the general prohibition against a State agency competing with private enterprise. Subsection (c) deletes the Authority from the list of boards and commissions on which legislators may not serve. Subsection (d) repeals the Authority's exemption from the State Personnel Act. Subsection (e) changes a cross-reference to a definition of regional partnership that is now set out in a statute that is repealed in subsection (a); it replaces the cross-reference with the substance of the definition and updates the definition to reflect the accurate names of the regional economic development partnerships.

74	Clarifies that the ½% sales tax for transit purposes authorized for Mecklenburg County exempts purchases of food.
75	Corrects a statutory reference.
76	Provides for the proration of taxation when property in a county law enforcement service district is annexed by a municipality.
77	Corrects proper name of one of the regional partnerships.
78	Provides that information concerning tax credits may be provided to consultants for the Joint Select Committee on Economic Development Incentives to compile statistical data. The consultants are employees of the University of North Carolina at Chapel Hill and are subject to the same confidentiality requirements as an employee of the State of North Carolina.

Tax on Short-Term Heavy Equipment Rentals.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-144	**SB 1852**	**Senator Brunstetter**

AN ACT TO RESOLVE PROBLEMS WITH APPLYING PROPERTY TAX TO HEAVY EQUIPMENT RENTED ON A SHORT-TERM BASIS BY REPLACING THE PROPERTY TAX ON THIS EQUIPMENT WITH A TAX ON THE GROSS RECEIPTS FROM RENTING THE EQUIPMENT.

OVERVIEW: This act replaces the property tax on certain heavy equipment that is offered at retail for short-term lease[79] or rental with a local option gross receipts tax for certain heavy equipment that is offered at retail for short-term lease or rental.

FISCAL IMPACT: No General Fund impact. The act is revenue neutral for local governments overall, however, individual jurisdictions will experience changes in revenue depending on where sales occur.

EFFECTIVE DATE: The property tax exemption for heavy equipment becomes effective for taxes imposed for taxable years beginning January 1, 2009. A local option gross receipts tax on heavy equipment may not become effective before January 1, 2009.

ANALYSIS: This act excludes from property tax certain heavy equipment that is offered at retail for short-term lease or rental, if the heavy equipment is leased or rented by a person whose principal business is the short-term lease or rental of heavy equipment, effective for taxes imposed for taxable years beginning on or after January 1, 2009. It replaces the

[79] A short-term lease is a lease or rental for a period of less than 365 days. (G.S. 105-187.1). Under current law, a long-term lease agreement generally requires the lessee to list and pay the property taxes due on the heavy equipment.

property tax on heavy equipment with a local option gross receipts tax. A local option tax may not become effective before January 1, 2009. The act clarifies that short-term heavy equipment is exempt from property tax regardless of whether a county or city imposes a gross receipts tax. In recent years, several owners of heavy equipment rental businesses expressed concerns about the unfairness and administrative inconsistencies of levying and collecting property tax on this equipment.

The local option tax applies to the gross receipts derived from the short-term rental or lease of earthmoving, construction, or industrial equipment that is mobile, weighs at least 1,500 pounds, and meets one or more of the following requirements:

- It is a self-propelled vehicle that is not designed to be driven on a highway.
- It is industrial lift equipment, industrial material handling equipment, industrial electrical generation equipment, or similar piece of industrial equipment.

The gross receipts tax rate that may be imposed by counties is 1.2% and the rate that may be imposed by cities is 0.8% for a combined rate of 2.0% if the heavy equipment rental business is located in a city. The gross receipts are subject to the local tax only if they are subject to the sales tax.

The gross receipts tax is paid quarterly and is due on the last day of the month following the end of the quarter. The tax is sourced based on the place from which the equipment is delivered and is intended to be added to the amount charged for the rental and paid to the heavy equipment business by the lessee.

The Department of Revenue is authorized to disclose otherwise confidential taxpayer information to counties and cities when it relates to the administration of the heavy equipment rental tax.

Property Tax Modifications.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-146, as amended by S.L. 2008-187[80]	**SB 1878**	**Senator Clodfelter**

AN ACT TO MODIFY THE SCHEDULE FOR GENERAL REAPPRAISALS OF REAL PROPERTY IN THE STATE TO REDUCE THE DISCREPANCY BETWEEN THE PROPERTY TAX VALUE OF PROPERTY AND ITS MARKET VALUE, TO MODIFY THE OWNERSHIP REQUIREMENTS OF PRESENT-USE VALUE PROPERTY TO REFLECT COMMON FORMS OF LAND OWNERSHIP, TO ALLOW PROPERTY TO REMAIN IN PRESENT-USE VALUE WHEN THE DEFERRED TAXES ARE

[80] Section 47.6 of S.L. 2008-187, the 2008 technical corrections bill, eliminates a codification conflict created in House Bill 1889 and Senate Bill 1878.

PAID AT THE TIME OF TRANSFER AND THE NEW OWNER CONTINUES TO FARM THE PROPERTY, TO CLASSIFY LOW-INCOME HOUSING PROPERTY, TO EXCLUDE FROM PROPERTY TAX PRESCRIPTION DRUGS GIVEN AS FREE SAMPLES, TO EXCLUDE FROM PROPERTY TAX EIGHTY PERCENT OF THE APPRAISED VALUE OF A SOLAR ELECTRIC SYSTEM, AND TO DIRECT THE REVENUE LAWS STUDY COMMITTEE TO STUDY THE EFFECT THAT THIS ACT HAS ON STAFFING NEEDS OF THE DEPARTMENT OF REVENUE AND THE DEFINITION OF INCOME AS IT APPLIES TO THE HOMESTEAD EXCLUSION.

OVERVIEW: This act makes the following changes to the property tax laws:

- Part I of the act retains the octennial schedule for reappraisal of real property but requires counties with a population of 75,000 or greater to advance the general reappraisal if the sales assessment ratio for the county drops below .85 or becomes greater than 1.15.[81] This part becomes effective July 1, 2009.
- Part II of the act modifies the present-use value ownership requirements to reflect modern estate planning and allows property to remain in present-use value when deferred taxes are paid at the time of transfer and the new owner continues to farm the land and files an application for present-use value status. This part is effective for taxable years beginning on or after July 1, 2008.
- Part III of the act classifies qualified North Carolina low-income housing developments as a special class of property and requires valuation of the property to be based on the actual (rent-restricted) income. This part is effective for taxes imposed for taxable years beginning on or after July 1, 2009.
- Part IV of the act exempts from property tax free samples of prescription drugs given to physicians and other medical practitioners to dispense free of charge in the course of their practice. This part is effective for taxable years beginning on or after July 1, 2008.
- Part V of the act excludes 80% of the appraised value of a solar energy electric system from property tax. This part of the act is effective for taxable years beginning on or after July 1, 2008.
- Part VI of the act directs the Revenue Laws Study Committee to study the following: whether the Department of Revenue needs positions to perform sales assessment ratio studies in additional counties and other functions related to the act, and the

[81] The Senate version of SB 1878 required counties to advance the general reappraisal if the sales assessment ratio for the county dropped below .90 for the previous year. The House version required counties to advance the general reappraisal if the sales assessment ratio for the county dropped below .70 or became greater than 1.10 for the previous year. The conference report required the advanced general reappraisal only for a county whose population is 75,000 or greater and when the county's sales assessment ratio dropped below .85 or became greater than 1.15.

definition of income as it applies to the homestead exclusion. This part became effective when the act was signed into law by the Governor on August 2, 2008.

FISCAL IMPACT: There is minimal impact on local government revenue associated with the changes to the reappraisal schedule, the PUV ownership requirements, the property tax exemption for sample prescription drugs, and the partial property tax exclusion for solar energy electric systems. The valuation change for low-income housing is estimated to reduce local government revenues by $21 million. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See **OVERVIEW.**

ANALYSIS: The act makes the following changes to the property tax laws:

Part I: Reappraisal Schedule

Counties are required to reappraise real property at least once every eight years. The law allows counties to advance the octennial schedule by adopting a shorter cycle, such as every four or six years. Each year, the Department of Revenue studies property values in every county and compares the value of the parcels as a function of their sales price with the value of the parcels as indicated by their assessed tax value. The Department notifies each county of the resulting sales assessment ratio on April 15 of the year following the study.

The act requires a county with a population of 75,000 or greater to advance its octennial reappraisal schedule if its sales assessment ratio drops below .85 or becomes greater than 1.15 in the previous year.[82] This change would occur when the assessed value differs from the sales price of the property by more than 15%. A county required to conduct a new reappraisal under this act must implement the new values by January 1 of the third year following the year the notification of the triggering sales assessment ratio was made. The act retains the octennial reappraisal schedule for all other counties. This part of the act becomes effective July 1, 2009, and applies to notices sent on or after that date.

The genesis for this Part came from a recommendation of the Revenue Law Study Committee. The act directs the Revenue Laws Study Committee to study the effect of the changes to the reappraisal schedules in this Part. Its study of the issue should consider whether new positions within the Department of Revenue are needed to perform sales assessment ratio studies in additional counties each year. This directive to the Committee was prompted by concerns raised by some of the smaller counties regarding whether they could handle the expense of more frequent reappraisals.

Part II: Present-Use Value Property Changes

Part II of the act makes changes to the present-use value (PUV) program, as recommended by the Revenue Laws Study Committee. These recommendations were proposed to the Committee by representatives of county tax assessors, the North Carolina Association of County Commissioners, the UNC School of Government, the North Carolina Farm Bureau,

[82] According to the most recent annual population estimates as certified by the State Budget Officer, each of the following counties has a population of 75,000 or greater: Alamance, Brunswick, Buncombe, Burke, Cabarrus, Caldwell, Catawba, Cleveland, Craven, Cumberland, Davidson, Durham, Forsyth, Gaston, Guilford, Harnett, Henderson, Iredell, Johnston, Mecklenburg, Moore, Nash, New Hanover, Onslow, Orange, Pitt, Randolph, Robeson, Rockingham, Rowan, Union, Wake, Wayne, and Wilson.

and the Department of Revenue. The changes are effective for taxes imposed for taxable years beginning on or after July 1, 2008.

The General Assembly created the PUV program in 1973. The program provides that farmland meeting certain ownership, size, and use requirements will be provided special property tax treatment.[83] The land is appraised and taxed at its PUV as opposed to its fair market value.[84] The difference between the taxes due on the PUV and taxes that would have been payable in the absence of the special tax treatment is known as 'deferred taxes'. When the land no longer qualifies for PUV treatment, the taxpayer is liable for the property taxes due in the year of disqualification plus the deferred taxes for the three previous years, with interest.[85]

In recent years, taxpayers as well as county tax assessors have voiced concerns about the complexities of the ownership requirements, and taxpayers have raised concerns about the perceived unfairness of these requirements. For example, qualifying land had to be individually owned, which meant that the land could be owned by a natural person, a business entity, a tenancy in common, a trust or a testamentary trust. If the land was owned a business entity or trust, all members of the business entity had to be natural persons, and beneficiaries of a trust had to be natural persons. If the land was owned by tenants in common, then a tenant in common could be a natural person or a business entity but not a trust. These restrictions did not allow for the use of modern estate planning vehicles such as a family limited partnership or family limited liability company. There was also no rationale for excluding certain trusts as a tenant in common.

The act addresses some of these concerns by changing the definition of 'individually owned' as follows:

- The awkward reference to 'owned by a natural person' is changed to 'owned by an individual'.
- Members of a business entity are no longer restricted to individuals and now include trusts and other business entities. A qualified business entity, however, may not be a corporation whose shares are publicly traded and none of its

---

[83] The farmland must be used for agricultural, horticultural, or forest purposes and be engaged in commercial production under a sound management program. Agricultural and horticultural land are also required to have one tract that produces at least $1,000 average gross income for the three years preceding the year the tax benefit is claimed. During the 2007 Session, the agricultural land classification was amended to include agricultural land used as an aquatic species farm, effective in the 2008-2009 tax year. During the 2008 Session, the PUV statutes were amended to allow property appraised at PUV and subject to a conservation easement to continue to qualify for use value appraisal if the taxpayer received no more than 75% of the fair market value of the donated property as compensation. Also wildlife conservation land was designated a special class of property for property tax purposes and authorized to be appraised and taxed as if it were classified as agricultural land under the PUV system. See S.L. 2008-171

[84] PUV is usually much less than market value.

[85] No deferred taxes are due if the property loses its classification for one of the following purposes: (1) the land is enrolled in the federal Conservation Reserve Program and is no longer in production and therefore does not meet the income requirement, (2) the land is conveyed by gift to certain exempt organizations and governmental entities. This applies to conveyances by gift to nonprofit organizations where the property will qualify for exclusion from the tax base because it is real property that will be exclusively used for educational and scientific purposes as a protected natural area, or where the property will be exclusively used for nonprofit historic preservation purposes, or (3) the property is conveyed by gift to the State, political subdivisions of the State, or the United States.

members may be corporations whose shares are publicly traded. When the membership of a business entity includes a business entity or a trust, then all members of the business entity and all beneficiaries of the trust must be individuals. These individuals are deemed to be indirect members of the qualified business entity.[86] The law continues to require the principal business of the business entity to be in agriculture, horticulture, or forestry, and each member must be actively engaged in one of these activities or related to a member who is actively engaged in one of these activities. Also, if the land is leased, all members of the business entity must be individuals and relatives.

- Beneficiaries of a trust may be a business entity as long as the members of the business entity are individuals who either created the trust or who are relatives of the creator. These individuals are deemed to be indirect beneficiaries.
- A tenant in common may include a trust in addition to an individual and business entity.

The following are examples of land that now qualify for PUV under the act, but would not have qualified under the prior law:

- A corporation applies for PUV. Four shareholders of the corporation are individuals who are actively engaged in farming the land and one shareholder is an LLC. The members of the LLC are all relatives of one of the individual shareholders. Under prior law, the corporation would not qualify because it has an LLC as a member.
- A tenancy in common applies for PUV, and one of the tenants is a trust. Under prior law, the property would not qualify because all tenants were required to be individuals or business entities.
- An LLC applies for PUV, and one of the members of the LLC is a trust. All beneficiaries of the trust are children of the individual members of the LLC that owns the land. Under prior law, the LLC would not qualify because the trust was not an individual.

There has been a long-standing exception to the standard ownership requirement that a person must own the land for four years. Under the exception, land may continue to be appraised at its PUV value when it is transferred to a new owner and the new owner (i) continues to use the land for its current PUV classification, (ii) files an application for PUV, and (iii) assumes the deferred taxes. This exception has been interpreted not to apply when the seller pays more than the current year's taxes at the time of transfer. In this situation, the seller is deemed to have voluntarily removed the property from the PUV program, and the new owner may have to wait four years to qualify for PUV. The act allows the land to remain in PUV when the deferred taxes are paid at the time of transfer. The new owner will

[86] The indirect ownership determination does not stop at the first tier of the business entity that owns farmland. For example, if a business entity has as one of its members an LLC and one of the members of the LLC is another LLC, then the indirect ownership will apply to any member of the second LLC if the member is an individual who is actively engaged in farming the land or a relative of an individual who is actively engaged in farming the land.

become liable for subsequent deferred taxes when the land no longer qualifies for the PUV program.[87]

Part III: Low-Income Housing Property

Part III of the act provides an additional property tax incentive for owners of low-income housing developments to which the North Carolina Housing Finance Agency has allocated a federal tax credit, effective for taxes imposed for taxable years beginning on or after July 1, 2009. Under prior law, an assessor appraised low-income qualified property using one of the following three generally accepted methods of appraisal:

- Cost approach - estimates property value by summing the land value and the depreciated value of any improvements.
- Income approach - estimates value by capitalizing an income stream into present value through the use of capitalization rates of the net operating income[88] which is usually by dividing the annual NOI by the capitalization rate.
- Sales comparison approach – estimates value by comparing a property's characteristics with those of comparable properties which have recently sold in similar transactions.

The act requires the assessor to use the income approach to determine the tax value of property allocated housing tax credits. The tax assessor must take into account any applicable rent restrictions and may not include tax credits as income of the property if those credits result from section 42 of the Internal Revenue Code or G.S. 105-129.42. In so doing, the property value determination is constrained solely to the use of the actual rental income as opposed to what a similarly situated property would be able to generate in rental income if the property were not subject to rent restrictions.

In 1986, Congress enacted the federal Low Income Housing Tax Credit to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The Internal Revenue Service (IRS) allocates the per capita low-income housing tax credit to state housing agencies such as the North Carolina Housing Financing Agency (HFA), which in turn allocate the credit to project developers who agree to lower project rents for low-income tenants. In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit. The State credit permits a taxpayer to receive the credit in the form of either (i) a credit against tax liability or (ii) a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount.[89] Neither a tax refund generated by the credit, nor a loan received as a result of the transfer of the credit is considered taxable income by the State.

Part IV: Prescription Drugs Given as Free Samples

Part IV of the act exempts from property tax free samples of drugs that are required by federal law to be dispensed only on prescription and are given to physicians and other

---

[87] See Section 2.2 of S.L. 2008-35.

[88] The capitalization rate is a measure of the ratio between the cash flow produced by an asset and either the price paid for the asset or its current market value. The Net Operating Income (NOI) equals gross potential income minus vacancy minus operating expenses (excluding debt service or depreciation charges).

[89] Owners of all but one of the 51 rental developments awarded federal credits in 2003 elected to use the State credit as part of their funding. All 50 project developers chose the loan option.

medical practitioners to dispense free of charge in the course of their practice, effective for taxable years beginning on or after July 1, 2008. Under prior law, drug samples in doctors' offices were treated as business personal property or supplies and subject to property tax. These drug samples do not come under the definition of inventory, which is exempt from property tax, because they are not goods held for sale in the regular course of business.

Part V: Solar Energy Electric Systems

Part V of the act exempts 80% of the appraised value of a solar energy electric system from property tax, effective for taxable years beginning on or after July 1, 2008. A solar energy electric system converts solar energy into electricity.[90] Currently, there are no solar energy electric systems being taxed. However, there are plans to construct a massive solar power plant in Davidson County which is expected to provide enough power for 2,600 homes. Also, two systems were built this year in Asheboro and Raleigh.

North Carolina provides other tax incentives for solar energy. G.S. 105-277(g) designates buildings equipped with solar energy heating and cooling systems as a special class of property and, for property tax purposes, assesses the buildings as if they are equipped with a conventional heating or cooling system rather than assign an additional value for the difference in cost between the solar energy or cooling system and a conventional system typically found in the county.[91] G.S. 105-129.16A and G.S. 105-129.16H provide an income tax credit for investing in renewable energy property, which would include a solar energy electric system. The credit is equal to 35% of the cost of the property placed in service. For non-residential property the maximum credit is $2.5 million per installation.

Economic Development Modifications.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-147	**SB 2075**	**Senator Berger of Franklin**

AN ACT TO CLARIFY QUALIFICATIONS FOR THE EXCEPTION FOR MULTIJURISDICTIONAL INDUSTRIAL PARKS TIER DESIGNATION AND TO PROVIDE FOR A TEMPORARY INCREASE IN THE CAP ON AMOUNTS COMMITTED UNDER THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM.

OVERVIEW: This act clarifies that the sale of parcels of land from a multijurisdictional industrial park (MIP) for industrial or commercial purposes does not change the original tier status of the MIP or the availability of the incentives to successive purchasers based on its original tier status. It also increases the cap on amounts committed under the Job Development Investment Grant Program (JDIG).

[90] S.L. 2007-307 requires utilities to provide a designated amount or percentage of power from renewable energy resources as a portion of their overall provision of electricity.

[91] This classification does not include solar energy electric systems.

FISCAL IMPACT: The total maximum cost of increasing the JDIG cap will be $120 million, or $10 million per year for the next 12 years. This estimate assumes that the maximum amount of total annual liability is awarded.

EFFECTIVE DATE: This act became effective when signed by the Governor on August 2, 2008.

ANALYSIS: Any two or more units of local government may enter into contracts or agreements to jointly undertake the development of an industrial or commercial park or site. The lowest development tier incentive status is granted to the entire MIP, regardless of the tier designation of each individual county, if certain criteria are met. One of the criteria is that there be 250 developable acres in each county where the park is located. As a county sells property in the MIP to businesses to carry out the purposes of the MIP, a county may not be able to meet the prerequisite number of acres it must own in the MIP. This act clarifies that the sale of parcels of land from a MIP for industrial or commercial purposes does not change the original tier status of the MIP or availability of the incentives to successive purchasers based on its original tier status.

The act also temporarily raises the maximum amount of total annual liability for grants for agreements entered into in calendar year 2008 under the Job Development Investment Grant Program from fifteen million dollars ($15,000,000) to twenty-five million dollars ($25,000,000).

Supplemental PEG Support.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-148	**SB 1716**	**Senator Clodfelter**

AN ACT TO CLARIFY THE DISTRIBUTION OF SUPPLEMENTAL PEG SUPPORT FUNDING AND TO CLARIFY THAT THE SERVICE AREA OF A CITY INCLUDES ANY AREA SUBSEQUENTLY ANNEXED BY THAT CITY.

OVERVIEW: This act does the following:

- It clarifies the distribution of supplemental PEG channel support funding. This part of the act was a recommendation of the Revenue Laws Study Committee, the League of Municipalities, and the Southeast Association of Telecommunications Officers and Advisors.
- It amends the video franchising statutes to clarify that, if the stated boundary of a cable service district is the boundaries of a city, the service area includes any subsequent annexations by the city.

FISCAL IMPACT: This act is expected to have no fiscal impact on General Fund revenues.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 2, 2008, and affects distributions made in fiscal year 2008-2009.

ANALYSIS: In 2006, the General Assembly established uniform taxes for video programming services by applying the combined general rate of sales tax to all video programming services and by repealing the authority local governments had to impose a local franchise tax. It preserved the local government revenue stream by distributing part of the sales tax revenues from telecommunications and video programming services to the counties and cities, based on the amount of cable franchise tax imposed during the first six months of fiscal year 2006-2007 plus any subscriber fees imposed during that same period.[92]

Of the revenue distributable to local governments, $2 million a year is allocated for supplemental PEG channel support. A PEG channel is a public, educational, or governmental access channel provided to a county or city. The $2 million allocation is distributed to counties and cities with qualifying PEG channels. The annual amount per qualifying PEG channel is $25,000. A county or city may not receive supplemental PEG channel support for more than three PEG channels. The amount distributed to a county or city as supplemental PEG channel support must be used by it for the operation and support of PEG channels. If the total amount distributed for qualifying PEG channels in a fiscal year is less than $2 million, the Secretary must credit the excess amount to the PEG Channel Fund to be used for matching local grants for PEG channel support.

When the General Assembly considered the legislation in 2006, the available data indicated there would be 36 qualifying PEG channels. For the March 2008 distribution, the Department of Revenue received PEG channel certifications for 276 channels. Some of the discrepancy is believed to be due to confusion on the form used by the Department which may have resulted in some channels being double counted or receiving a distribution when they did not qualify.

The act clarifies the distribution requirements, reduces the number of channels receiving the distribution, and provides that all qualifying PEG channels receive supplemental PEG support funding. The act defines in the distribution statute what constitutes a 'qualifying PEG channel' (a channel with character generated programming that does not exceed 15% of eight hours of scheduled programming and is operated for at least 90 days during the year). A county or city must certify all qualifying PEG channels and allocate the proceeds it receives equally among all of its certified PEG channels. A distribution must be made to the PEG channel within 30 days of the county or city's receipt of the supplemental PEG support revenue. This modifies the prior law, in which a county or city could only receive supplemental funding for three PEG channels. These changes address the concerns of some qualifying PEG channels regarding whether supplemental funding is being distributed fairly among the channels by ensuring (i) that each qualifying PEG channel receives supplemental funding, even if a county or city has more than three qualifying channels; (ii) that each qualifying PEG channel receives an equal amount of funding; and (iii) that each qualifying PEG channel receives the funding in a timely manner.

The act also defines a PEG channel operator, requires a county or city to include the name of the PEG channel operator for each qualifying PEG channel it certifies, and requires the

[92] The purpose of using the 'first six months of fiscal year 2006-2007' was to capture the most recent local franchise tax rates imposed on cable companies and the most recent subscriber fees imposed on consumers of cable service.

county or city to distribute the proceeds to the PEG channel operator. This change better ensures that the money is distributed by the local government for the use of the PEG channels. In addition, where a single PEG channel has more than one operator or the PEG channel is claimed by more than one local government, the change ensures that the funds go to the operator of the PEG channel. It limits a PEG channel operator from being included in multiple certifications for the same PEG channel, which should reduce the number of qualifying PEG channels by eliminating much of the double counting that currently occurs. The act also provides a method to account for revenues that are distributed in error by requiring any county or city that received a distribution in error to submit a revised certification and return all funds received in error. Such funds are added to the amount to be distributed in the following year as supplemental PEG support funding.

Finally, the act allows the Secretary of Revenue to request additional information and extends from July 15, 2008, to September 15, 2008, the period of time a county and city has to make its certification in 2008. The act permits the Department to make the distribution of supplemental PEG channel support for the quarter ending June 30, 2008, based upon the qualifying PEG channel certifications in effect for fiscal year 2007-2008 distributions.

The Senate added a provision to the enacted legislation to address an issue with the video franchising statutes. The act amends the video franchising statutes to clarify that, if the stated boundary of a cable service district is the boundaries of a city, the service area includes any subsequent annexations by the city. Prior law was interpreted as requiring a new notice of franchise to be filed for the newly annexed area. The act requires a new filing only if the original notice of franchise stated that the boundaries of the service area were the boundaries of the city, as those boundaries existed on a day certain.

Sales Tax Refund for Certain Nonprofits.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-154	**HB 2509**	**Representative Gibson**

AN ACT TO AUTHORIZE A SEMIANNUAL SALES AND USE TAX REFUND TO A NONPROFIT ORGANIZATION THAT PROCURES, DESIGNS, CONSTRUCTS, OR PROVIDES FACILITIES TO A CONSTITUENT INSTITUTION OF THE UNIVERSITY OF NORTH CAROLINA.

OVERVIEW: This act allows a semi-annual refund of sales and use taxes paid by a nonprofit organization that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina.

FISCAL IMPACT: The act is estimated to reduce General Fund revenues by more than $1.5 million in fiscal year 2008-2009 and by approximately $450,000 in each year thereafter. The act will also reduce local revenues by $810,000 in fiscal year 2008-2009 and by approximately $190,000 each year thereafter. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective retroactively to January 1, 2004, and applies to purchases made on or after that date. A refund claim for the period January 1, 2004 through December 31, 2007, will be considered timely filed if it is submitted to the Department of Revenue by October 15, 2008.

ANALYSIS: Direct purchases by a State agency, which by definition includes The University of North Carolina, may be exempt from State and local sales and use tax.[93] A State agency may also receive a quarterly refund of local sales and use taxes paid by it indirectly on building materials, supplies, fixtures, and equipment that become part of a facility owned or leased by the agency.[94] This act provides similar sales and use tax treatment to a nonprofit entity that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina[95] by expanding the list of nonprofit organizations allowed a semi-annual refund of sales and use tax to include this type of nonprofit organization. The act specifically allows the refund to an entity exempt from taxation as a disregarded entity of such a nonprofit organization.

The act provides a refund to a type of nonprofit entity that was denied a sales tax refund from the Department of Revenue in 2004 on the grounds that the nonprofit organization did not qualify as one of the statutorily eligible entities.[96] One such entity, Affinity Housing LLC, filed a lawsuit against the Department challenging the Department's denial of its refund claim. Affinity Housing LLC is a single-member LLC of Western Carolina University Research and Development Corporation, a section 501(c)(3) nonprofit entity formed to aid and promote the educational and charitable purposes of Western Carolina University. Affinity Housing LLC constructs housing facilities for WCU. The act makes the application of the change retroactive to January 1, 2004, and applicable to purchases made on or after that date. This time period will allow Affinity Housing LLC to receive the refund it originally sought.

Constituent institutions of The University of North Carolina have begun to use nonprofit organizations to procure, design, and construct facilities, such as student housing and dining facilities, on their behalf. An institution leases property to a nonprofit organization and the nonprofit organization constructs the facility on the property. The institution leases the facility from the nonprofit and usually operates and manages the facility. The lease payments made by the institution, recouped through rents charged to students, enable the nonprofit to pay the indebtedness on the facility. At the conclusion of the lease and the retirement of the debt, the ownership of the facility lies with the institution. The General Assembly recognized the trend in 2004 when it expanded the property tax exemption for educational property[97] by exempting property held by a nonprofit entity for the sole benefit of a university located in the State and by expanding the definition of educational purposes to include the operation of a student housing facility or a student dining facility.[98]

---

[93] G.S. 105-164.13(52).

[94] G.S. 105-164.14(e).

[95] A constituent institution would include the universities as well as the North Carolina School of the Arts and the North Carolina School of Science and Mathematics. See G.S. 116-4.

[96] See analysis of Section 28.22 of S.L. 2008-107. It specifies the type of nonprofit entities entitled to a sales and use tax refund. The nonprofit entity described in this act does not meet the criteria developed by that act.

[97] G.S. 105-278.4

[98] S.L. 2004-173

The above process has continued to evolve. The institutions have found that privatized facility projects cost less to construct and are completed sooner than traditional facility projects, primarily because the projects are not subject to the State's bidding laws and construction process. At its inception, some of the financing was private financing. Increasingly, the financing is secured through self-liquidating revenue bonds. Today, most of these projects are included in the bond projects submitted to the General Assembly for its approval by The University of North Carolina. The Treasurer's Office exercises oversight of the lease agreements between the institutions and the nonprofit entities.

Resale of Tickets via Internet.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-158	**SB 1407**	**Senator Hartsell**

AN ACT TO PROTECT CUSTOMERS WHEN PURCHASING TICKETS VIA THE INTERNET AND TO PROHIBIT THE USE OF SOFTWARE TO UNFAIRLY PURCHASE TICKETS OVER THE INTERNET.

OVERVIEW: The act allows the Internet resale of admission tickets in excess of the price printed on the ticket unless the venue where the event occurs prohibits resale, and it prohibits the use of software to unfairly purchase tickets.

FISCAL IMPACT: No fiscal impact estimate is available at this time.

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 3, 2008, and expires June 30, 2009. Liability and duty to report are not affected by the expiration date of the act.

ANALYSIS: Under current law, it is a Class 2 misdemeanor for a seller or reseller of an admission ticket to charge more than "...the combined face value of the ticket, tax,[99] and the authorized service fee.[100] Because reselling tickets online is a new and growing business, the act provides an exception to the prohibition against admission tickets being resold on the Internet at a price greater than the price printed on the face of the ticket.

The act includes a number of provisions designed to protect the customer and the venue. First, the act makes it an unfair and deceptive trade practice for a person to knowingly sell, give, transfer, use, distribute, or possess software that is primarily designed or produced for the purpose of interfering with the operation of a ticket seller who, pursuant to a written agreement with the venue, sells admission tickets over the Internet. A ticket seller, as well as the venue, has standing to bring a private right of action under the Unfair and Deceptive Trade Practice Act. Under G.S. 75-1.1, each individual violation of the statute constitutes a

---

[99] The tax on the sale of admission prices for entertainment events is a gross receipts tax of 3%. See G.S. 105-37.1.

[100] The service fee is limited to no more than $3.00 unless the promoter of the event and the ticket sales agency, in writing, agree to and make known to the public a different amount.

separate violation. If a person is found to have violated the statute, the aggrieved person is entitled to treble the amount of damages fixed by the verdict. The act requires a person who resells admission tickets to report to the Department of Revenue by the 10th day after the end of each month on the gross receipts received during the previous month from reselling admission tickets for events in the State. The report must include the total amount of gross receipts derived from resell activity (minus the face value on the tickets), the event and venue for which each ticket was sold, the entity from which the reseller purchased each ticket, the amount the reseller paid for each ticket, the price received by the reseller for each ticket, the name and address of reseller-purchasers of each ticket, and any other information required by the Department.

In addition, the act requires a person who resells admission tickets online to provide a ticket guarantee that must be conspicuously displayed on the person's Website and to direct a prospective purchaser to the ticket guarantee before completion of a resale transaction. Additionally, the ticket guarantee must provide a purchaser with a full refund of the amount paid for the ticket if the event is cancelled, the purchaser is denied admission through no fault of the purchaser, or the ticket is not delivered to the purchaser and the failure to receive the ticket results in the purchaser's inability to attend the event. A person may withhold handling and delivery fees from a refunded amount if the Website informs the purchaser of this policy. Finally, a venue may prohibit a person from reselling tickets to an event it sponsors if it files a notice of prohibition with the Secretary of State and posts the notice on its Website and on the Website of the primary ticket seller. A prohibition may not become valid until 30 days after the notice is posted on the Website. The prohibition expires on December 31 of each year unless the venue renews its prohibition.

The bill, as originally introduced in the Senate, provided for the imposition of a 3% gross receipts privilege tax on the difference between the price of the ticket sold and the face price on the ticket.[101] This provision was deleted from the bill when the bill was in the House Finance Committee. The sunset date will necessitate the General Assembly revisiting this issue during the 2009 Session.

Future Conveyances/Special Assessments.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-165, as amended by S.L. 2008-187	**HB 1770**	**Representative McComas**

AN ACT TO CLARIFY THE AUTHORITY OF THE PARTIES TO CONSERVATION AND PRESERVATION AGREEMENTS TO INCLUDE PROVISIONS IN THE AGREEMENTS FOR THE PAYMENT OF FEES UPON FUTURE CONVEYANCE OF PROPERTY SUBJECT TO THE AGREEMENTS AND TO ALLOW SPECIAL ASSESSMENTS TO BE PAID IN MORE THAN TEN ANNUAL INSTALLMENTS AND TO BE PLEDGED TO THE

[101] The gross receipts tax is currently imposed on the face price of the ticket when it is originally sold.

REPAYMENT OF REVENUE BONDS ISSUED FOR CRITICAL INFRASTRUCTURE NEEDS.

OVERVIEW: Sections 2 and 3 of this act give counties and cities an opportunity to finance long-term capital projects related to water and sewer infrastructure, stormwater infrastructure, public transportation, schools, and roads through the issuance of revenue bonds that will be paid by levying special assessments on the affected properties. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: There is no impact on General Fund revenues.

EFFECTIVE DATE: These sections became effective when signed into law by the Governor on August 3, 2008, and expire on July 1, 2013. The expiration does not affect the validity of assessments imposed or bonds issued or authorized under the provisions of this act prior to the effective date of the expiration.

ANALYSIS: Sections 2 and 3 of this act give counties and cities an opportunity to use assessments as a financing tool for long-term capital projects related to water and sewer infrastructure, stormwater infrastructure, public transportation, schools, and roads. The act accomplishes this goal by enacting new articles within Chapter 153A and Chapter 160A supplementing the current authority counties and cities have to levy assessments and issue revenue bonds.[102] Counties and cities will be able to pay for a project for which an assessment is imposed solely with revenue bonds to be paid from the assessments or from a combination of financing sources that include revenue bonds, general obligation bonds, and general revenue. This change will particularly aid counties and cities that face increased demands for infrastructure improvements as a result of rapid growth and development. The act gives counties and the cities located within the counties the authority to impose assessments for the following projects:

- Providing sanitary sewer systems, including community sewerage facilities for the collection, treatment, and disposal of sewage or septic tank systems and other on-site collection and disposal facilities or systems.
- Providing storm sewers and flood control facilities, including levees, dikes, diversionary channels, drains, catch basins, and other facilities for storm water drainage.
- Providing water systems, including facilities for the supply, storage, treatment, and distribution of water.
- Providing public transportation facilities, including equipment for public transportation, buses, surface and below ground railways, ferries, and garage facilities.
- Providing school facilities, including schoolhouses, buildings, plants and other facilities, physical and vocational educational buildings and facilities, including in connection therewith classrooms, laboratories, libraries, auditoriums, administrative offices, gymnasiums, athletic fields, lunchrooms, utility plants, garages, and school buses and other necessary vehicles.

[102] See Article 9A of Chapter 153A (Counties) and Article 10A of Chapter 160A (Cities and Towns) of the act.

- Providing streets and sidewalks, including bridges, viaducts, causeways, overpasses, underpasses, and alleys; paving, grading, resurfacing, and widening streets; sidewalks, curbs and gutters, culverts, and drains; traffic controls, signals, and markers; lighting; and grade crossing and the elimination thereof and grade separations.

The governing body of a county or city may not impose assessments under the new articles unless it receives a petition for the project to be financed through assessments signed by at least a majority of the owners of the property assessed. The county board of commissioners or city council must establish an assessment method that will most accurately assess property according to the benefits conferred upon it by the project for which the assessment is made. In establishing the assessment method, the county board of commissioners or city council must first determine the project's total estimated cost, and a preliminary assessment roll may then be prepared before the costs of the project are incurred based on the estimated cost of the project.[103] Unlike assessments currently imposed under Article 9 of Chapter 153A and Article 10 of Chapter 160A, the cost of assessments imposed for these infrastructure projects may include any expenses allowed under the State and Local Government Revenue Bond Act. The primary expense allowed under the Revenue Bond Act that is not considered under Article 9 and Article 10 is interest on the bonds or notes issued in anticipation of the revenue bond issuance during construction and an establishment of debt service reserves. Also, unlike assessments the county or city may currently impose, assessments issued for long-term infrastructure projects under the act must be paid in annual installments over a period not to exceed 30 years.[104] These annual payments are due on the date property taxes are due.

In addition to other financing tools available for infrastructure projects, the act provides that an infrastructure project for which an assessment may be imposed under the new articles may be considered a revenue bond project for purposes of the State and Local Government Revenue Bond Act, and that the assessments imposed under the new articles may be considered revenues for purposes of the Act. All of the provisions governing revenue bonds in Article 5 of Chapter 159 apply to the new articles. To issue revenue bonds, a county or city must first apply to the Local Government Commission (LGC) for approval of the revenue bond issue. The State and Local Government Revenue Bond Act sets forth the matters the LGC must consider before giving a county or city approval to issue revenue bonds. It must determine that the proposed revenue bond issue is necessary, that the amount proposed is adequate and not excessive, that the proposed project is feasible, that the county's or city's debt management procedures and policies are good, and that the proposed revenue bonds can be marketed at reasonable interest costs.

Except as otherwise provided under these new articles, the provisions for imposing special assessments under Article 9 of Chapter 153A and Article 10 of Chapter 160A apply to the special assessments imposed under these new articles. Under Article 9 and Article 10, when a county or city decides to finance all or part of a project by special assessments, it must first adopt a preliminary assessment resolution that describes the project, the proposed basis for making the assessment, and information concerning the cost of the work and the terms of

---

[103] Sections 47.5.(a) and (b) of S.L. 2008-187, the 2008 technical corrections bill, clarify that a preliminary assessment roll may be prepared based on the estimated cost of the project, corrects a statutory reference, and adds a phrase that was inadvertently omitted.

[104] Assessments under Articles 9 and 10 must be paid in full unless the county or city provides that they may be paid in annual installments, which may not be more than 10 years.

payment of the assessment. If the basis for making the assessment is either the area of land benefited by the project or the valuation of the land benefited by the project, then the resolution must contain a description of the boundaries of the area benefited. The county or city must hold a public hearing on the matter, prepare a preliminary assessment roll, and publish a confirmation of the assessment roll once it is adopted. An owner of property against which an assessment is made may file a notice of appeal to the General Court of Justice if the owner is dissatisfied with the amount of the assessment. Unpaid assessments bear interest at a rate fixed in the assessment resolution. A county or city may foreclose assessment liens under procedures provided by law for the foreclosure of property tax liens.

Wildlife Land Property Tax Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-171	**HB 1889**	**Rep. Harrison, Gibson, Hill, Brubaker**

AN ACT TO PROVIDE PROPERTY TAX RELIEF FOR QUALIFYING WILDLIFE CONSERVATION LAND, TO CLARIFY THE PRESENT-USE VALUATION OF PROPERTY SUBJECT TO A CONSERVATION EASEMENT, AND TO PROVIDE A PROPERTY TAX EXEMPTION FOR LEASEHOLD INTEREST IN CERTAIN EXEMPTED PROPERTY.

OVERVIEW: This act does three things:

- It designates wildlife conservation land as a special class of property for property tax purposes and provides that it may be appraised and taxed as if it were classified as agricultural land under the present-use value system. This part of the act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2010.
- It provides that property appraised at its present-use value will continue to qualify for present-use value when the owner donates the property for conservation purposes so long as the property is subject to a conservation easement that qualifies for the conservation income tax credit for donated lands and the owner received no more than 75% of the fair market value of the donated property as compensation. This part of the act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2010.
- It exempts from property tax a leasehold interest in property if the property itself is exempt from property tax because it is owned by a unit of government and the property is used to provide affordable housing for employees of the unit of government that owns the property. This part of the act became effective for taxes imposed for taxable years beginning on or after July 1, 2008.

FISCAL IMPACT: The fiscal impact of this act will affect local government revenues. The North Carolina Wildlife Commission has indicated that no reliable data is available regarding

the number of acres that may qualify for the wildlife conservation classification; therefore, no estimate is available for this part of the act. The difference in the assessed value of property subject to a conservation easement and property in the present-use value program do not significantly differ; therefore this part of the act is expected to have minimal impact. Lastly, the act provides a property tax exemption for certain leasehold interests in exempt property. At the present time, Dare County is the only county that has property that will be impacted by this change and the impact is expected to be minimal.

EFFECTIVE DATE: See the **OVERVIEW**.

ANALYSIS: The act establishes a new property tax classification for property used for wildlife conservation and values that property at its value as agricultural land rather than its fair market value. It clarifies the present-use valuation of property subject to a conservation easement, and it exempts from property tax a leasehold interest in certain property used to provide affordable housing.

Wildlife Conservation Land. – Since 1973, the General Assembly has provided special property tax treatment for farmland that is classified and used for agricultural, horticultural, or forest purposes. If the farmland meets certain ownership and size requirements and is engaged in commercial production under a sound management program, the land may be appraised and taxed at its present-use value (PUV) as opposed to its fair market value. Agricultural land and horticultural land must also meet an income requirement: the land must have one tract that produced at least $1,000 average gross income over the three preceding years. The difference between the taxes due on the PUV and the taxes that would have been payable in the absence of the special tax treatment are known as deferred taxes. When the land becomes disqualified for PUV, the land is taxed at its fair market value for the year in which it loses its classification and the deferred taxes for the three previous years become due and payable, with interest.

During the 2007 session, the General Assembly extended PUV treatment and classification to land used as an aquatic species farm[105] and to working waterfront property.[106] This act extends PUV treatment to property used for wildlife conservation. To be eligible for this classification, the property must meet the following size, ownership, and use requirements:

- **Size.** – The land must consist of at least 20 contiguous acres. An owner may not classify more than 100 acres of land as wildlife conservation land within a county.
- **Ownership.** – The land must be owned by an individual, a family business entity[107] or a family trust[108] and it must have been owned by the same owner for the previous five years. Land owned by a business entity[109] is not eligible for PUV classification if

---

[105] Part III, S.L. 2007-497.

[106] Part I, S.L. 2007-485.

[107] A family business entity is defined as a business entity whose members are, directly or indirectly, individuals and relatives. An individual is indirectly a member of a business entity if the individual is a member of a business entity or a beneficiary of a trust that is part of the ownership structure of a business entity.

[108] A family trust is defined as a trust that was created by an individual and whose beneficiaries are, directly or indirectly, individuals who are the creator of the trust or a relative of the creator. An individual is indirectly a beneficiary of a trust if the individual is a beneficiary of another trust or a member of a business entity that has a beneficial interest in the trust.

[109] A business entity is defined as a corporation, a general partnership, a limited partnership, or a limited liability company.

the business entity is a corporation whose shares are publicly traded or one of its members is a corporation whose shares are publicly traded. The act provides these exceptions to the ownership requirements:

- The 5-year time period is considered met if the land has been owned by a member of the family business for five years or if owned by a beneficiary of the family trust for five years.[110]
- The 5-year time period is waived if the property acquired was classified as wildlife conservation land in the hands of the previous owner and the current owner continues to use the land as wildlife conservation land. To classify property under this exception, the new owner must file an application for PUV and must sign the wildlife habitat conservation agreement in effect for the property within 60 days after acquiring it.

- **Use.** – The land must meet both of the following use requirements:
  - The land is managed under a wildlife habitat conservation agreement[111] with the North Carolina Wildlife Resources Commission and the agreement is in effect as of January 1 of the year for which the benefit is claimed. The agreement must require the owner to manage the land to protect an animal species that lives on the land and is on a North Carolina protected animal list published by the Commission[112] or to conserve one of the following priority animal wildlife habitats: longleaf pine forest, early successional habitat, small wetland community, stream and riparian zone, rock outcrop, or bat cave.
  - The land must have been classified as either agricultural, horticultural, or forest land under the PUV classification when the wildlife conservation agreement was signed. This requirement may be waived if the owner can demonstrate to both the Wildlife Resources Commission and the county tax assessor that the owner used the land for a purpose specified in the signed wildlife conservation agreement for three years preceding the year for which the benefit of this special tax treatment is desired.

Property classified as wildlife conservation property under the PUV system loses its eligibility for the special tax treatment whenever it fails to meet one or more of the size, ownership, and use requirements. The owner of property classified as wildlife conservation

---

[110] These are the PUV ownership changes enacted in S.L. 2008-146. The members of a business entity would no longer be restricted to individuals but would include trusts and other business entities as long as a member was not a corporation whose shares are publicly traded and none of its members are corporations whose shares are publicly traded.

[111] The North Carolina Wildlife Resources Commission does not currently have a wildlife habitat conservation agreement. It will develop this agreement.

[112] The North Carolina Wildlife Action Plan, developed in compliance with a Congressional mandate, was submitted in 2005 to provide a conservation blueprint to advance the sound management of fish and wildlife resources in the future. The Plan identifies fish and wildlife resources and priority conservation needs associated with those resources. There are currently about 12 identified priority wildlife habitats in the State. There are a number of federally-listed threatened or endangered animal species and State listed animal species. There are also State and federal natural resource management plans for which wildlife habitat is its primary objective, such as Forest Stewardship, Cooperative Upland Habitat Restoration and Enhancement Program (CURE), and Wildlife Habitat Incentives Program. Link to North Carolina State and Federally listed wildlife species: www.ncwildlife.org/fs_index_07_conservation.htm

property must notify the county assessor whenever there is a change in the size, ownership, or use of the property that necessitates a review of the exclusion. An owner who fails to do so is subject to a penalty equal to 10% of the amount of the deferred taxes and interest for each listing period that the owner fails to report.[113]

As with other property in the PUV classification, property that loses its eligibility for the classification will be taxed at its fair market value for the year in which it loses its eligibility and the deferred taxes for the three previous years will become due and payable, with interest. The act provides several exceptions to this rule:

- No deferred taxes are due, and the lien for deferred taxes is extinguished, when the owner conveys the property by gift to a nonprofit organization for educational and scientific purposes as a protected natural area or for nonprofit historic preservation purposes; or to the State, a political subdivision of the State, or the United States.
- No deferred taxes are due, but the deferred taxes remain a lien on the property, when the property reverts back to its original farmland use under the PUV program. This exception requires that the property was previously classified under the PUV program and that the ownership of the property does not change. Similarly, no deferred taxes are due on property originally classified as farmland if the property is reclassified as wildlife conservation land.[114]
- No deferred taxes are due, but the deferred taxes remain a lien on the property, when the property is transferred to an owner who signs the wildlife habitat conservation agreement in effect for the land at the time of the transfer and the land remains classified as wildlife conservation property.[115]

The issue of classifying wildlife conservation property as a special class of property whose value may be partially excluded from taxation has been discussed for several years. This part of the act represents the collaborative work of representatives from the North Carolina Association of County Commissioners, various conservation groups, county tax assessors, the Forestry Association, the Wildlife Resources Commission, and the North Carolina Farm Bureau. The act directs the Revenue Laws Study Committee to study the three-year impact of the wildlife conservation land classification and its fiscal impact on local governments. The Committee is to report its findings to the 2015 General Assembly.

Land Subject to a Conservation Easement. – North Carolina provides an income tax credit to individual and corporate taxpayers who donate an interest in real property for conservation purposes to the State, a local government, or a body that is organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions.[116] The property tax value determination of property subject to a conservation

---

[113] G.S. 105-282.1 requires an owner of any property eligible to be exempted or excluded from property tax to notify the county tax assessor of any change in the property's value or property's eligibility for the exemption or exclusion.

[114] See Section 5 of the act.

[115] This exception to the payment of the deferred taxes coincides with the waiver of the 5-year ownership requirement when the property acquired was classified as wildlife conservation land in the hands of the previous owner and the current owner continues to use the land as wildlife conservation land.

[116] The property interest must be donated in perpetuity and be useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, forestland or farmland conservation, watershed

easement must take into consideration the advantages and disadvantages of the conditions of the easement on the market value of the property. In some instances, the value of property subject to an easement is greater than the value that property would be if it was classified as farmland under the PUV program.

Prior to 2002, property classified within the PUV program that became subject to a conservation easement lost its PUV assessment because the property could no longer meet the use and income-producing requirements for PUV classification. Whenever property becomes ineligible for the program, the current year's taxes, as well as the three years of deferred taxes, become due and payable. In 2002, the General Assembly created an exception to the use and income-producing requirements for PUV by allowing property subject to a conservation easement to remain in the PUV program.

The Property Tax Division within the Department of Revenue interprets this exception to the PUV program narrowly to allow property to remain in the program only when the entire conservation easement is donated. In contrast, the Income Tax Division within the Department has allowed an income tax credit for any percentage of the easement value that is donated. For example, if a taxpayer donates an easement for conservation purposes to the State valued at $100,000 and receives $60,000 for the easement, the taxpayer has donated an easement worth $40,000. The taxpayer is then allowed an income tax credit equal to 25% of the donated value, or $10,000. However, because the taxpayer received some compensation for the easement, the property becomes ineligible for special property tax treatment under the PUV program. This act specifies that property may remain in the PUV program as long as it is subject to an enforceable conservation easement and the taxpayer received no more than 75% of the fair market value of the donated property interest in compensation. This part of the act becomes effective for taxable years beginning on or after July 1, 2010.

Property Tax Exemption of Certain Leasehold Interests. – This act exempts from property tax a leasehold interest in exempt property, effective for taxes imposed for taxable years beginning on or after July 1, 2008, if the following two conditions are met:

- The property itself is exempt from property tax because it is owned by a unit of government.
- The property is used to provide affordable housing for employees of the unit of government that owns the property.

An example of this property tax exemption is the leasehold interest of the Dare Education Foundation in property that is exempt in the hands of its owner, the Dare County Board of Education and used to provide affordable housing for teachers. An application for this exemption is timely if filed on or before September 1, 2008. Prior to this change, a leasehold interest in exempted property was subject to property tax.

---

protection, conservation of natural areas, conservation of natural or scenic rivers areas, conservation of predominantly natural parkland, or historic landscape conservation.

UNC Nonapp. Cap. Projects/Airport Authority.

Session Law	Bill #	Sponsor
S.L. 2008-204	SB 1925	Senator Kerr

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS OF THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA; TO REVISE UNIVERSITY GENERAL OBLIGATION INDEBTEDNESS; TO ALLOW THE UNIVERSITY OF NORTH CAROLINA TO CREATE AIRPORT AUTHORITIES TO SUPPORT THE MISSION OF THE UNIVERSITY, ITS CONSTITUENT INSTITUTIONS, OR THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM; TO AUTHORIZE THE STATE EDUCATION ASSISTANCE AUTHORITY TO SET THE INTEREST RATE FOR THREE SCHOLARSHIP LOAN PROGRAMS AT A RATE NOT TO EXCEED TEN PERCENT PER ANNUM; AND TO MODIFY THE RESPONSIBILITIES OF THE NORTH CAROLINA FEDERAL TAX REFORM ALLOCATION COMMITTEE.

OVERVIEW: This act does the following:

- Authorizes the construction of numerous projects by The University of North Carolina using revenue bonds and special obligation bonds.
- Revises a UNC Bond Project from the 2000 Higher Education Bond Program by reducing a portion of the 2000 general obligation bond issuance for 'Berryhill Laboratory Building' at UNC-Chapel Hill by $8.6 million and using the money to fund a new project, 'Division of Laboratory Animal Medicine – Upfits'.
- Exempts the purchase, construction, and operation of capital facilities by Gateway University Research Park, Inc., a joint Millennial Campus in Greensboro, from the procurement provisions required for capital facilities financed through the State Capital Facilities Financing Act, except for the procurement provisions in Article 8 (Public Contracts) of the Act.
- Authorizes the Board of Governors to create one airport authority in Orange County for the sole purpose of resiting and operating the Horace Williams Airport. The authorized airport authority must support the mission of the University of North Carolina at Chapel Hill or the University of North Carolina Health Care System.
- Authorizes the State Education Assistance Authority to set the interest rate for three scholarship programs in an amount not to exceed 10% a year instead of the current fixed rate of 10%.

- Allows North Carolina to issue tax-exempt qualified educational facility bonds, the proceeds of which are used by a private for-profit corporation that has entered into a public-private partnership agreement with a local school administrative unit to construct, rehabilitate, refurbish, or equip an elementary or secondary public school.

FISCAL IMPACT: There is no impact on General Fund revenues. The self-liquidating projects are financed with funds available to the institutions from gifts, grants, receipts, self-liquidating indebtedness, or other funds or a combination of these funds, but not including funds received for tuition or appropriated from the General Fund. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except at otherwise specified, this act became effective when signed into law by the Governor on August 8, 2008.

ANALYSIS:

Part I: Self-Liquidating Projects

Each year the University of North Carolina requests legislative authorization for needed capital projects at its constituent or affiliated institutions. These projects are funded by two types of self-liquidating bonds that may be issued by the University's Board of Governors.[117] Section 1.2 of the act authorizes 31 projects on nine campuses.[118] The Chancellors and Boards of Trustees for the listed campuses, as well as the President and the Board of Governors have approved these projects. Construction of these projects is expected to begin before June 30, 2009. The maximum principal amount of bonds to be issued for the projects will not exceed the specified costs of the projects plus $25 million for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest. Section 1.3 of the act authorizes planning money for five projects on three campuses. Sections 1.6 and 1.9 of the act exempt the following projects from the statutory requirement regarding location of special obligation projects: UNC-Chapel Hill's Research Resource Facility – Phase III capital project, UNC-Chapel Hill's Cogeneration and Steam Infrastructure Improvement and Expansion capital project, ECU's Athletic Facilities Expansion and Improvement capital project, and NCSU's Avent Ferry Administration Center Renovation capital project. Sections 1.7 and 1.8 of the act authorize UNC-Chapel Hill and Appalachian State University to construct and finance the expansion and renovation of their football stadiums through lease arrangements to and from a third party. Once constructed and approved by the State reviewing agencies, these improvements would transfer to the State. Section 1.7 of the act also provides that after the property is transferred to the State, UNC-Chapel Hill may provide for the operation and maintenance of the facilty through a contractual or lease agreement with a third party.

Part II: Revise University General Obligation Indebtedness

---

[117] Article 21 of Chapter 116 of the General Statutes authorizes the Board to issue revenue bonds for educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. These revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility but not from tax revenues. Article 3 of Chapter 116D of the General Statutes authorizes the Board to issue special obligation bonds payable with any sources of income or receipts of the Board or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund. These bond proceeds can be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions.

[118] These projects include academic, research, clinical and administrative space and improvements to student services, residential living, dining, recreation, and athletic facilities.

This part of the act modifies a UNC bond project authorized in the 2000 Higher Education Bond Program by transferring up to $8.6 million of the 2000 bond funding for the Berryhill Hall Laboratory Building to a related project called 'Division of Laboratory Animal Medicine – Upfits'. Berryhill Hall is the primary education building for the UNC School of Medicine. The Hall is not large enough to support the planned enrollment expansion in the medical program. UNC-Chapel Hill will recommend replacement of Berryhill Hall and seek needed funding in the future. The new project, Division of Laboratory Animal Medicine – Upfits, will use the balance of the Berryhill Hall renovation funds to renovate other related teaching and research support space in existing campus facilities. These renovated facilities will provide the necessary space for those displaced during the construction of the new medical education building and future projects.

Part III: Procurement Modifications

This part of the act removes the purchase, construction, and operation of capital facilities by Gateway University Research Park, Inc. (hereinafter Gateway) from all procurement provisions required for capital facilities financed through the State Capital Facilities Financing Act, except for those provisions in Article 8 of the Act.[119] Article 8 requires separate contract specifications, adherence to minority business participation goals, and bidding requirements. Gateway is a 501(c)(3) organization controlled by North Carolina A & T and UNC-G to manage construction projects at the Gateway University Research Park, a joint millennial campus created by the Board of Governors. This statutory change codifies Gateway's authority to manage construction projects in accordance with Gateway's Management Services and Development Agreement with North Carolina A & T and UNC-G and its Ground Lease Agreement with the State approved by the Council of State in 2007. The change to G.S. 142-94 allows Gateway to continue to follow its streamlined bidding and procurement process for construction of all facilities located on the Joint Millennial Campus. This process is explicitly described and included in the Ground Lease Agreement, which also incorporates substantial oversight protections. Currently, this statutory change affects two projects.

Part IV: Allow the University of North Carolina to Create an Airport Authority

This part of the act establishes a new article in Chapter 116 of the General Statutes authorizing the Board of Governors to create one airport authority in Orange County for the sole purpose of resiting and operating the Horace Williams Airport.[120] The airport authority must support the mission of UNC-Chapel Hill or the UNC Health Care System. Horace Williams Airport is a university-owned airport that opened in 1940. The Airport is the hub for planes serving the North Carolina Area Health Education Centers (AHEC) Program based in the UNC School of Medicine. AHEC transports UNC medical faculty across the State to provide specialty clinics and educational programs in underserved areas. The Airport also houses private planes. As early as 2002, the University announced plans to close the Airport and use the site for a planned satellite research campus, Carolina North. After much debate among the University, the Town of Chapel Hill, supporters of AHEC, and private pilots, the General Assembly authorized the Board of Governors to create the airport authority.

---

[119] G.S. 142-94 of Article 9, Chapter 142.

[120] Article 13 of Chapter 116 (Higher Education) of the General Statutes.

An airport authority authorized by the Article must consist of 15 appointed members and may be created to support the mission of UNC-Chapel Hill, one constituent institution and the UNC Health Care System, or the UNC Health Care system. In August, the Board of Governors decided to create an airport authority to support the mission of the constituent institution, UNC-Chapel Hill, and the University of North Carolina Health Care System. Pursuant to the Article, the 15 appointed members must consist of the following: one member appointed by the General Assembly upon the recommendation of the Speaker of the House, one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate, eight members appointed by the Board of Governors (four members upon the recommendation of the UNC-Chapel Hill Board of Trustees and four members by the UNC Health Care System), three members appointed by the Orange County Board of Commissioners, and one member appointed by the Chapel Hill Town Council. No member of the General Assembly may serve on an airport authority created under the Article.

The general powers of an airport authority created under the Article include the following: powers that a city or county has over airports; powers regarding financing capital expenditures and operations that are delegated to or conferred upon constituent institutions or the UNC Health Care System; to sue and be sued; to establish, operate, and maintain an airport; to expend funds for these purposes; to lease property; to receive a sales tax refund; to borrow money; and to acquire property by eminent domain, except over property held on July 1, 2008 by a 501(c)(3) organization organized for educational purposes. If regulations adopted by the airport authority and development regulations adopted by Orange County or a municipality in the County apply to land owned by and the approaches to land owned by the airport authority, then the more restrictive regulations apply.

If the airport authority created under the Article ceases its operation, then the title to the authority's property shall vest in The University of North Carolina. The proceeds of the sale of the property must first be distributed pro rata to the constituent university member or to the UNC Health Care System for reimbursement purposes.

Part V: Interest Rate for Scholarship Loan Programs[121]

This part of the act authorizes the State Education Assistance Authority (SEAA) to set the interest rate for the following three scholarship programs at a rate not to exceed 10%: the Nursing Scholars Program, the Graduate Nurse Scholarship Program for Faculty Production, and Principal Fellows Program. A loan under each of these scholarship programs is a free grant if the student fulfills the service commitment, and the intent of the loan is for the recipient to serve the State as opposed to repaying in cash. This part of the act becomes effective January 1, 2009, and applies to loans issued on or after July 1, 2009.

The responsibility for establishing the interest rate for the State scholarship loan programs differs according to the program. In some cases, the SEAA has the responsibility to set the rate, in others, such as these three programs, the interest rate is set by statute at 10%. According to the SEAA, the statutorily set 10% rate has been a promotional obstacle for these scholarship programs because it is significantly higher than federal loan rates, such as

[121] Part V of the act was initially introduced in Senate Bill 1070, which passed the Senate. The substance of SB 1070 was put in Part V of the act, because it did not appear that the bill was eligible for consideration during the Short Session.

the Stafford Loan, which has a rate of 6.8%. The SEAA requested this change to encourage students to apply for the programs. Below are descriptions of the three programs:

- **Nursing Scholars Program** - This program offers scholarship loans of up to $6,500 per year with a maximum of four years per recipient to North Carolina residents interested in preparing to become registered nurses through an associate or baccalaureate degree program. If also offers up to $6,500 per year per recipient for two years of study leading to a master of science in nursing. The loan is forgiven if, within seven years after graduation, the recipient practices nursing in North Carolina for one year for each year of aid received. While the statutory maximum was increased to $6,500 in 2006, the current award amounts actually offered are $3,000 per year for applicants pursuing an associates degree or hospital diploma in nursing and $5,000 per year for applicants pursing a bachelor of science degree in nursing.
- **Graduate Nurse Scholarship Program for Faculty Production** – This program offers scholarship loans in the amount of $15,000 per year per recipient for the following: (1) students enrolled in a masters program in nursing education; (2) students enrolled in a doctoral degree program in nursing education; and (3) nursing faculty in the North Carolina Community College System enrolled in a masters degree program in nursing education. The loan is forgiven if, within seven years after graduation, the recipient teaches in a public or private nursing education program in a public or private educational institution in North Carolina for one year for every year of aid received. If the recipient was a nursing faculty member of a community college, the loan will be forgiven if the recipient teaches in a community college nursing education program in North Carolina one year for each year of aid received.
- **Principal Fellow Program** – This program requires, within six years after graduation, a four-year commitment to serve as a school administrator in a North Carolina public school to receive the $30,000 first-year stipend and the second-year loan in the amount of 60% of the beginning salary for an assistant principal plus $4,100 for tuition, fees, and books.[122]

Part VI: Modify TRAC Responsibilities[123]

This part of the act enables North Carolina to issue tax-exempt qualified educational facility bonds, the proceeds of which may be used by a private for-profit corporation that has entered into a public-private partnership agreement with a local school administrative unit to construct, rehabilitate, refurbish, or equip an elementary or secondary public school.

Qualified private activity bonds are tax-exempt bonds[124] issued by a state or local government, the proceeds of which are used for a defined qualified purpose by an entity other than the government issuing the bonds. A qualified private activity bond is secured by the financed project's revenues rather than the full faith and credit of the governmental unit. Qualified private activity bonds enable the private sector to access tax-exempt capital

---

[122] These amounts may be adjusted to take into account increases in tuition, fees, and the cost of books; increases in the State principal assistant salary schedule; and changes in the stipend paid to participants in the program during the second-year internship.

[123] Part VI of the act was initially introduced in Senate Bill 1902, which passed the Senate, and House Bill 2724. The substance of these bills was put in Part VI of the act, because it did not appear that these bills were eligible for consideration during the Short Session.

[124] The interest paid to the bondholder is not includable in their taxable income.

markets, thereby reducing a project's financing costs. Federal law limits the aggregate amount of private activity bonds that may be issued by a state.

In the Economic Growth and Reconciliation Act of 2001, Congress expanded the purpose for which qualified private activity bonds could be issued to include qualified public educational facilities. A qualified educational facility is a public elementary or secondary school owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency. The expansion of a qualified purpose to include educational facilities allows more tax-exempt financing of public school construction. In 2006, the General Assembly enacted legislation to facilitate the building of public school facilities through public-private partnerships.[125] The authorization allowing local school administrative units to use capital lease financing expires July 1, 2011. To date, no school facilities have been financed through this authority.

North Carolina cannot currently avail itself of the use of qualified educational facility bonds because the statutes do not authorize their allocation or issuance. The General Assembly created the North Carolina Federal Tax Reform Allocation Committee in 1987 to manage the allocation of tax exempt private activity bonds and low-income housing credits. This act expands the authority of the Committee to include the allocation and issuance of qualified public educational facility bonds. This legislation, together with the legislation enacted in 2006, provides another financing alternative for public school construction.

Federal law limits an issuing authority to a maximum amount of tax-exempt bonds that may be issued to finance a qualified educational facility to the greater of $5 million or $10 multiplied by a state's population. Based upon North Carolina's population, its 2008 allocation is $90.6 million and its 2007 allocation was $88 million. A state may elect to carry forward the unused bond volume cap for any calendar year for three years following the calendar year in which the unused volume cap arose. This election is made by filing IRS Form 8328. The Treasurer's Office filed a carryforward for 2007. On the effective date of the act, North Carolina had two years of allocation, or approximately $178 million, to allocate for qualified educational facility bonds.

Home Inspector Privilege License.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-206	**HB 2558**	**Representative Ross**

AN ACT TO REQUIRE LICENSED HOME INSPECTORS TO OBTAIN A PRIVILEGE LICENSE.

OVERVIEW: This act imposes a $50 State privilege license tax on individuals licensed under the Home Inspector Licensure Act.

FISCAL IMPACT: The act increases General Fund revenues by $77,000.

[125] S.L. 2006-232, as amended by S.L. 2006-259

EFFECTIVE DATE: This act became effective when signed into law by the Governor, August 9, 2008, and applies to taxable years beginning on or after July 1, 2008.

ANALYSIS: This act imposes an annual State privilege license tax of $50 on an individual licensed under the Home Inspector Licensure Act.[126] The State's privilege license tax is imposed on a fiscal year basis and is due by July 1 of each year. The full amount of the tax applies to a person who, during the fiscal year, begins to engage in an activity for which a privilege license is required. Since the act became effective after July 1, 2008, it includes a provision extending the time in which a person engaged in the business of home inspection has to obtain the required State license for fiscal year 2008-2009, from July 1, 2008, until October 1, 2008.

By imposing a State license tax on this profession, the act repeals the authority of cities to impose a local license tax on this profession.[127] Under the general authority of G.S. 160A-211, several cities impose a privilege license tax on home inspectors. Since many of these cities have already collected the tax for fiscal year 2008-2009, the act specifically authorizes its imposition and collection by those cities for this fiscal year. A city cannot impose a license tax on this profession for fiscal years beginning on or after July 1, 2009.

An individual required to have a State privilege license may not engage in the licensed activity until a license is obtained. To obtain a license, an individual must file a completed application with the Department of Revenue and pay the required tax. An application for a license is considered a return. The license does not of itself authorize the practice of a profession, business, or trade for which a State qualification license is required.

Solid Waste Tax Changes/Unsalable OTP Refund.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-207	**HB 2530**	**Rep. Harrison, T. Harrell, Luebke, Thomas**

AN ACT TO MAKE ADMINISTRATIVE CHANGES TO THE SOLID WASTE DISPOSAL TAX AND TO ALLOW A REFUND FOR ALL UNSALABLE OTHER TOBACCO PRODUCTS.

OVERVIEW: This act does two things:

- It makes changes the Solid Waste Disposal Tax that became effective July 1, 2008.
- It allows a refund of the tax paid on unsalable tobacco products other than cigarettes (OTP).

FISCAL IMPACT: This act is expected to reduce General Fund Revenues by approximately $9,000 annually.

---

[126] Article 9F of Chapter 143 requires home inspectors and associate home inspectors to be licensed. The state privilege license tax imposed under this act applies to both types of licenses.
[127] G.S. 105-42(h).

EFFECTIVE DATE: The provisions allowing a refund of the tax paid on unsalable OTP became effective October 1, 2008, and apply to products returned on or after that date. The remainder of the act became effective when signed into law by the Governor on August 9, 2008.

ANALYSIS: The act makes certain administrative changes to the solid waste disposal tax. First, it clarifies that the tax and the return are due on a quarterly basis. Second, if a third party fails to pay the amount charged for the disposal of waste tonnage and an owner or operator has deducted that amount from gross income as a bad debt, then the owner or operator may deduct the amount of that tonnage if the tax was paid on the tonnage. If the owner or operator is not subject to income tax, the owner or operator may take the deduction when it is determined that the charges are not collectible. Finally, the act excludes a city or county from receiving proceeds if it does not provide solid waste management programs and services and is not responsible by contract for payment, unless the city or county is served by a regional solid waste management authority. If the city or county is served by the authority, then the city or county must forward the amount of proceeds it receives to that authority. To assist the Department with distribution, the Department of Environment and Natural Resources must provide the Department with a list of cities and counties that are excluded by May 15 of each year.

In S.L. 2007-323, the General Assembly increased the excise tax levied on OTP from 3% to 10%, effective October 1, 2007, with the Secretary of Revenue remitting the additional tax to the University Cancer Research Fund. This act permits wholesale and retail dealers who possess unsalable OTPs to return them to the manufacturer and apply for a refund of the excise tax paid on them. A similar provision already exists for cigarettes and cigars. The act also conforms the discount and refund provisions for OTPs and cigarettes.

Toll Enforcement Authority Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-225	SB 1697	Senator Jenkins

AN ACT TO PROVIDE FOR THE ENFORCEMENT OF TOLLS ON TURNPIKE PROJECTS OF THE NORTH CAROLINA TURNPIKE AUTHORITY, TO MODIFY LAWS APPLICABLE TO THE NORTH CAROLINA TURNPIKE AUTHORITY, AND TO CLARIFY THE AUTHORIZATION MADE IN A PRIOR LAW TO TOLL AN EXISTING SEGMENT OF N.C. 540.

OVERVIEW: This act provides for the enforcement of tolls at toll facilities operated by the North Carolina Turnpike Authority and clarifies the authorization made in a prior law to toll an existing segment of NC 540.

FISCAL IMPACT: No estimate available.

EFFECTIVE DATE: The majority of the provisions of the act became effective when the act was signed into law by the Governor on July 18, 2008.

ANALYSIS: This act addresses four areas pertaining to the North Carolina Turnpike Authority. First, it clarifies the authority to toll the specific segment of NC 540 for which the prohibition on tolling was lifted in 2006. Second, it establishes the procedure for the collection and enforcement of tolls by the Authority. Third, it treats documents and bids on contracts for a toll road the same as those for other roads with respect to confidentiality, registration of maps, and resolution of construction claims. Fourth, it exempts the Authority from the purchase and contract statutes that apply to other State agencies and from rulemaking, except as provided for contesting liability for unpaid tolls.

In 2002, the General Assembly established the North Carolina Turnpike Authority as an independent agency responsible for toll roads and designated the toll road projects. Current law enables the Turnpike Authority to set and collect tolls on Turnpike projects, but it does not establish any procedures for the collection or enforcement of the tolls.

The method by which the Authority plans to impose tolls is through an 'open road' tolling system. Under this system, there are no toll booths and drivers do not have to stop to pay the toll. Vehicles are identified electronically by means of transponders[128] and cameras. Tolls are collected by debiting a prearranged account, by payment by the driver at a facility off the tolled roadway, or by sending the driver a bill for the unpaid toll. The act requires the Authority to post signage notifying drivers that they are approaching a highway for which a toll is required and indicating the methods by which the toll must be paid. The Authority must also operate a facility within the immediate vicinity of the Turnpike project that accepts cash payment of the toll.

The act requires tolls for the same class of vehicle to be the same, but allows a discount of up to 35% of the amount of the toll for vehicles that have transponders. The person who is the registered owner of a vehicle is responsible for a toll unless the owner can establish that the vehicle was in the care, custody, or control of another when the vehicle incurred the toll.

If a toll is not paid within 15 days of when it is incurred, the Authority sends the owner of the vehicle a bill for the toll. The owner has 30 days to pay the bill. If the bill is not paid within 30 days, a processing fee is added to the amount the person owes. The Authority must set the processing fee at an amount that does not exceed the costs of identifying the owner of a motor vehicle that is subject to an unpaid toll and billing the owner for the unpaid toll. The maximum processing fee for a billing period may not exceed $6. A person may not be charged more than $48 in processing fees in a calendar year. A person who receives one or more bills for unpaid tolls during a six-month period and who has not paid the amount due on those bills within 30 days after the end of the six-month period is subject to a civil penalty of $25. Only one civil penalty may be assessed for a six-month period.

If the amount of unpaid tolls remains unpaid after 30 days, the Authority will notify the Division of Motor Vehicles that the toll, fee, and penalty have not been paid and the Division will block the renewal registration of the vehicle until the amount is paid. A person whose motor vehicle registration renewal is blocked due to unpaid tolls, processing fee, or civil penalties may pay the amount due to the Division when renewing the vehicle's

[128]An automatic device that transmits a predetermined message or generates a signal in response to a predefined signal.

registration so that the block may be removed. The Division must remit the revenue received to the Authority. The Division's costs of collecting the tolls, fees, and penalties are considered a necessary expense of the operation of the Authority and the Authority must reimburse the Division for these costs.

The act establishes an administrative review process for contested tolls. A person who disputes liability for a toll may, within 30 days after receiving the bill, request a review by the Authority. If after the informal review process, the Authority determines the person is liable for the toll, the person may contest this determination by filing a petition for an administrative hearing at the Office of Administrative Hearings (OAH). Judicial review of an administrative decision by OAH is on the record.

Under current law, it is an infraction for the operator of a motor vehicle to willfully cover or conceal the numbers on a registration plate for the purpose of interfering with the taking of a clear photograph by a traffic control system, such as the 'red-light cameras'. This act adds toll collection systems to this offense, effective December 1, 2008.

In 2006, the General Assembly removed the prohibition on tolling existing roads with respect to a segment of existing NC 540. The 2006 change, however, did not include the identified segment of NC 540 in the group of 'Turnpike Projects' for which a toll can be imposed. Therefore, this act also clarifies the authority of the Turnpike Authority to toll a segment of NC 540 in Wake County that has already been constructed.

Appendix A

TABLE OF CONTENTS

(Sorted by Bill #)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-165, as amended by S.L. 2008-187	HB 1770	Future Conveyances/Special Assessments.	Representative McComas	63
S.L. 2008-171	HB 1889	Wildlife Land Property Tax Changes.	Rep. Harrison, Gibson, Hill, Brubaker	65
S.L. 2008-107	HB 2436	Modify Appropriations Act of 2007.	Rep. Michaux, Adams, Alexander, Crawford	4
S.L. 2008-118	HB 2438	2008 Budget Technical Corrections.	Rep. Michaux, Tolson, Yongue	37
S.L. 2008-154	HB 2509	Sales Tax Refund for Certain Nonprofits.	Representative Gibson	60
S.L. 2008-207	HB 2530	Solid Waste Tax Changes/Unsalable OTP Refund.	Rep. Harrison, T. Harrell, Luebke, Thomas	77
S.L. 2008-206	HB 2558	Home Inspector Privilege License.	Representative Ross	76
S.L. 2008-158	SB 1407	Resale of Tickets via Internet.	Senator Hartsell	61
S.L. 2008-225	SB 1697	Toll Enforcement Authority Changes.	Senator Jenkins	78
S.L. 2008-134	SB 1704	Rev Laws Tech., Clarifying, & Admin	Senator Hartsell	38

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
		Changes.		
S.L. 2008-148	SB 1716	Supplemental PEG Support.	Senator Clodfelter	58
S.L. 2008-144	SB 1852	Tax on Short-Term Heavy Equipment Rentals.	Senator Brunstetter	49
S.L. 2008-35	SB 1876	Deferred Property Tax Programs Changes.	Senator Clodfelter	1
S.L. 2008-146, as amended by S.L. 2008-187	SB 1878	Property Tax Modifications.	Senator Clodfelter	51
S.L. 2008-204	SB 1925	UNC Nonapp. Cap. Projects/Airport Authority.	Senator Kerr	70
S.L. 2008-147	SB 2075	Economic Development Modifications.	Senator Berger of Franklin	57
Appendices		*Appendix A - Table of Contents Sorted by Bill #*		
		Appendix B - Table of Contents Sorted by Short Title		
		Appendix C - Table of Contents Sorted by Sponsor		

Appendix B

TABLE OF CONTENTS

(Sorted by Short Title)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-118	HB 2438	2008 Budget Technical Corrections.	Rep. Michaux, Tolson, Yongue	37
S.L. 2008-35	SB 1876	Deferred Property Tax Programs Changes.	Senator Clodfelter	1
S.L. 2008-147	SB 2075	Economic Development Modifications.	Senator Berger of Franklin	57
S.L. 2008-165, as amended by S.L. 2008-187	HB 1770	Future Conveyances/Special Assessments.	Representative McComas	63
S.L. 2008-206	HB 2558	Home Inspector Privilege License.	Representative Ross	76
S.L. 2008-107	HB 2436	Modify Appropriations Act of 2007.	Rep. Michaux, Adams, Alexander, Crawford	4
S.L. 2008-146, as amended by S.L. 2008-187	SB 1878	Property Tax Modifications.	Senator Clodfelter	51
S.L. 2008-158	SB 1407	Resale of Tickets via Internet.	Senator Hartsell	61
S.L. 2008-134	SB 1704	Rev Laws Tech., Clarifying, & Admin Changes.	Senator Hartsell	38
S.L. 2008-154	HB 2509	Sales Tax Refund for Certain Nonprofits.	Representative Gibson	60

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-207	HB 2530	Solid Waste Tax Changes/Unsalable OTP Refund.	Rep. Harrison, T. Harrell, Luebke, Thomas	77
S.L. 2008-148	SB 1716	Supplemental PEG Support.	Senator Clodfelter	58
S.L. 2008-144	SB 1852	Tax on Short-Term Heavy Equipment Rentals.	Senator Brunstetter	49
S.L. 2008-225	SB 1697	Toll Enforcement Authority Changes.	Senator Jenkins	78
S.L. 2008-204	SB 1925	UNC Nonapp. Cap. Projects/Airport Authority.	Senator Kerr	70
S.L. 2008-171	HB 1889	Wildlife Land Property Tax Changes.	Rep. Harrison, Gibson, Hill, Brubaker	65

Appendices

Appendix A - Table of Contents Sorted by Bill #

Appendix B - Table of Contents Sorted by Short Title

Appendix C - Table of Contents Sorted by Sponsor

TABLE OF CONTENTS
(Sorted by Sponsor)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-154	HB 2509	Sales Tax Refund for Certain Nonprofits.	Rep. Gibson	60
S.L. 2008-171	HB 1889	Wildlife Land Property Tax Changes.	Rep. Harrison, Gibson, Hill, Brubaker	65
S.L. 2008-207	HB 2530	Solid Waste Tax Changes/Unsalable OTP Refund.	Rep. Harrison, T. Harrell, Luebke, Thomas	77
S.L. 2008-165, as amended by S.L. 2008-187	HB 1770	Future Conveyances/Special Assessments.	Rep. McComas	63
S.L. 2008-107	HB 2436	Modify Appropriations Act of 2007.	Rep. Michaux, Adams, Alexander, Crawford	4
S.L. 2008-118	HB 2438	2008 Budget Technical Corrections.	Rep. Michaux, Tolson, Yongue	37
S.L. 2008-206	HB 2558	Home Inspector Privilege License.	Rep. Ross	76
S.L. 2008-158	SB 1407	Resale of Tickets via Internet.	Sen. Hartsell	61
S.L. 2008-225	SB 1697	Toll Enforcement Authority Changes.	Sen. Jenkins	78
S.L. 2008-204	SB 1925	UNC Nonapp. Cap. Projects/Airport Authority.	Sen. Kerr	70

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2008-147	SB 2075	Economic Development Modifications.	Senator Berger of Franklin	57
S.L. 2008-144	SB 1852	Tax on Short-Term Heavy Equipment Rentals.	Senator Brunstetter	49
S.L. 2008-35	SB 1876	Deferred Property Tax Programs Changes.	Senator Clodfelter	1
S.L. 2008-146, as amended by S.L. 2008-187	SB 1878	Property Tax Modifications.	Senator Clodfelter	51
S.L. 2008-148	SB 1716	Supplemental PEG Support.	Senator Clodfelter	58
S.L. 2008-134	SB 1704	Rev Laws Tech., Clarifying, & Admin Changes.	Senator Hartsell	38

Appendices

Appendix A - Table of Contents Sorted by Bill #

Appendix B - Table of Contents Sorted by Short Title

Appendix C - Table of Contents Sorted by Sponsor

Stan Jenkins

The Revenue Law Study Committee
North Carolina State Legislature
Raleigh, North Carolina
October 22, 2008

First, I would like to thank all of you for your invitation to speak before your committee today. In particular I want to recognize Trina Griffin. She has been extremely helpful and on your behalf she has been most gracious in welcoming me.

In the last five years the Champaign County Board of Review has challenged the charitable, tax exempt status of our only two local hospitals. For somewhat different reasons the Board did not believe the hospitals met the legal requirements to be exempt from taxation. Today both are on the tax rolls. Both cases are also being appealed.

In Illinois, when an application for property tax exemption is filed, it is filed with the county Board of Review. The Board of Review then makes a recommendation to the IDOR and it's the Department of Revenue that actually grants or denies that exempt status. Front that point, the appeal process can begin.

Since this first began there have been hearings and debate at every level of government from local city councils to the U.S. Congress.

Virtually all of the discussion has centered around four core issues:

1. Differential pricing for the uninsured
2. Availability and Level of charity care
3. Billing and collection procedures.
4. And the huge profits that are being realize by many not-for-profit hospitals.

Over the last few years I've learned a lot about these issues and other issues that are having an enormous impact on the hospital industry and their patients. To say, "I've experienced a dramatic learning curve" would be an understatement. Today I would like to discuss what we looked at when we did our work, as well as, some observations I've made since this all began. I will be referencing both hospitals in Champaign County to illustrate the issues. When I'm through, I'll welcome your questions.

Let me speak for a moment about the legal background for the work we did. The legal requirements for tax exempt status in Illinois are remarkable similar to those in many other states, including North Carolina.

Tax exemption is not an inherent right just because an organization is a hospital or because it is tax exempt under federal law as a 501(c)3. Under state law, *the burden of proof* is always on the hospital to demonstrate that it deserves an exemption from paying taxes by virtue of the charitable benefits it returns to the community. It is important for

committees such as this and for state and federal lawmakers to ask a fundament question. What exactly *is* society getting in return for the privilege of being tax exempt?

To be exempt from paying property tax, a property must be in Exempt Ownership and in Exempt Use

The standards for tax exemption are addressed not only in our state Constitution but also in the Property Tax Code *and* in case law. The Constitution says that for an organization to be tax exempt, the property must be *"used exclusively* for charitable purposes" The Property Tax Code goes on to say that the property has to be "actually and *exclusively* used for charitable or beneficent purposes, and not leased or otherwise used with a view to profit."....and that's critical. Case law goes back nearly a century defining the criteria that have to be met to qualify for tax exemption.

The benchmark case is Methodist Old Peoples Home v. Korzen.
It says that for an organization to be tax exempt:

- It must benefit an indefinite number of people.
- It must have no stocks and earn no profits and it does not provide profit in a private sense to any person connected with it.
- It derives its funds from public & private charity.
- It dispenses charity care to all who need and apply for it and places no obstacles in front of those people.
- It is actually and factually used exclusively for charitable purposes.
- And finally, the term *"exclusively used"* means the primary purpose for which the property is used...*and not any secondary or incidental purpose*. These are important words.

As recently as December of 2004 the Illinois Supreme Court reaffirmed these criteria in yet another case. *These are the standards that must be met.*

Let's talk for a moment about Exempt Ownership and Exempt Use.

Exempt Use first.

"Exclusively" and "not leased or otherwise used with a view to profit" In both cases, significant areas inside these hospitals were being used by various for-profit physicians groups and service providers. In the case of Provena, there were at least eight outside, for-profit entities doing business inside this tax-exempt hospital.

Let's look at Carle Foundation Hospital. Carle Foundation is a not-for-profit entity. Carle Clinic Association, is a doctor-owned, *for profit* entity. Most people in our community would tell you that is a distinction on paper only.

The lease between Carle Foundation and Carle Clinic gives the Clinic, it doctors and its staff, full, complete, unfettered access to that not-for-profit hospital. The Clinic also owned and operated the radiology department as well as the lab inside both of the

hospital. The clinic and the hospital shared the same phone number, the same website; the same advertising. The Clinic owned the I.T. Department and other Carle entities would buy or rent that service from the Clinic. The Carle Cancer Center was a joint service. Clinic doctors served on the Boards of Carle Foundation, the Carle Development Foundation, the Hospital and other Carle entities.

So when patients would go to Carle hospital, a tax exempt, non profit, charitable hospital, those patients were given a Carle Clinic number, treated by Carle Clinic doctors, x rayed on Carle Clinic equipment; read by Carle Clinic radiologist; tests were run by the Carle Clinic lab and patients were billed separately for those services by Carle Clinic Association. (a for-profit entity with no charity care policy and absolutely no obligation to provide any charity care whatsoever.)

These facts have never been disputed.

What about exempt ownership? This answer was not so clear cut, but as we looked at the various "pieces" of this issue, and put them all together, a picture began to form. What we saw was much more compelling (and disturbing) than the "use issue."

Not only did our two hospitals not meet that "burden of proof," in many respects they fell far short and a few particular areas stood out.

All over this country, uninsured patients are typically charged higher prices than anyone else for *exactly* the same care and treatment.

The list prices (or chargemaster prices as they are called) are the same for all patients, it's the discounts (or lack thereof) that are different. So when I discuss "differential pricing" it's not the "chargemaster" prices going in that I'm referring to; it's the final billing going out. An uninsured patient DOES NOT get the same discounts that an insured patient receives...or a Medicare patient. Uninsured patients routinely pay three to five times more than an insured patient pays for the exact same care, treatment or procedure. Three to five times more for the same band-aid, the same aspirin; the same room or the same bed.

People who are without insurance are usually in that situation because they can't *afford* to have insurance in the first place. It's not by choice. To then force these same people to pay higher prices than anyone else has to pay is just plain wrong and it is not befitting a charitable institution...and this is happening today in many not-for-profit hospitals.

Too often, instead of working on reasonable payment plans with uninsured patients, our hospitals were using some pretty egregious collection practices including suing hundreds of their own patients. Property was seized; wages were garnished; patients were forced into bankruptcy; arrest warrants were issued. In some cases patients were actually jailed for failing to appear in court over a hospital bill. (A few years ago, this became a front page story in the Wall Street Journal.) We considered these practices to be contrary to what *any* charitable organization should be doing.

The Illinois Fourth District Appellate Court recently ruled against Provena and summed it up very succinctly. Provena gave free or discounted care to only 302 patients—and then hired a collection agency to contact 64 of those same 302 charity care patients. Provena's attorneys, argued this was their way of "helping" those patients. Turning patients over to collections would give them an opportunity to set up a payment plan.

Who in this room has ever been contacted by a collection company and believed that they were there to help you? The appellate court didn't buy that argument.

We also looked at the level of charity care provided. For the years in question, the level of actual charity care provided by Carle was less than ½ of 1% of total revenues. This was at a time this institution posted a $32 million profit. Provena was at 7/10 of one percent.

The appellate court also noted that even after Provena knocked 50% or 25% off the list price, Provena still covered their costs and came out ahead "and therefore extended no charity care at all those patients. The court went on to say that as small as Provena's charity care numbers were relative to total revenues, even that appeared to be an exaggeration.

Countless thousands of for-profit businesses across this nation contribute more than one half of one percent of their revenues to various charitable activities every year. They do so out of a sense of community obligation and good citizenship. However, they neither expect nor receive the benefits of tax-exemption.

If you put "exclusively" on one end of the spectrum and "secondary or incidental" on the other end of the spectrum...where do *you* think ½ of 1% falls?

We found that both of these *not-For-Profit* hospitals had intimate business relationships with *for-Profit* entities directly related to their own corporate organizations. In the case of Provena, there had been almost $160 million dollars transferred out of our community, from not-for profit Provena Hospital and from not-for-profit Provena Senior Services up to the "corporate headquarters" and then $23 million was transferred back to a for-profit subsidiary...and then still claiming the hospital was not-for-profit. That *just* didn't make sense to us.

Let's look at this from another perspective. Now this is Carle I'm speaking of.

After all expenses were paid; after all physicians, nurses, administrators and employees were paid market-based wages; after all capital expenses; after buying supplies and equipment, after everything, this institution posted a $32 million profit. That's over a half a million dollars a week.

That ½ of 1% of actual charity care provided amounted to about $1.3 million. The tax saving on just two parcels of property (the main hospital campus) was about $2 million.

Two million dollars saved versus 1.3 million dollars in actual charity care returned to the community. That's not even a dollar for dollar trade-off from *just* those two parcels and they owned numerous properties that were tax exempt.

We all know charity care isn't the only contribution hospitals make to the community. But in this case, that two million dollars wasn't the only *savings* realized by this institution either...not by a long shot.

Never mind the money saved from the other properties this institution owned that were also tax exempt. Never mind the money saved by having an exemption from paying sales tax. Never mind the money saved with exemptions from state and federal income tax.

Two million dollars saved versus 1.3 million dollars in actual charity care, while showing a $32 million dollar profit. And at the same time uninsured patients were being charged the highest list prices and when they were unable to pay those prices they were subjected to the collection practices I mentioned earlier.

In learning more about hospital practices around the country, I know that the practices of our two hospitals in relation to pricing, collections, charity care and profits are very common. But common practice does not make something right and it *certainly* does not make a hospital truly not-for-profit or truly charitable.

Knowing what I know now, if I was reviewing a hospital's activities today (any hospital) here are some of the areas that would be looked at very closely. And these issues are not specific to Illinois.

I would look at pricing for the uninsured and let me make something clear—I believe hospitals have every right to be paid for the goods and services they provide...like any other business. In a competitive market, I believe hospitals have the right to set their prices however they want...like any other business. They have the right to pursue collections through the courts and they have the right to sue people...like any other business. I would respectfully suggest, however...they can't have it both ways. You can't conduct business *like* any other business, yet expect exemption from taxation *unlike* any other business.

I would also look at the availability and level of charity care provided within the financial means of the hospital.

I would review the hospital's Collection Practices.

I would look at the For-Profit entities associated with a Not-For Profit hospital and the financial relationships that exist between them.

I would look at Executive Compensation and believe me, this is a touchy subject but it is no longer, "off of the radar screen." I would encourage all of you to read Minnesota

Attorney General Mike Hatch's testimony before the U.S. Senate Finance Committee. It was in the spring of 2005 and it was truly *astounding*!

Attorney General Hatch's investigation involved a couple of hospital systems in Minnesota. Here is just *some* of what he found...and his findings are not unique to Minnesota.

- One hospital paid for employees to travel to Hawaii, Aruba, London, Paris, Venice, Athens, Cancun, and various other foreign destinations.

- It paid $89,000 for its board members and executives to travel to Arizona where it spent $14,000 on food and alcohol.

- Another time, executives charged the organization for $100 floral arrangements to decorate their $855 per night suites.

- When asked to explain the "business purpose" for one such trip, the Attorney General was told the trip was designed to inspire discussions...about "health care reform."

- On another occasion, $42,000 was spent to send executives and their spouses to an exclusive golf resort where they spent $18,000 on golf and golf lessons.

- On another occasion, the hospital paid for its executives and spouses to take a three-day wine-tasting tour of the Napa Valley, complete with limousines and hot air balloon rides.

- There was yet another excursion to Monterey, California where hospital executives traveled in private limousines and expensed thousands of dollars at the area's most exclusive restaurants. When the Attorney General questioned these expenses, he was told the trip was designed to teach hospital executives how to run a health care system with a "moral center."

- It paid over $17,000 for its CEO to travel to Brazil, Chile, and Ireland on "trade mission retreats" though the organization only operates in Minnesota and western Wisconsin.

- It paid $9000 for its CEO to travel to Australia to find out: (and I quote) "Are we pricing consumers out of health care?"

  I couldn't make this stuff up.

  At the very least there was a violation of the public trust that had been placed in these not-for-profit, tax-exempt institutions.

Just a side note-- do you think the labor unions in Minnesota just might mention these trips and expenses to those employees who clean out the bedpans and mop the floors...and get paid a minimum wage? It's shameful.

When looking at Executive Compensation, I would not only look at the bonuses, perks, and deferred compensation but I would also ask, "Is *any* of that compensation based on the financial performance of that hospital?" If the answer is, "yes," I would suggest there is a conflict of interest...and this isn't just my opinion.

In May, 2005 an Administrative Law Judge in Illinois, in yet another case said that if compensation is based on profitability it is "not consistent with being a charitable operation." Executive compensation is rapidly becoming part of the equation. As I said, this is a "touchy subject" but it is no longer off limits and its going to come under increased scrutiny, not only at the federal level *but also* at the state and local levels, *as well it should!*

Another area I would look at is actual Charity Care provided and *not* the Community Benefits Report. A Community Benefits Report is a self-generated report by the hospital and too often it is little more than a good marketing piece with all the bells and whistles thrown in to make it look as good as possible, but not necessarily an accurate reflection of how "charitable" an organization really is.

In one instance the Community Benefits Report we looked at cited over 5500 hours of employee's time volunteered to the community. It had the names of the individual employees and the number of hours they volunteered. It so happened I knew one of those employees. I called her and ask her about it. She told me the hospital administration had sent out a questionnaire *to all* employees asking them if they did volunteer work in the community and how much volunteer work they did. She did, in fact, do volunteer work...on her own. It wasn't part of her job duties; it wasn't during work hours. It was on her time and on her dime. Yet those volunteer hours showed up in the hospital's Community Benefits Report and the hospital administration was taking credit for those hours.

I would look at the level of actual charity care provided....meaning free or discounted care *"at cost."*

When going back to that original question, What exactly *is* society getting in return for the privilege of being tax exempt, it is critically important to distinguish between actual charity care as defined by law and community benefits as defined by a hospital. There's a huge difference.

I know hospitals can't provide charity care to everyone. If they give away everything today, they won't be around tomorrow to provide healthcare to anyone. I understand that.

But, people understand the inherent unfairness of this differential pricing. There is a sense of common outrage when the poorest among us are being treated this way. When

the general public understands this issue... they don't like what they see. For the uninsured patient, who can't afford insurance in the first place, to be charged more than anyone else is just adding insult to injury...(or illness) as the case may be.

Look at this from a different perspective. There are approximately 30 million uninsured working adults in this country. Let's assume your grown son or daughter comes home for a visit. They're earning $20,000 or $30,000 a year in a job with no benefits. (that's not uncommon) And you're sitting around the kitchen table and your own kid says to you...

I can't get the insurance I want to have.
I got an illness I didn't want to have.
I was put in a hospital I couldn't afford.
I was charged more than anyone else.
Then when I couldn't pay...I got sued.

If this was your own son or daughter...*what would you think*?

And when looking at the amount of actual charity care provided, you must also look at the Total Asset Accumulation of these institutions, not just their profits. In 2007, Provena Health reported a profit of $49,771,000 but they also had $477,203,000 in accumulated assets sitting in the bank. That's almost a half a billion dollars. Yet some poor working stiff with a $10,000 hospital bill will have his financial future ruined for years. And it will have a direct impact on the quality of life of that family.

As of March 31, 2008 Carle's cash and investments were $642,481,000...*over a half a billion dollars.*

What do you think? ½ of 1 percent? Is society getting enough in return in exchnge for the privilege of being tax exempt? And let me be clear...these two hospitals are not the exception! The evidence is there, but you do have to be persistent and tenacious when digging through the available information to discover these things.

These have become national issues with very credible voices now being heard. In 2005 the United States Senate Finance Committee held hearings and Senator Charles Grassley said, "It's my job to make sure charities are earning their generous tax breaks. *Tax-exempt status is a privilege."* And it is!!

Rep. Bill Thomas of The House Ways and Means Committee said, "We really can't tell the difference between a for-profit and a not-for-profit hospital. What is the taxpayer getting in return for the tens of billions of dollars per year in tax subsidy?"...and it is a subsidy.

The Congressional Budget Office and the G.A.O. (the Government Accountability Office) have conducted studies asking the same question, I have posed here today. What exactly *is* society getting in return for the privilege of being tax exempt? Their findings

were that the differences between what not-for-profit, hospitals and what for-profit hospitals provided in charity care to their local communities was negligible. In many instances the "for-profits" actually contributed more in charity care...and this was using the same yardstick to measure both entities.

In fact, HCA (the Hospital Corporation of America) the nation's largest for-profit healthcare system actually provided 4% of their total revenues to charity care. Compare that with the numbers I have been quoting here today.

Some analysts have concluded that it's only a matter of time until the Federal Trade Commission becomes involved. After all, tax exemption, by any other word is a subsidy. It is a subsidy that one segment of the healthcare industry enjoys while competing with the other segment that does not enjoy the same subsidy. It is fundamentally unfair and anticompetitive. It has also proven to be very unfriendly to the consumer.

So, what exactly *is* society getting in return for the privilege of being tax exempt? It's a fair question and one that should be asked. More importantly it is one that should be answered.

Thank you for you patience and attention. If you have any questions, I'll try to answer them.

REVENUE LAWS STUDY COMMITTEE
Wednesday, October 22, 2008
Room 544, Legislative Office Building
9:30 a.m.

MINUTES

The Revenue Laws Study Committee met at 9:30 a.m. on Wednesday, October 22, 2008, in room 544 of the Legislative Office Building. Twelve members of the committee were present. Representative Luebke presided as chair.

Overview of 2008 Finance Law Changes and Fate of the Revenue Laws Study Committee's Recommendations to the 2008 General Assembly

Cindy Avrette, a staff attorney with the Research Division, was recognized to explain the 2007-2009 biennium tax law changes and which committee recommendations were enacted. A copy of her presentation is attached.

Budget Outlook

Barry Boardman, a fiscal analyst with the Fiscal Research Division, was recognized to give an overview of the current condition of the General Fund and a 2008-2009 economic forecast. A copy of Mr. Boardman's presentation is attached.

Overview of Exemptions for Nonprofits

Trina Griffin, a staff attorney with the Research Division, and Rodney Bizzell and Lee Dixon, fiscal analysts with the Fiscal Research Division, were recognized to provide an overview of nonprofits and their tax treatments. This included property tax exemptions and hospital charity care. A copy of their presentations is attached.

Discussion of the Illinois *Provena Covenant Medical Center Case*

Stan Jenkins, Supervisor of Assessments, Champaign County, Illinois, was recognized to explain the case which questioned the tax exemption status of not-for-profit hospital corporations. Hugh Tilson, the lobbyist with the NC Hospital Association, was recognized for comments and will provide staff with North Carolina hospital information before the end of the year. A copy of Mr. Jenkins' presentation is attached.

Representative Paul Luebke, Presiding Chair
Revenue Laws Study Committee

DeAnne Mangum, Committee Clerk

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

Senator John H. Kerr, III, Co-Chair *Representative Paul Luebke, Co-Chair*

November 7, 2008

NOTICE

TO: Members, Revenue Laws Study Committee

FROM: Senator John Kerr, Co-Chair
Representative Paul Luebke, Co-Chair

SUBJECT: Revenue Laws Study Committee Meeting

There will be a meeting of the **Revenue Laws Study Committee** as follows:

DAY: **Wednesday**

DATE: **November 19, 2008**

TIME: **9:30 am**

LOCATION: **Room 544, Legislative Office Building**

Please advise DeAnne Mangum, Committee Clerk, at (919) 733-2405 or e-mail deannem@ncleg.net if you will be unable to attend.

REVENUE LAWS STUDY COMMITTEE AGENDA
CO-CHAIRS AGENDA

Sen. John Kerr — Rep. Paul Luebke

Wednesday, November 19, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from October 22 Meeting

Brubaker moves

II. Update on Combined Reporting

(1) • *Cindy Avrette, Research Division*
(2) • *Mark Morton, General Counsel for Revenue Operations, West Virginia Tax Department*
2 handouts
* helps control income shifting

* commerce handouts
map ~~opposition~~ positions
Greg Radford, DOR
Mark Morton
Carmen Hine
available to answer
why did last biennium questions
fiscal impact of spinoffs not pass
to CR issues
- franchise tax issues
- transitional & administrative issues

III. Privilege License Taxes in North Carolina

(3) Trina will give a very brief intro of this issue and introduce Chris (about 3 minutes). Trina will also make some brief, concluding remarks at the end of his presentation.

(4) • *Christopher McLaughlin, Assistant Professor of Public Law and Government, UNC School of Government*
(5) • *Trina Griffin, Research Division*
(6) Karl Knapp, NCLM, has concerns about any repeals but amenable to clarification of law.
(7) Jim Blackburn - worried distribution would fade - has to be equitable way to work this out.

IV. Sales Tax Treatment of Food vs. Prepared Food

(8) • *Sandra Johnson, Fiscal Research Division*
(9) Karen Bennett ~~DeTinco~~ Dalenko - ① food vs prepared food (hidden tax on service)
② food considered as a consumed bag of chips (consume chips but not bag)

V. Adjournment

12:02 pm

Next Meeting Date: Monday, December 15, 2008
All meetings in Room 544, LOB, at 9:30 a.m.

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Wednesday, November 19, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from October 22 Meeting

II. Update on Combined Reporting

- *Cindy Avrette, Research Division*
- *Mark Morton, General Counsel for Revenue Operations, West Virginia Tax Department*

III. Privilege License Taxes in North Carolina

- *Christopher McLaughlin, Assistant Professor of Public Law and Government, UNC School of Government*
- *Trina Griffin, Research Division*

IV. Sales Tax Treatment of Food vs. Prepared Food

- *Sandra Johnson, Fiscal Research Division*

V. Adjournment

Next Meeting Date: Monday, December 15, 2008
All meetings in Room 544, LOB, at 9:30 a.m.

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — November 19, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
KEITH DAVIS	Bank of America
Linda Millsaps	NCDOR
Michael Hansen	NCDOR
[illegible] Bryson	AT+T
Cady Thomas	NC Assn of REALTORS
John McKay	COCOMAG
Rebecca Troutman	NCACC
Ron Crouch	NCBA
Guy Ridgill	NC DOR
Andy Sabol	NC DOR

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — November 19, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Jake Cashion	WS Chamber
John Sadoff	NC DOR
Kay Hobart	DOJ
David Baker	DOR
Kelli Kukura	NCLM
Karl Knapp	NCLM
Deatrice Williams	CUCA
Henry Paulson	Dept of Treasury
Bill Spencer	DOR
Nathan Kauffman	OSBM
Mike Hamrick	PWC

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — November 19, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Bill Wilson	AARP
Chris Fitzsimon	NC Policy Watch
John McMillan	MFAS
Jim Ahler	NCACPA
Roby Sawyers	NC State University, College of Mgt.
Mark S. Morton	WV Tax Dept.
Debra Derr	AT+T
Marvin Alexander	Pappas Strategies

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

November 19, 2008
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Jeff Tally	Nelson Mullins
Steve Brewer	EMBARQ
Marty Bocock	EMBARQ
Daniel Rabon	K&L Gates
Butch Gunnells	NC Beverage Assoc
Scott Gardner	Duke Energy
Lori Ann Harris	LATA
Robin Lewis	Robin Lewis Consulting, 116 Foothill Rd 27107
Jim Blackburn	NC Association of County Commissioners

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — November 19, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Jay Stem	NCAA
Jim Johnson	BSA
Daniel Ambuin	Electricities of N.C. Inc.
Tim McDowell	NCICU
[signature]	NCAEC
Kathy Hawkins	Progress Energy
John Goodman	NC Chamber
Thomas Moore	Edwards Mobley
Brad Phillips	TWC
[signature]	CBIA
John McAlister	NC Chamber

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — November 19, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Connie Wilson	SSI
Cam Coven	BPMHL
Mary Trotter	BPMHL
Charles Mercer	Nelson Mullins Riley & Scarborough
Pam Caysetts	
Daniel H. Moenter	Marathon Petroleum Company LLC
Bill Weathersbon	NC-APA
Paul Stark	NCBA
David Heinen	NC Center For Nonprofits
Jodi Mugnai	GMA & Assoc
Patrick Bell	NMRS

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — November 19, 2008

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
[illegible]	WM
Martha McConnell	Carolinas HealthCare Sys.
Sandy Sands	WCSR
[illegible]	JD, AL, PA
DAVID BARNES	Poyner Spruill
Christine Craig	Wake Med
Elizabeth Dalton	NCRMA
Andy Ellen	NCRMA
[illegible]	E&Y
[illegible]	NCANPHA
Doug Heron	Williams Mullen

Update on Combined Reporting

Revenue Laws Study Committee
November 19, 2008
Cindy Avrette, Research Division

Combined Reporting

- **WHAT IS IT?**
  It is a method of calculating the income of a group of affiliated corporations for tax purposes
- **HOW?**
  It looks beyond the legal structure of separate incorporations to determine whether two or more affiliated corporations are engaged in a **single unitary business**
- **WHY?**
  To ensure the income of a multiple entity unitary business computed and apportioned in the same manner as a single corporate business

Single Entity Reporting

- Vulnerability of single entity reporting state to income shifting strategies
  - IHC in a low tax or no tax state
  - IHC in a combined reporting state
  - "Embedded royalty"
  - Interest expense
  - Transfer prices
  - Other inter-company transactions

NC Legislative Efforts

- **2001:** Royalty add-back
- **2002:** Broad definition of business income
- **2005:** Consideration of "throwout" rule
- **2006:** Patent and copyright add-back
- **2007:** Captive REITs

Revenue Laws Goals

- Provide comprehensive way to nullify income shifting strategies
- Modernize state tax code to adapt to the growth of multi-state corporations
- Broaden the corporate tax base
- Reduce uncertainty about when corporations need to filed combined returns
- Provide a more level playing field

Revenue Laws Recommended

- Mandatory combined reporting
- By affiliated corporations of a unitary business
- In a worldwide combination, with a water's edge election,
- Using the Joyce method of apportionment

SB 244 and HB 462

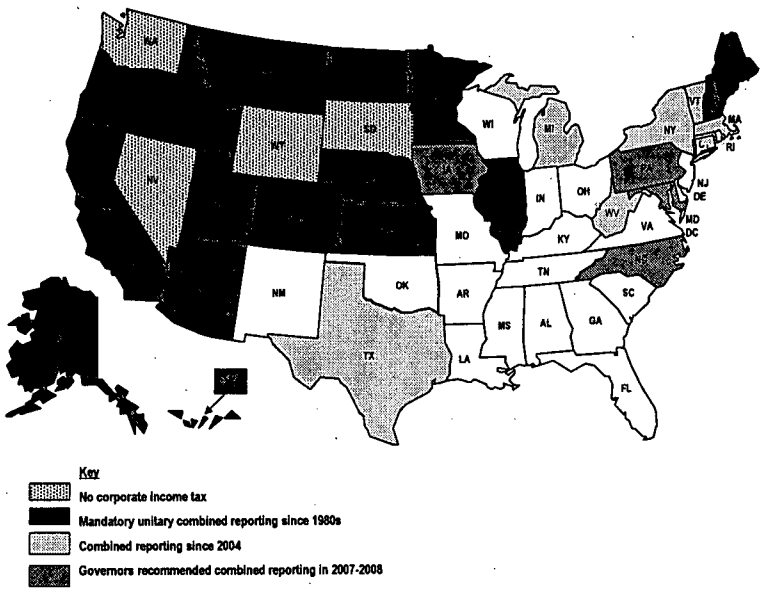
- Recommendation needs further development
  - Franchise tax issues
  - Special apportionment formula issues
  - Transitional & administrative issues
- Fiscal impact determination
- Corporate rate determination

Also Recommended by ...

- **2001:** Governor's Commission to Modernize State Finances
- **2007:** Income Tax Modernization Subcommittee of the State and Local Fiscal Modernization Commission
- **2007:** Governor Easley recommended combined reporting in his budget proposal

Combined Reporting in US

- **Prior to 1980s:** 16 states required combined reporting
- **2004:** VT enacted combined reporting
- **2006:** MTC adopted model combined reporting statute
- **2007-2008:** 5 additional states enacted some form of combined reporting (22)
- **2007-2008:** Considered by several other states



HISTORY AND CONSIDERATIONS FOR COMBINED REPORTING:

WILL STATES ADOPT A MODEL COMBINED REPORTING STATUTE?

Accepted for publication in *The Tax Lawyer - The State and Local Tax Edition* and *The State and Local Tax Lawyer - Symposium Edition*

Joe Huddleston[1]

Shirley Sicilian[2]

I. INTRODUCTION

Recent years have witnessed a second wave of separate entity states re-considering a move to combined reporting. The trend is pronounced, it perseveres despite increasing opposition from important sectors of the tax community, and it shows little sign of slowing. As legislators in separate entity states take up the issue, and administrators in newly christened combination states struggle with the learning curve, the first question is "what is a combined report?" Section II of this paper defines combined reporting, in contrast to separate entity reporting, in the context of fundamental unitary business and formulary

---

[1]Joe Huddleston is Executive Director for the Multistate Tax Commission.

[2]Shirley Sicilian is General Counsel for the Multistate Tax Commission.

apportionment concepts. Section III gives a brief history of the development and adoption of combined reporting as an extension of these fundamental concepts.

Once we've defined combination, the second question is "why use it?" Section IV of this paper explores some of the contemporary reasons separate entity states are again considering combined reporting.

A third question deals with the details of existing and new combined reporting structures: "when is combined reporting required, who is required to be combined, and how is combination accomplished?" In answering these questions, the second generation of combined reporting states is reconsidering some of the details adopted by first-generation states. Section V considers the level of uniformity in states' answers to these questions as things now stand, whether the trend is one of increasing or decreasing uniformity, and the impact of the Multistate Tax Commission's model combined reporting statute.

II. WHAT IS COMBINED REPORTING?

When a taxpayer does business in more than one state, the question arises as to how a state may tax its income. The U.S. Supreme Court requires the income to be fairly

apportioned.[3] States have different ways for meeting the "fairly apportioned" requirement, but virtually all use formulary apportionment. The two components of a formulary apportionment system are, of course, the pool of income subject to apportionment, and the apportionment formula. The apportionment formula is typically some combination of property, payroll, and/or sales factors. As for determining the pool of income, about half the states use the Uniform Division of Income for Tax Purposes Act's (UDITPA's) "business/non-business" rule.[4] The others either categorize income by type or apportion to "the full extent allowed under the U.S. Constitution." The Supreme Court has noted that the UDITPA rule is "compatible" with the Constitution.[5]

So, what is the "full extent allowed under the Constitution?" The Supreme Court has said that that the "linchpin of apportionability" is the unitary business

---

[3]*Complete Auto Transit v. Brady*, 430 U.S. 274 (1977)

[4]BNA Tax Management Portfolios, State Series, 1140-1st: Income Taxes: The Distinction Between Business and Nonbusiness Income; Worksheet 2 Adoption of UDITPA, Apportionable Income (September, 2007); The UDITPA rule defines "business income" as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations." UDITPA, sect. 1(a).

[5]Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U. S. 768, 786 (1992).

principle.[6] This principle establishes that if income arises from transactions or operations of *a single economic enterprise*, parts of which are carried out in the state, the state can apply formulary apportionment to determine the share of that enterprise's income attributable to the state. The single economic enterprise - that is, the "unitary business" - does not necessarily correspond to a single legal entity. A unitary business could be carried out through one division of a single legal entity or through several separate, but affiliated, legal entities operating together.

All states, separate entity states as well as combined reporting states, must abide by the unitary business principle in applying formulary apportionment. Indeed, when the full scope of the unitary business is contained within all or a part of a single legal entity, the apportionment calculation will be the same under both separate entity and combined reporting apportionment approaches.

The basic difference between the combined reporting and separate entity approaches is only arises when the unitary business is conducted by more than one separate legal entity. The difference is simply a matter of how

---

[6] *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425 (1980).

narrowly a state limits the types of unitary entities whose income and factors will be included in the taxpayer's apportionment calculation. A state may not constitutionally require the taxpayer to include in its apportionment calculation the income and factors of any entities that are not engaged in the unitary business. But states routinely limit the calculation to exclude income and factors of some entities that are engaged in the unitary business.[7] Indeed, no state requires taxpayers to determine their apportioned share of unitary business income based on the income and factors of the entire unitary business. Even states that use combined reporting all either limit, or allow taxpayers the option to limit, application of the formula to a combined group of unitary affiliates that will usually fall short of the entire unitary group.[8] Separate entity apportionment is essentially the narrowest limitation. Under separate entity apportionment, the apportionment calculation includes only the income and factors of the separate legal entity that is the taxpayer itself.

Thus, a combined report is an apportionment schedule the taxpayer uses to calculate its share of the income

---

[7]For example, many states exclude foreign affiliates. This exclusion is discussed in more detail below.

[8]For example, most states exclude, or allow an exclusion for, foreign corporations.

arising from a particular unitary business that is attributable to the taxing state. More specifically, a combined report is used when the state requires the taxpayer to include the income and factors of other affiliates engaged in the same unitary business in determining its own apportioned share of the unitary business's income. Separate entity states limit the apportionment computation to only the income and factors of the taxpayer itself, a single legal entity, and have no need for a multi-entity based apportionment schedule.

III. BRIEF HISTORY OF COMBINED REPORTING

A. *Late 1800's: Genesis of the Unitary Business Principle in Context of Property Tax*

Combined reporting developed as a natural corollary to the unitary business principle. A history of combined reporting, therefore, starts with the development of the unity concept in the late 1800's. At that time, property tax was the dominant form of taxation, and the railroads were one of the few types of businesses that typically operated in more than one state. Railroad property, tracks and traveling cars, literally spanned state lines. States

and County governments felt that the value of the railroad property which formed their tax base was not simply the stand-alone value of rail and cars in the state. They argued, essentially, that the value of the whole was greater than the sum of the parts. In *In Re State Railroad Tax Cases,* 92 U.S. 575 (1875), the U.S. Supreme Court agreed and explained:

> [A] railroad must be regarded for many, indeed for most, purposes as a *unit*. The track of the road is but one track from one end of it to the other, and except in its use as one track is of little value. In this track as a whole each county through which it passes has an interest much more important than it has in the limited part of it lying within its boundary. Destroy by any means a few miles of this track within an interior county … its effect upon the value of the remainder of the road is out of all proportion to the mere local value of the part of it destroyed … *It may well be doubted whether any better mode of determining the value of that portion of the track within any one county has been devised than to ascertain the value of the whole road and apportion the value within the county by its relative length to the whole*.

In re State Railroad Tax Cases, 92 U.S. 575, 608 (1875)(emphasis added)

In a similar, 1897 decision, the Court reasoned that the taxing state "contributes to that aggregate value not merely the separate value of such tangible property as is

within its limits, but its proportionate share of the value of the entire property [or unit]."[9]

B. *1910 - 1920's: Application of the Unitary Business Principle to Corporate Income Tax*

In 1909 the Federal government enacted the Corporate Income Tax, and States soon followed. The same sort of multistate apportionment issues then naturally arose in the context of an income tax. In *Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113 (1920), the U.S. Supreme Court considered a case where the taxpayer earned its income through "a series of transactions beginning with manufacture in Connecticut and ending with sale in other states. The legislature, in attempting to put upon this business its fair share of the burden of taxation, was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment." The Court upheld the State's logic of applying the unitary

[9]*Adam's Express v. Ohio State Auditor,* 165 U.S. 194 (1897)

concept of formulary apportionment, developed under property tax, to the income tax.[10]

A few years later, in *Bass, Ratcliff & Gretton v. State Tax Commission,* 266 U.S. 271 (1924), the Court was faced with the same issue but in a case where the taxpayer was a foreign corporation, with all of its manufacture and a large part of its sales in England. It imported a portion of its product into the United States which it sold through branch offices in New York and Chicago. The Court relied on *Underwood Typewriter,* and found the state was justified in attributing to itself a portion of the income earned by this multinational corporation from the conduct of its unitary business partly within and partly outside the state. Thus, the Court confirmed that the unitary business and formulary apportionment concepts could apply in the context of an income tax on a world-wide, as well as domestic, basis.

C. *1930's - 1940's: California Combined Reporting*

---

[10]*Underwood Typewriter Co. v. Chamberlain,* 254 U.S. 113, 120-121 (1920); See also, *Bass, Ratcliff & Gretton v. State Tax Commission,* 266 U.S. 271 (1924)

By the 1930's, more corporations were choosing to separately incorporate segments of their business that might have once been distinguished only as divisions of a single corporation. Because most states treat each separate corporation as a separate taxpayer, this raised the question of whether, and if so how, to apportion the income of a unitary business when the business is carried out through separate affiliated taxpayers, rather than through divisions of a single taxpayer.

California faced the issue with the movie industry during the 1930's. Movies were produced in California, and then sold to out-of-state affiliate distributors. As a result of the pricing, virtually all of the income from filmmaking was reflected by the out-of-state affiliates, and essentially none of it by "Hollywood."

California took the position that the income attributable to the State should not vary depending on the corporate structure in which a business chose to operate and that prices charged between commonly owned affiliates should not drive the apportionment result. Rather, production and distribution of film were two parts of a single unitary business. Thus, some share of the income from that entire single business should be attributed to the in-state taxpayer and apportioned to the state. So in

1937, without explicit statutory authority, California determined the taxpayer should apportion based on a "combined report" that includes the income and factors of all separately incorporated unitary affiliates in order to properly reflect that taxpayer's share of the entire unitary business income attributable to the state. The State argued combined reporting was implicit in the apportionment statutes, based on the unitary business principle.

Under the combined report, the entire unitary business's income was included in the pool of income to be apportioned and the entire unitary business's factors were included in the denominators of the apportionment factors. Because the numerator of the apportionment factors included only the taxpayer's own factors, the California combined report did not calculated the income attributable to the state from the entire unitary business, but only the taxpayer's share of the entire unitary business's income attributable to the state.

The movie industry did not challenge the California position. It wasn't until 1947, in *Edison Ca. Stores v. McColgan*, 30 Cal.2d 472 (1947), that the California Court of Appeals upheld the application of formulary apportionment to a unitary business conducted through

separate affiliated entities - i.e., combined reporting. And it was another sixteen years before the same California Court held in *Honolulu Oil Corp. v. Franchise Tax Board,* 60 Cal2d. 414 (1963) that the use of a combined report was not something to be imposed at the direction of the tax administrator, but was mandatory in all unitary situations in order to properly apportion income under the unitary business principle.

D. *1950's - 1960's: Widespread Adoption of Uniform Formulary Apportionment*

The 1950's and 1960's are characterized by widespread adoption of uniform formulary apportionment across the states. The National Conference of Commissioners on Uniform State Laws (NCCUSL) promulgated the Uniform Division of Income for Tax Purposes Act (UDITPA) in 1957. It took the States some time to warm up to it, but by the mid-1960's, as Congress seriously considered preemptive legislation[11], the states rallied. Many adopted UDITPA directly into their statutes. Some adopted it by enacting the Multistate Tax Compact, Article IV of which incorporates UDITPA nearly

[11]H.R. Rep. No. 952, 89th Cong., 1st Sess., Pt. VI, at 1139*ff* (1965).

word for word.[12] The Compact became effective in 1967 when the required minimum of seven states had enacted it.[13] The Compact also created the Multistate Tax Commission as its administrative agency[14], and charged the Commission with several responsibilities. One of these responsibilities is interpretation of Article IV, UDITPA, through promulgation of proposed model uniform laws.[15]

E. *1970's - 1980's: Other States Consider Combined Reporting*

With UDITPA now widely in place, the 1970's and 1980's saw other states pick up on California's lead from the 1930's and consider whether combined reporting is inherent in UDITPA and unitary apportionment. Courts in Idaho,

---

[12]Some states have enacted both UDITPA and the Compact.

[13]The U.S. Supreme Court upheld the validity of the Compact in *United States Steel Corp.* v. *Multistate Tax Comm'n* (1978) 434 U.S. 452. Today, twenty states are members of the Compact: Alabama, Alaska, Arkansas, California, Colorado, District of Columbia, Hawaii, Idaho, Kansas, Michigan, Minnesota, Missouri, Montana, New Mexico, North Dakota, Oregon, South Dakota, Texas, Utah and Washington. Another twenty-eight states have joined the Commission as either sovereignty or associate members. Sovereignty members are Georgia, Kentucky, Louisiana, Maryland, New Jersey, West Virginia and Wyoming. Associate members are Arizona, Connecticut, Florida, Illinois, Iowa, Indiana, Maine, Massachusetts, Mississippi, Nebraska, New Hampshire, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont and Wisconsin.

[14]Compact, Art. VI

[15]Compact, Art.VII.1.

Illinois, Kansas, Montana, Nebraska, and Oregon found that it is.[16] But the tide seemed to turn a bit in the later 1980's, as state courts in Maine and Massachusetts held there must be either explicit statutory authority or distortion in order for the state to require combination.[17]

By the end of this period, implicitly or explicitly, sixteen states had adopted combined reporting, and the litigation slowed. It was 2007 before another state, North Carolina, took the position that combination was inherent in formulary apportionment. The State was upheld and the matter is on appeal[18]

F. *1980's - 1990's: World-Wide Combined Reporting*

In 1983, California was once again on the forefront. This time, the State was before the U.S. Supreme Court, in *Container Corporation of America v. Franchise Tax Board,*

---

[16]*Coca Cola Co. v. Oregon Department of Revenue,* 533 P.2d 788 (Ore., 1975); *Montana Department of Revenue v. American Smelting &Refining Co.,* 567 P.2d 901 (Mont., 1977); *American Smelting & Refining Co.v. Idaho State Tax Com.,* 592 P.2d 39 (Id., 1979); *PMD Investment Co. v. State Dep't of Revenue, 216 Neb.* 553, 345 N.W.2d 815 (1984); *Caterpillar Tractor Co. v. Lenckos,* 417 N.E.2d 1343 (Ill., 1981); *Pioneer Container Corp. v. Beshears,* 684 P.2d 396 (Kan., 1984)

[17]*Polaroid Corp. v. Comm. of Rev.,* 472 N.E.2d 259 (Mass., 1984); *Sears Roebuck & Co. v. State Tax Assessor,* 561 A.2d 172 (Maine, 1989)

[18]*Wal-Mart Stores East, Inc. a/k/a Wal-Mart Stores East I, Inc. v. Hinton,* No. 06-CV-3928, 12/31/07, on appeal to the North Carolina Ct. App. No.: COA08-450

463 U.S. 159 (1983), on the question of whether formulary apportionment could be applied to an international unitary business even if the foreign aspects of the business were separately incorporated. Recall that one of the Court's earliest precedents upholding formulary apportionment, *Bass, Ratcliff & Gretton v. State Tax Commission,* 266 U.S. 271 (1924), involved a business operating in both England and the United States. The question now was whether a state could include the income and factors of unitary foreign operations that were separately incorporated. The Court agreed that it could.

Then, in 1994, California was once again before the Court in *Barclays Bank PLC v. Franchise Tax Board,* 512 US 298 (1994). There the Court upheld combined apportionment even though the parent was a foreign corporation.

After the *Container* and *Barclays* cases, a number of states began to show interest in worldwide combined reporting. The international business community and foreign governments became concerned, in part because unitary apportionment was not the standard for United States' or foreign governments' taxation of international income at the national level. The U.S. Treasury formed a Working Group, with state, federal, and business community representatives. The 20 members of this Working Group

included chairs of large corporations (Ford, Exxon, IBM, and others) State legislators (such as the house speakers from Florida and New Hampshire), Governors (from Utah, Illinois, and California) and high level federal staff (including the U.S. Secretary of the Treasury and an Under Secretary of State). Although no agreement was reached, The Working Group Chairman's Report ultimately recommended States adopt water's-edge combination that includes only those foreign entities doing business in a tax haven.[19] As a result of the report and the extreme unpopularity of the concept, the States stepped away from worldwide combined reporting.

G. *2000's: Second Generation Combined Reporting*

A second wave of interest in combined reporting took hold in 2004 when Vermont became the first state in almost 20 years to enact it. Over the last four years, six additional states have joined the original sixteen. The six states are Massachusetts, Michigan, New York, Texas, Vermont, and West Virginia. Today, twenty-two states require combined reporting:

[19]Worldwide Unitary Taxation Working Group - Chairman's Report and Supplemental Views (August 1984)

• Alaska	• Minnesota
• Arizona	• Montana
• California	• Nebraska
• Colorado	• New Hampshire
• Hawaii	• New York
• Idaho	• North Dakota
• Illinois	• Oregon
• Kansas	• Texas
• Maine	• Utah
• Massachusetts	• Vermont
• Michigan	• West Virginia

In 2007 and 2008 alone, the governors of Iowa, Maryland, Massachusetts (adopted), Michigan (adopted), New York (adopted), North Carolina and Pennsylvania proposed adoption of mandatory combined reporting.[20] And in August of 2006, the Multistate Tax Commission adopted its model combined reporting statute.

IV. WHY ARE STATES ONCE AGAIN MOVING TO COMBINED REPORTING?

Some of the benefits States expect from combined reporting are (1) a more accurate measure of income, (2) control over income shifting to out-of-state affiliates, (3) an apportionment method that has been approved by the

[20]Iowa HF 326, SB 1074 (2007); Maryland SB 2 (2008); Massachusetts? (2008); Michigan SB 94 (2007); New York SB 210 (2008); North Carolina SB 244, HB 462 (2007); Pennsylvania HB 1186 (2008)

U.S. Supreme Court, (4) a more uniform tax structure, and (5) efficiencies in audit and compliance.

A. *More Accurate Measure of Income*

The premise of combined reporting is that the "synergies, interdependencies, and sharing of knowledge, know-how, and experiences that are typical features of a unitary business often cannot be properly captured by [the alternative,] separate accounting." [21] With combined reporting, the enterprise-wide contributions to income that result from these features are not pigeon-holed into a few affiliates. Rather, they are apportioned across the entire enterprise, as they would be for a single corporation operating through divisions.

In this way, the substance of the business activity conducted in the state controls the amount of income subject to apportionment, regardless of the organizational structure of the business entity or entities conducting those activities. Whether a business chooses to operate as one corporation with numerous divisions or to incorporate

[21] *Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana;* 61 Louisiana Law Review 699, 700, by Michael J. McIntyre, Paull Mines and Richard D. Pomp (2001), p. 704.

those divisions into subsidiaries will not impact the amount of income produced by the business as a whole, subject to apportionment, and attributable to the state.

By contrast, attempting separate accounting when a business has incorporated its divisions is very difficult, if not, in truth, impossible. Separate accounting "…ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise."[22] It fails to reflect that the value of the whole is greater than the sum of the parts.

B. *Control Income Shifting*

In principle, combined reporting is a revenue neutral accounting system. Its application to any individual taxpayer could either increase or decrease the amount of tax due, depending on the particular facts of that taxpayer's unitary business. In some cases, combination will increase the pool of income subject to apportionment. But in other cases, combination will cause an in-state taxpayer's profits to be off-set with an out-of-state

[22]*Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159, 165 (1983).

affiliate's losses, and will reduce the amount of income subject to apportionment. Even where combination brings in only affiliates with net income as opposed to losses, the effect of combination still could be either positive or negative depending on the out-of-state affiliates' apportionment factors, as those factors will be added to the taxpayer's apportionment factor denominators and reduce the taxpayer's apportionment percentage.

Although the tax effect of combined reporting is neutral in principle, in practice combined reporting is likely to have a positive impact on tax revenue because it eliminates the tax benefit from shifting income to out-of-state affiliates. Where profits of a unitary business have been concentrated in an out-of-state affiliate, combination will recognize these profits as part of the income of the unitary business, subject to apportionment.

More recently, states have had to grapple with tax planning that purposely shifts an operating company's income by transferring trademarks, patents or other intangible property to an affiliated intangible holding company. The affiliate may be located in a state that does not tax income on intangibles, such as Delaware or Nevada, or a foreign tax-haven. The affiliate then charges the operating company for the use of its trademarks or patents.

The charge creates a deductible expense for the operating company, which offsets income that otherwise would be taxable by the state in which the company is doing business and earning income. In addition, the royalty or patent income of the affiliated holding company may be loaned back to the operating company, and a second deduction may be allowed for the payment of interest on the loan. Other examples include transactions with an out-of-state affiliate to purchase tangible goods or services that may or may not be undertaken at market prices.

Under combined reporting, affiliated unitary corporations must report income on a combined basis, effectively determining the tax base as though the group were a single business entity, and blocking potential tax benefits from income shifting transactions among the group members. With combined reporting, there is no need for the tax agency to specifically identify these income shifting transactions or defend against them. There is no need to audit and review transfers among affiliates to ensure they were made at arm's length and reflect market prices. Instead, the incomes of the affiliates are simply combined as a matter of course in determining the apportionable income base.

Some states have used add-backs to address this income shifting. But add-backs are a limited response to income shifting. Usually they only address income shifting from very specific circumstances, such as licensing of intangibles or interest expenses. In addition, add-back statutes have proven difficult to draft and administer, particularly where a state wants to include provision to avoid double taxation or to recognize intangible expenses that aren't primarily a vehicle for tax avoidance.

Compared to the alternatives, for example §482 style arms length pricing audits or add-backs, combined reporting is simpler and less costly for both the tax agency and the taxpayer, and is an administratively preferred method for neutralizing income shifting.

C. *Sanctioned by the U.S. Supreme Court*

The constitutionality of combined reporting has been reviewed by the U.S. Supreme Court. As noted above, the Court's first review was the *Container* case, where combined reporting was sustained as constitutional, even though some of the entities in the group were foreign subsidiaries.[23]

[23]*Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983). It should be noted that in *Container* the taxpayer did not challenge combined reporting for domestic affiliates.

Later, in *Barclay's Bank PLC*, the U.S. Supreme Court sustained the application of worldwide combined reporting where the parent of the group was a foreign corporation.[24] In *Barclays*, the U.S. Supreme Court held California's worldwide combined reporting system was not burdensome and appropriately apportioned the taxpayer's income attributable to California.

By contrast, add-backs are only now beginning to be litigated and the outcomes are uncertain.[25] Many states that currently have add-back provisions are considering adoption of combined reporting[26] which suggests add-backs are not necessarily a complete, or administratively satisfactory, answer to the income shifting problem.

D. *More Uniform Tax Systems*

As noted above, twenty-two states now require combined reporting. Another six states allow its use either at the election of the taxpayer or upon some finding by the tax

---

[24]*Barclay's Bank PLC v. Franchise Tax Board*, 512 US 298 (1994).

[25]*See, Surtees v. VFJ Ventures, Inc.*, No. 2060478 (Ala. Ct. Civ. App. February 8, 2008), cert. granted (Ala. Sup. Ct. Apr. 8, 2008).

[26]*See,e.g.*, Connecticut HB 5884 (2008), Maryland SB 2 (2007), Massachusetts HB 4499 (2008).

administrator.[27] To the extent states use, or allow the use of, the same methodology for determining the amount of a business's income subject to tax in the state, the potentials for double taxation and "nowhere" income are reduced and tax preparation is simplified, benefiting both multistate taxpayers and state governments.

E. *Efficiencies in Audit and Compliance*

Virtually all states and multistate taxpayers should be familiar with the unitary business principle. All states that use formulary apportionment - and today that means essentially all states with a corporate income or franchise tax - are required by the dormant Commerce Clause of United States Supreme Court jurisprudence to abide by unitary principles, even in the context of separate entity reporting. For example, the determination of whether an item of income may be properly included in the pool to be apportioned requires application of the unitary business principle even in separate entity states where only a single taxpayer's income is at issue.[28] If two divisions of taxpayer are engaged in different unitary businesses, the

---

[27]See paper by conference co-panelists, Charolette F. Noel and Carolyn Joy Lee, both of Jones Day.

[28]*Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 100 S.Ct. 1223 (1980).

income from those businesses must be apportioned separately, even in separate entity states. Extending the unitary determinations to all entities included within a combined reporting group presents no greater challenges and should, in fact, simplify the process. Use of combined reporting, and the use of a single return for reporting purposes for all members of the unitary business, can reduce the number of returns filed and will eliminate the need to review intercompany transactions to make sure prices are arms' length and income is fairly reflected.

V. CURRENT COMBINED REPORTING STRUCTURES - HOW UNIFORM ARE THEY?

Any combined reporting structure must answer three main questions: (1) When is combined reporting required? (2) Who is required to be combined? (3) How is combination accomplished? While there is clearly diversity in the details across the combined reporting states, there is actually a large degree of uniformity on the fundamental policy choices. In addition, the Multistate Tax Commission has developed a model combined reporting statute that is primarily based on the features of existing structures and

should help increase uniformity among the states that are now considering combined reporting.[29]

A. *When is Combination Required?*

Of the 22 states listed above as combined reporting states, all require combination of unitary affiliates, rather than: (a) merely permitting combined reporting upon the request of either the taxpayer or the department; or (b) conditioning combined reporting on some triggering event, such as a showing of distortion or improper transfer pricing. The Commissions model statute follows this approach.[30]

This policy choice reflects a position that combined reporting is the superior method for determining the amount of income properly attributable to a state. Required combination helps ensure the rule will be applied uniformly, regardless of the impact on tax liability in individual cases. A combined reporting rule which applies only upon the request of a taxpayer would do little to address the potential for income shifting to out-of-state

[29]*See* Multistate Tax Commission model combined reporting statute: http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Uniformity/Uniformity Projects/A - Z/Combined%20Reporting%20-%20FINAL%20version.pdf

[30]Multistate Tax Commission model combined reporting statute §2.A.

affiliates, since a taxpayer that wished to engage in shifting would simply not request combined reporting.

B. *Who is Required to be Combined?*

1. *Unitary Entities*

As mentioned above, constitutional principles prohibit a state from requiring an entity to be included in the taxpayer's apportionment calculation unless that entity is engaged in a unitary business with the taxpayer. U.S. Supreme Court precedent largely governs the determination of unity, so states are largely consistent with respect to this requirement. Where states have defined unity in statute or regulation, they have by and large defined it using the language from one or more of this handful of landmark U.S. Supreme Court cases, along with one state case, *Edison California Stores* 183 P.2d 16 (Cal. 1947), which was cited favorably by the U.S. Supreme Court in *Barclays*.[31] (See Table 1.) To enhance state uniformity in applying these judicial standards, the Commission has

[31] *Barclays Bank PLC v. Franchise Tax Bd. of California*, 512 U.S. 298, 304 (1994)

adopted a model regulation that defines a unitary business in detail.[32]

Because so many states have long-required combined reporting, many taxpayers now have extensive experience determining whether their various affiliates are unitary such that combination is required. And, because the determination of unity is largely governed by U.S. constitutional principles, once a taxpayer has identified its unitary group for one state it has likely determined it for others.

2. *World-Wide vs. Water's-Edge*

Whether or not, and the extent to which, unitary foreign affiliates are included in the apportionment calculation is one of the most significant policy issues addressed in a combined reporting statute. In principle, a combined group should include all affiliates participating in the group's unitary business, domestic and foreign. If combination includes only domestic corporations, then the apportionment of income associated with the foreign activity of a multinational unitary business can be

[32]See MTC General Allocation and Apportionment Regulations; Regulation IV.1(b) Unitary Business (revised January 15, 2004). http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Uniformity/Uniformity Projects/A - Z/Combined%20Reporting%20-%20FINAL%20version.pdf

manipulated through changes in the corporate structure. The income (or loss) and apportionment factors associated with the foreign activity could be excluded by conducting the activity as a foreign affiliate, or it could be included by conducting the activity as a foreign division of the domestic corporation. Many tax experts have noted this policy rationale supporting world-wide combined reporting.[33]

But as we've seen, despite its conceptual superiority and U.S. Supreme Court sanction[34], the worldwide approach was extremely unpopular with multinational corporations and much of the international tax community.[35] As a result, few states now require worldwide combined reporting. Those that do, allow taxpayers to *elect* to file on a water's-edge basis. Only Alaska mandates worldwide combined reporting, and only for oil and gas producers and pipeline companies.[36]

---

[33]*See Use of Combined Reporting by Nation States*, by Michael J. McIntyre, Tax Notes International; p. 945 (Sept. 6, 2004). *See also Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana; Supra*, p. 732; citing to *Slicing the Shadow: A Proposal for Updating U.S., International Taxation*, by Reuven S. Avi-Yonah, 58 Tax Notes 1511 (March 15, 1993); *Design of a National Formulary Apportionment Tax System*, by Michael J. McIntyre, 84th Conf. on Tax'n, Nat'l Tax Ass'n 118 (Frederick D. Stocker ed. 1991).

[34]*Container*, 463 U.S. 159, 103 S. Ct. 2983; *Barclays*, 512 U.S. 298, 114 S. Ct. 2268.

[35]*Designing a Combined Reporting Regime for a State Corporate Income Tax: A Case Study of Louisiana; Supra*, p. 732.

[36]Alaska Stat. § 43.20.072

Three states include entities doing business in tax havens - Montana, Alaska and West Virginia.[37]

The Commission's model combined reporting statute follows a similar policy. It requires worldwide combination, with a water's-edge election. The water's-edge election does not exclude unitary foreign affiliates if the affiliate is doing business in a tax haven. The Commission's model defines "tax haven" as a jurisdiction that is either identified by the Organization for Economic Co-operation and Development (OECD) as a tax haven …" , or "exhibits the…characteristics established by the OECD in its 1998 report…as indicative of a tax haven…"[38]

3. *Entities That Are Not Corporate Income Taxpayers*

A unitary business may be carried on by many types of entities acting together, not just corporations and certainly not just corporations that are corporate income taxpayers. It would be theoretically correct and, in many

---

[37]Alaska Stat. § 43.20.073(a)(5); Mont. Code § 15-31-322(f); W. Va. Code, § 11-24-13f(a)(7).

[38]*See* MTC model combined reporting statute §1.I. http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Uniformity/Uniformity Projects/A - Z/Combined%20Reporting%20-%20FINAL%20version.pdf. *See also,* Harmful Tax Competition: An Emerging Global Issue (Organization for Economic Cooperation and Development, 1998) http://www.oecd.org/dataoecd/33/1/1904184.pdf

states, legally acceptable to require inclusion of all such entities in the apportionment calculation in order to properly apportion the taxpayer's share of unitary business income.

This question has only grown in importance over the last fifteen years as Congress began breaking down barriers between different types of financial services industries.[39] One outcome of the federal changes is that industries such as banking and insurance companies, which are often exempted from the corporate income tax, may now branch out and engage in a unitary business with other financial service industries that are subject to the tax.

Some states have taken the position that non corporate income taxpayers should be excluded from the combined group.[40] Others have either taken the position that they are includable or have not addressed the issue yet. For example, in *State ex rel. Dept. of Revenue v. Penn Independent Corp.* [41], the Oregon Tax Court found the

---

[39]See *e,g,* Riegle-Neal Act and Gramm-Leach-Bliley Acts of 1994 and 1999.

[40]*See, e.g.,* Vermont and California. The "in lieu of" provisions for insurance premiums tax is a constitutional provision in California, unlike most states where it is statutory.

[41]*State ex rel. Dept. of Revenue v. Penn Independent Corp.* 15 Or. Tax 68 (1999); *See also, Appeal of Wendy's International,* Kansas Board of Tax Appeals Docket No. 2006-3929-DT.

apportionable income of a unitary group should include the income of an insurance corporation even though that corporation was not subject to Oregon's corporate income tax, but instead paid a gross premiums tax. The Tax Court noted "[i]t is important to remember that including the income of a nontaxable member of a unitary group does not subject that income to taxation by Oregon. It merely provides the base from which the taxable corporation's share is apportioned."[42] The appropriateness of this holding was recognized by Walter Hellerstein: "Although the result in this case is unusual, Judge Byers's thoughtful analysis of the theoretical justification for the result is plainly correct."[43]

Nonetheless, only corporate income taxpayers have are required to be combined under the Commission's model statute. The rationale for this limited requirement is that combination of entities which operate under significantly dissimilar financial and tax regimes can create serious mechanical issues that need to be worked out. Furthermore, the resolution of those mechanical issues is likely to be different depending on the type of business entity or

---

[42]*Penn Independent*, p. 74

[43]Hellerstein, State Taxation: 2001 Cumulative Supplement No. 1, ¶ 8.11[3][e].

industry at issue. For example, combination of insurance companies may engender questions of how to establish "taxable income" for the insurance company that at the state level is subject only to a tax on gross premiums. Combination of financial institutions in states that exclude these entities from the corporate income tax may raise issues surrounding the treatment of financial instruments in the calculation of the sales or property factors. In addition, different entities subject to different tax regimes in different states, e.g. exempt organizations under IRC section 501(c)(3) may or may not be properly combined in those states. A review of state constitutional, mechanical or policy impediments to combination for each of the different types of entities may be advisable.

For these reasons, the Commission's model statute does not require combination of non corporate income taxpayers. But the model statute does authorize the tax administrator to require combination of such entities by regulation, so that proper inquiry can be made in each situation.[44]

---

[44]MTC model combined reporting statute §2.B. The model statute also allows combination on an ad hoc basis in the case of tax avoidance or evasion.http://www.mtc.gov/uploadedFiles/Multistate Tax Commission/Uniformity/Uniformity Projects/A - Z/Combined%20Reporting%20-%20FINAL%20version.pdf

C. *How is Combination Accomplished?*

Of course the method of combination involves a great deal of technical detail and as such states are more likely to deviate in their answers to this question. Nonetheless, there is still a good deal of uniformity with respect to the main policy choices. A threshold policy choice is whether the state treats the members of the combined group as separate taxpayers or treats the group itself as a single taxpayer. This determination can drive the treatment of many other issues, including net operating losses, sharing (or not) of credits, and determination of factor numerators. Most states treat the group members as separate entities. For these states, each entity's share of the combined group's unitary business income attributable to the state is generally determined as shown in Table 2. A handful of states - Arizona, Utah, and New York - view the group as a single taxpayer for some apportionment purposes.[45] In particular, these States include the entire group's sales in the state numerator, regardless of whether some members of the group making those sales would have had

[45]*See,* Disney *Enterprises, Inc., et al. v. Tax Appeals Tribunal of the State of New York et al.,* 888 N.E.2d 1029 (N.Y.,2008); *Airborne Navigation Corporation v. Arizona Department of Revenue,* Ariz. Bd. of Tax Appeals, Docket No. 395-85-I (February 5, 1987); Utah R865-6F-24.

nexus or been protected by PL86-272 if viewed on a stand-alone basis. A few states which treat members as separate taxpayers - Kansas, Michigan and Indiana - employ the reasoning in the California case, *Finnigan*[46], to achieve a similar apportionment result for the group when viewed as a whole.

Under the Commission's model statute, the combined report does not disregard the separate identities of the taxpayer members of the combined group. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to the state, which includes, among other items of income, the taxpayer's apportioned share of the unitary income of the combined group. The statute takes into account that taxpayer members may be engaged in more than one unitary business.

Because individual group members are recognized as separate taxpayers, as a general rule, deductions and credits are taken only by the taxpayer that earned the deduction or credit, and not against the total combined income or liability of the group. Likewise, the amount of business income apportioned to a state is calculated as a function of each taxpayer's own factors in that state (the

[46]*Appeal of Finnigan Corporation*, 88 SBE 022 (1988).

Joyce method[47]), as opposed to the factors for the entire group as a whole (the *Finnigan* method[48]).

The Commission's model statute does provide some exceptions to this general rule preserving the separate identity of the taxpayer. In particular, a charitable contribution deduction is allowed to be taken first against the business income of the combined group (subject to federal income limitations as applied to the entire business income of the group), and any remaining amount may then be treated as a nonbusiness expense allocable to the member that incurred the expense (subject to the federal income limitations applied to the nonbusiness income of that taxpayer member).

D. *Will States Adopt the Commission's Model Uniform Combined Reporting Statute?*

The Multistate Tax Commission adopted its model uniform combined reporting statute in August of 2006. Since then, West Virginia and Massachusetts have moved to combined reporting and both utilized the Commission model.[49]

---

[47]*Appeal of Joyce, Inc.*, 66 SBE 069 (1966)

[48]*Finnigan*, 88 SBE 022 (1988)

[49]Also since August 2006, New York has amended its existing combined reporting statute.

West Virginia adopted the model nearly verbatim. The Massachusetts legislation is based on the Commission's model with modifications. In 2008, legislation introduced in Florida, Kentucky, and Tennessee also included the model's provisions.[50] It seems the model is given serious consideration by the states that are interested in moving to combined reporting. It should have its intended result of helping to increase uniformity.

---

[50]Florida HB 1237 (2008); Kentucky HB 302(2008); Massachusetts HB 4645 (2008); Tennessee SB 3158 (2008).

Table 1

Tests for Unity

- *Mobil* 3 Factors
  445 U.S. 425 (1980)
  - Functional Integration
    - Transfer
    - Pooling
  - Economies of Scale, and
  - Centralized Management

- *Container*
  463 U.S. 159 (1983)
  - Flow of Value, or
  - Substantial mutual interdependence
  - And unity of ownership

- *Butler Bros.* 3 unities
  315 U.S. 501 (1942)
  - Unity of ownership
  - Unity of operation, and
  - Unity of use

- *Edison Ca. Stores*
  183 P.2d 16 (Cal. 1947)
  - Contribution, or
  - Dependency

Table 2

Typical Computation of Tax Liability Using Combined Report

TP's federal taxable income (determined w/o regard to federal consolidated rules)

+ or – state adjustments

– TP's non-apportionable income

– TP's apportionable income from another unitary business (separately apportioned)

= TP's unitary apportionable income

+ Other group members' similarly calculated unitary apportionable income

x TP's apportionment percentage (average of 3 factors where each factor numerator is TP's in state factor, and each factor denominator is the sum of all group members' factors)

= TP's state unitary apportioned income

+ TP's non-apportionable income allocated to the state

+ TP's apportioned income from another unitary business (separately apportioned)

= TP's state taxable income

x tax rate

= TP's gross state tax

– TP's state tax credits

= TP's state tax liability

HP LaserJet P1505

Self Test / Configuration

Product Information

Product Name:	= HP LaserJet P1505
Formatter Number:	= CA57295
Product Serial Number:	= CNBK204283
Service ID:	= 18154
Firmware Version:	= 20070816
Max Print Resolution:	= FastRes 1200

Memory

Total Memory:	= 2 MBytes
Available Memory:	= 0 MBytes

Counters

Total Pages printed	= 2666
Input Jams	= 0
Output Jams	= 1
Narrow Media Page Count	= 4
Cartridge Jams	= 0
Average Job Size	= 2.84
Total Jobs Printed	= 937
Average Coverage	= 5

Status Log

Code	Page
13.0002	2246

Multistate Tax Commission
Proposed Model Statute for Combined Reporting

As approved by the Multistate Tax Commission August 17, 2006

Section 1. Definitions.

A. "Person" means any individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership, foreign limited liability partnership, association, corporation (whether or not the corporation is, or would be if doing business in this state, subject to [state income tax act]), company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of any kind.

B. "Taxpayer" means any person subject to the tax imposed by [State Corporate income tax act].

C. "Corporation" means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this state, wherever located, which if it were doing business in this state would be a "taxpayer." The business conducted by a partnership which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation's distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation.

D. "Partnership" means a general or limited partnership, or organization of any kind treated as a partnership for tax purposes under the laws of this state.

E. "Internal Revenue Code" means Title 26 of the United States Code of [date] [and amendments thereto] without regard to application of federal treaties unless expressly made applicable to states of the United States.

F. "Unitary business" means [a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.] Drafter's note: This portion of the definition is drafted to follow MTC Reg. IV(b), defining a "unitary business." A state that does not wish to define unitary business in this manner should consider alternative language. In addition, this MTC Regulation defining unitary business includes a requirement of common ownership or control. A state which treats ownership or control requirements separately from the unitary business requirement will need to make additional amendments to the statutory language. Any business conducted by a partnership shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner's distributive share of the partnership's income, regardless of the percentage of the partner's ownership interest or its distributive or any other share of partnership income. A business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this section 1.F. are satisfied, to wit: there is a synergy, and

exchange and flow of value between the two parts of the business and the two corporations are members of the same commonly controlled group.

G. "Combined group" means the group of all persons whose income and apportionment factors are required to be taken into account pursuant to Section 2.A. or 2.B. in determining the taxpayer's share of the net business income or loss apportionable to this State.

H. "United States" means the 50 states of the United States, the District of Columbia, and United State's territories and possessions.

I. "Tax haven" means a jurisdiction that, during the tax year in question:

i. is identified by the Organization for Economic Co-operation and Development (OECD) as a tax haven or as having a harmful preferential tax regime, or

ii. exhibits the following characteristics established by the OECD in its 1998 report entitled Harmful Tax Competition: An Emerging Global Issue as indicative of a tax haven or as a jurisdiction having a harmful preferential tax regime, regardless of whether it is listed by the OECD as an un-cooperative tax haven:

(a) has no or nominal effective tax on the relevant income; and

(b) (1) has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

(2) has tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available;

(3) facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

(4) explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market; or

(5) has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

Section 2. Combined reporting required, when; discretionary under certain circumstances.

A. Combined reporting required, when. A taxpayer engaged in a unitary business with one or more other corporations shall file a combined report which includes the income, determined under Section 3.C. of this act, and apportionment factors, determined under [provisions on apportionment factors and Section 3.B. of this act], of all corporations that are members of the unitary business, and such other information as required by the Director.

B. Combined reporting at Director's discretion, when. The Director may, by regulation, require the combined report include the income and associated apportionment factors of any persons that are not included pursuant to Section 2.A., but that are members of a unitary business, in order to reflect proper apportionment of income of entire unitary businesses. Authority to require combination by regulation under this Section 2.B. includes authority to

require combination of persons that are not, or would not be if doing business in this state, subject to the [State income tax Act].

In addition, if the Director determines that the reported income or loss of a taxpayer engaged in a unitary business with any person not included pursuant to Section 2.A. represents an avoidance or evasion of tax by such taxpayer, the Director may, on a case by case basis, require all or any part of the income and associated apportionment factors of such person be included in the taxpayer's combined report.

With respect to inclusion of associated apportionment factors pursuant to Section 2.B., the Director may require the exclusion of any one or more of the factors, the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State, or the employment of any other method to effectuate a proper reflection of the total amount of income subject to apportionment and an equitable allocation and apportionment of the taxpayer's income. .

Section 3. Determination of taxable income or loss using combined report.

The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include, in addition to other types of income, the taxpayer member's apportioned share of business income of the combined group, where business income of the combined group is calculated as a summation of the individual net business incomes of all members of the combined group. A member's net business income is determined by removing all but business income, expense and loss from that member's total income, as provided in detail below.

A. Components of income subject to tax in this state; application of tax credits and post apportionment deductions.

i. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include:

(a) its share of any business income apportionable to this State of each of the combined groups of which it is a member, determined under Section 3.B.,

(b) its share of any business income apportionable to this State of a distinct business activity conducted within and without the state wholly by the taxpayer member, determined under [provisions for apportionment of business income],

(c) its income from a business conducted wholly by the taxpayer member entirely within the state,

(d) its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under Section 3.C.ii.(g), below,

(e) its nonbusiness income or loss allocable to this State, determined under [provisions for allocation of non-business income],

(f) its income or loss allocated or apportioned in an earlier year, required to be taken into account as state source income during the income year, other than a net operating loss, and

(g) its net operating loss carryover or carryback. If the taxable income computed pursuant to Section 3 results in a loss for a taxpayer member of the combined group, that taxpayer member has a [state] net operating loss (NOL), subject to the net operating loss

limitations, carryforward and carryback provisions of [provisions on NOLs]. Such NOL is applied as a deduction in a prior or subsequent year only if that taxpayer has [State] source positive net income, whether or not the taxpayer is or was a member of a combined reporting group in the prior or subsequent year.

ii. Except where otherwise provided, no tax credit or post-apportionment deduction earned by one member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of the group or applied in whole or in part against the total income of the combined group; and a post-apportionment deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member in a subsequent year, will be considered in the computation of the income of that member in the subsequent year, regardless of the composition of that income as apportioned, allocated or wholly within this state.

B. Determination of taxpayer's share of the business income of a combined group apportionable to this State.

The taxpayer's share of the business income apportionable to this State of each combined group of which it is a member shall be the product of:

i. the business income of the combined group, determined under Section 3.C., and

ii. the taxpayer member's apportionment percentage, determined under [provisions on apportionment factors], including in the [property, payroll and sales factor]numerators the taxpayer's [property, payroll and sales, respectively,] associated with the combined group's unitary business in this state, and including in the denominator the [property, payroll and sales] of all members of the combined group, including the taxpayer, which property, payroll and sales are associated with the combined group's unitary business wherever located. The [property, payroll, and sales] of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group in accordance with Section 3.C.ii.(c). and the denominator of which is the amount of the partnership's total unitary income.

C. Determination of the business income of the combined group.

The business income of a combined group is determined as follows:

i. From the total income of the combined group, determined under Section 3.C.ii., subtract any income, and add any expense or loss, other than the business income, expense or loss of the combined group.

ii. Except as otherwise provided, the total income of the combined group is the sum of the income of each member of the combined group determined under federal income tax laws, as adjusted for state purposes, as if the member were not consolidated for federal purposes. The income of each member of the combined group shall be determined as follows:

(a) For any member incorporated in the United States, or included in a consolidated federal corporate income tax return, the income to be included in the total income of the combined group shall be the taxable income for the corporation after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].

(b) (1) For any member not included in Section 3.C.ii.(a), the income to be included in the total income of the combined group shall be determined as follows:

(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by the [state tax code]

(D) Except as otherwise provided by regulation, the profit and loss statement of each member of the combined group, and the apportionment factors related thereto, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records.

(E) Income apportioned to this state shall be expressed in United States dollars.

(2) In lieu of the procedures set forth in Section 3.C.ii.(b)(1), above, and subject to the determination of the Director that it reasonably approximates income as determined under [the State tax code], any member not included in Section 3.C.ii.(a) may determine its income on the basis of the consolidated profit and loss statement which includes the member and which is prepared for filing with the Securities and Exchange Commission by related corporations. If the member is not required to file with the Securities and Exchange Commission, the Director may allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If above statements do not reasonably approximate income as determined under [the State tax code] the Director may accept those statements with appropriate adjustments to approximate that income.

(c) If a unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business income.

(d) All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the earnings and profits of the unitary business included in the combined report, in the current or an earlier year, be eliminated from the income of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group.

(e) Except as otherwise provided by regulation, business income from an intercompany transaction between members of the same combined group shall be deferred in a manner similar to 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred business income resulting from an intercompany transaction between members of a combined group shall be restored to the income of the seller, and shall be apportioned as business income earned immediately before the event:

(1) the object of a deferred intercompany transaction is

(A) re-sold by the buyer to an entity that is not a member of the combined group,

(B) re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged, or

(C) converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged, or

(2) the buyer and seller are no longer members of the same combined group, regardless of whether the members remain unitary.

(f) A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Internal Revenue Code Section 170, be subtracted first from the business income of the combined group (subject to the income

limitations of that section applied to the entire business income of the group), and any remaining amount shall then be treated as a nonbusiness expense allocable to the member that incurred the expense (subject to the income limitations of that section applied to the nonbusiness income of that specific member). Any charitable deduction disallowed under the foregoing rule, but allowed as a carryover deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of this section shall apply in the subsequent year in determining the allowable deduction in that year.

(g) Gain or loss from the sale or exchange of capital assets, property described by Internal Revenue Code Section 1231(a)(3), and property subject to an involuntary conversion, shall be removed from the total separate net income of each member of a combined group and shall be apportioned and allocated as follows.

(1) For each class of gain or loss (short term capital, long term capital, Internal Revenue Code Section 1231, and involuntary conversions) all members' business gain and loss for the class shall be combined (without netting between such classes), and each class of net business gain or loss separately apportioned to each member using the member's apportionment percentage determined under Section 3.B., above.

(2) Each taxpayer member shall then net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this State, using the rules of Internal Revenue Code Sections 1231 and 1222, without regard to any of the taxpayer member's gains or losses from the sale or exchange of capital assets, Section 1231 property, and involuntary conversions which are nonbusiness items allocated to another state.

(3) Any resulting state source income (or loss, if the loss is not subject to the limitations of Internal Revenue Code Section 1211) of a taxpayer member produced by the application of the preceding subsections shall then be applied to all other state source income or loss of that member.

(4) Any resulting state source loss of a member that is subject to the limitations of Section 1211 shall be carried forward [or carried back] by that member, and shall be treated as state source short-term capital loss incurred by that member for the year for which the carryover [or carryback] applies.

(h) Any expense of one member of the unitary group which is directly or indirectly attributable to the nonbusiness or exempt income of another member of the unitary group shall be allocated to that other member as corresponding nonbusiness or exempt expense, as appropriate.

Section 4. Designation of surety.

As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may annually elect to designate one taxpayer member of the combined group to file a single return in the form and manner prescribed by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report, and agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

Section 5. Water's-edge election; initiation and withdrawal.

A. Water's-edge election.

Taxpayer members of a unitary group that meet the requirements of Section 5.B. may elect to determine each of their apportioned shares of the net business income or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account all or a portion of the income and apportionment factors of only the following members otherwise included in the combined group pursuant to Section 2, as described below:

i. the entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;

ii. the entire income and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and sales factors within the United States is 20 percent or more;

iii. the entire income and apportionment factors of any member which is a domestic international sales corporations as described in Internal Revenue Code Sections 991 to 994, inclusive; a foreign sales corporation as described in Internal Revenue Code Sections 921 to 927, inclusive; or any member which is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

iv. any member not described in [Section 5.A.i.] to [Section 5.A.iii.], inclusive, shall include the portion of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code without regard to federal treaties, and its apportionment factors related thereto;

v. any member that is a "controlled foreign corporation," as defined in Internal Revenue Code Section 957, to the extent of the income of that member that is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income") not excluding lower-tier subsidiaries' distributions of such income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income; any item of income received by a controlled foreign corporation shall be excluded if such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in Internal Revenue Code Section 11;

vi. any member that earns more than 20 percent of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined group, to the extent of that income and the apportionment factors related thereto; and

vii. the entire income and apportionment factors of any member that is doing business in a tax haven, where "doing business in a tax haven" is defined as being engaged in activity sufficient for that tax haven jurisdiction to impose a tax under United States constitutional standards. If the member's business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria established in Section 1.I., the activity of the member shall be treated as not having been conducted in a tax haven.

B. Initiation and withdrawal of election

i. A water's-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under [state income tax code]. The Director shall develop rules and regulations governing the impact, if any, on the scope or application of a water's-edge election, including termination or deemed election, resulting from a

change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

ii. Such election shall constitute consent to the reasonable production of documents and taking of depositions in accordance with [state statute on discovery].

iii. In the discretion of the Director, a water's-edge election may be disregarded in part or in whole, and the income and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section, if any member of the unitary group fails to comply with any provision of [this act] or if a person otherwise not included in the water's-edge combined group was availed of with a substantial objective of avoiding state income tax.

iv. A water's-edge election is binding for and applicable to the tax year it is made and all tax years thereafter for a period of 10 years. It may be withdrawn or reinstituted after withdrawal, prior to the expiration of the 10 year period, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the Director. If the Director grants a withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal. Upon the expiration of the 10 year period, a taxpayer may withdraw from the water's edge election. Such withdrawal must be made in writing within one year of the expiration of the election, and is binding for a period of 10 years, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water's edge election shall be in place for an additional 10 year period, subject to the same conditions as applied to the original election.

Oppose SB244/HB462 Modernize Corporate Income Tax Filing

The following organizations and companies are opposed to the adoption of mandatory unitary combined reporting as reflected in SB244/HB462. Passage of this legislation would put the State out of step with a majority of states, particularly states in the southeast, and therefore would have a chilling effect on the State's economic development climate. It would particularly impact research and development, as well as distribution companies--a growing part of our economy.

Mandatory combined reporting is not necessary in North Carolina. The Secretary of Revenue currently has the tools necessary to combat abusive intercompany transactions designed only to evade tax. Pursuant to existing statutory authority, he has imposed tax on out-of-state companies to which income was transferred - which was upheld by the State Court of Appeals. In other cases, he has required out-of-state companies to file using a combined methodology with the in-state company. Another statute disallows deductions for royalty payments made to a related company not filing returns in the State.

Enacting mandatory unitary combined reporting would unfairly cast a net over taxpayers that accurately reflect income in the State without adding to the Secretary's ability to pursue those engaged in tax evasion. Moreover, not only do states with mandatory unitary combined filing spend enormous resources in auditing and litigating the application of unitary law, requiring corporate taxpayers to file their income tax return using the new mandatory combined reporting will create an uncertain environment for both the taxpayer and North Carolina as to the final tax liability.

In short, this drastic change in policy creates:

- An anti-competitive business environment. Only 18 states require unitary combined reporting. None of North Carolina's neighboring states and no states in the Southeast require it. Florida adopted the practice over 20 years ago but quickly repealed it because of the negative impact on jobs.

- Tax and revenue uncertainty for both the corporate taxpayer and the State. It is difficult to determine the fiscal impact of a change to unitary combination as there are so many variables.

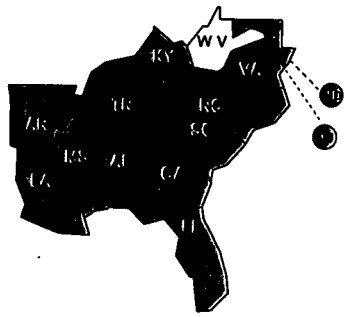
- A complex method of taxation which will lead to litigation and increased administrative and compliance costs for both the taxpayer and the State.

In summary, the adoption of "mandatory" combined reporting would place North Carolina "behind the curve" on state tax policy. It would create uncertainty for taxpayers and the state and would increase administrative and compliance costs. Most importantly, however, it causes a major setback in the state's efforts to attract and retain new jobs and investments in North Carolina.

AT&T
Abbott Laboratories
Alcoa
Amgen Inc.
Bank of America
Baxter HealthCare
Belk Stores
Charlotte Chamber of Commerce
CSX Transportation Inc.
First Charter Bank
Food Lion
General Electric
GlaxoSmithKline
Goodrich Corporation
Johnson & Johnson
Kimberly Clark
Raleigh Chamber of Commerce

LabCorp
Lorillard Tobacco
MCIC
Miller Brewing
National Gypsum
NC Bankers Association
NC Biosciences Organization
NC Retail Merchants Assoc.
Norfolk Southern Corp.
North Carolina Chamber
PepsiCo
Pfizer
Piedmont Natural Gas
Raleigh Chamber of Commerce
Reynolds American
Smithfield Foods
The Coca-Cola Company

Southeast States Mandatory Unitary Combined Reporting



☐ Mandatory Unitary Combined Reporting States

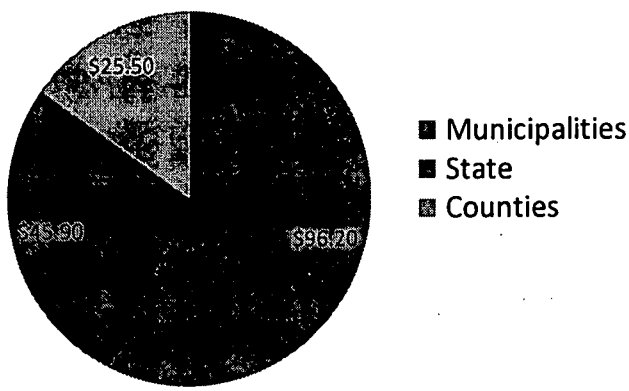
(Revised: 6/7/07)

Palmists, Peddlers & Pressing Clubs: Privilege License Taxes in North Carolina

Christopher B. McLaughlin
November 19, 2008

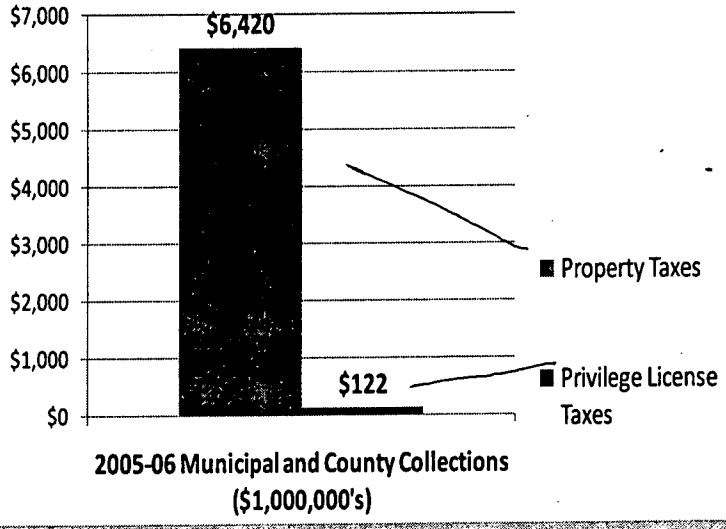
UNC SCHOOL OF GOVERNMENT www.sog.unc.edu

PLT Collections 2005-06



Total: $167,600,000

PLT v. Property Taxes



Municipal PLTs 2005-06

- $96,200,000 statewide
- 380 municipalities collected PLTs
  - 40% < $10,000
  - 80% < $100,000
  - only 14 > $1,000,000
- Three cities accounted for 40% of total
  - Charlotte ($15 M)
  - Raleigh ($14 M)
  - Winston-Salem ($9 M)



County PLTs 2005-06

- $25,500,000 statewide
- All 100 counties collected PLTs
  - 47 < $100,000
  - 6 > $1,000,000
- More evenly distributed than municipal PLTs
  - top 3 counties accounted for 18% of total
    - Harnett ($1,8 M)
    - Wake ($1.7 M)
    - Buncombe ($1.3 M)

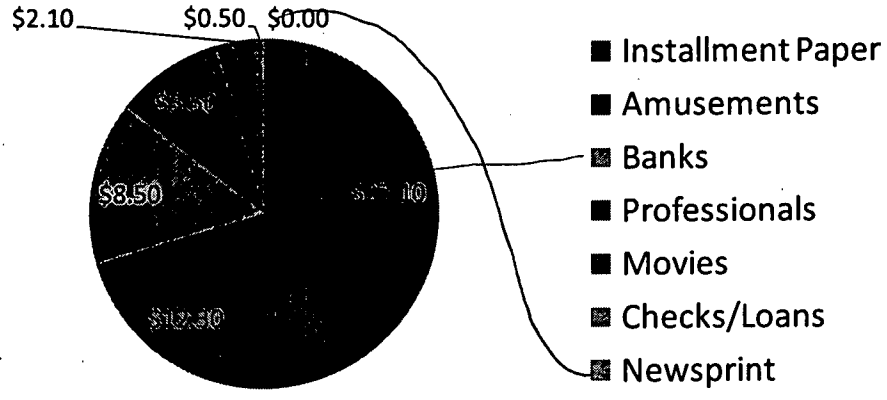


Current State PLTs

(All but 7 state PLTs were repealed as of July 1997)

Amusements	3%
Motion Picture Shows	1%
Professionals	$50
Installment Paper Dealers (Car loans primarily)	277% of face value of obligations/quarter
Loan agencies, check cashers, pawnbrokers	$250 per location
Banks	$30 for each $1 million in assets
Newsprint publishers	$15 on each ton that fails to meet the applicable content percentage

State PLT Collections
$56 M in 2007-08

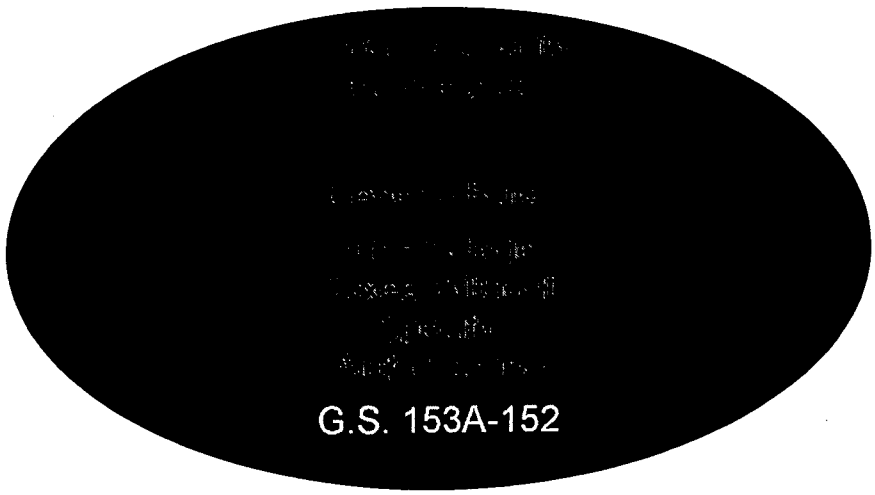


Local PLT's Since 1997

- **Municipalities** (§160A-211):
  - GENERAL authority to levy PLT's on <u>all</u> businesses EXCEPT as limited by 30 repealed Schedule B provisions
- **Counties**(§153A-152):
  - SPECIFIC authority to levy PLT'S on <u>certain</u> businesses ONLY as permitted by 11 repealed Schedule B provisions

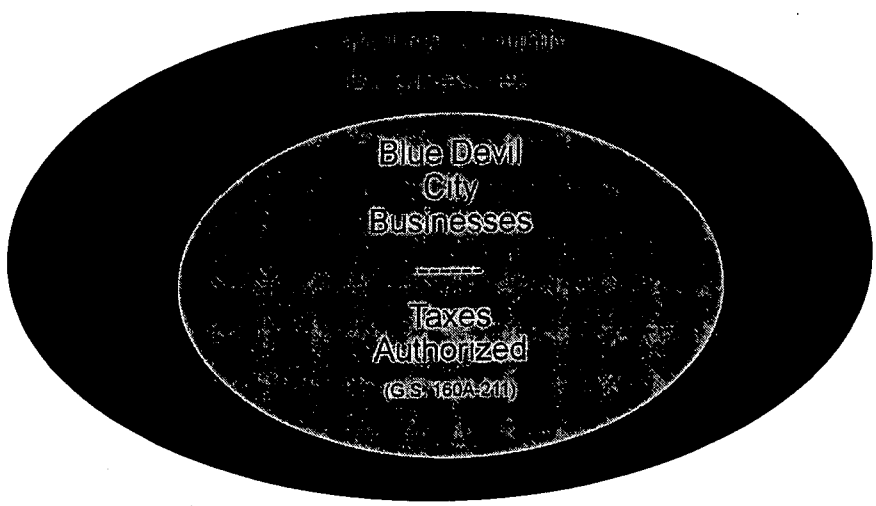


Local Privilege License Taxes In North Carolina



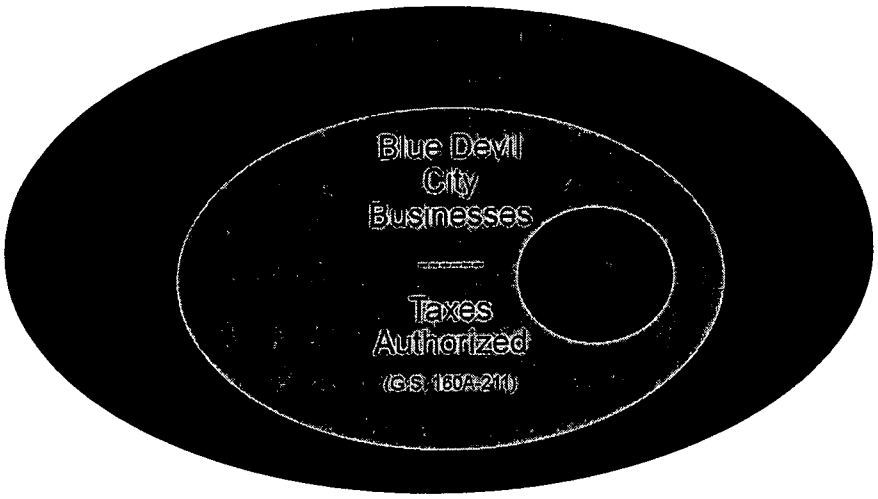
UNC SCHOOL OF GOVERNMENT

Local Privilege License Taxes In North Carolina



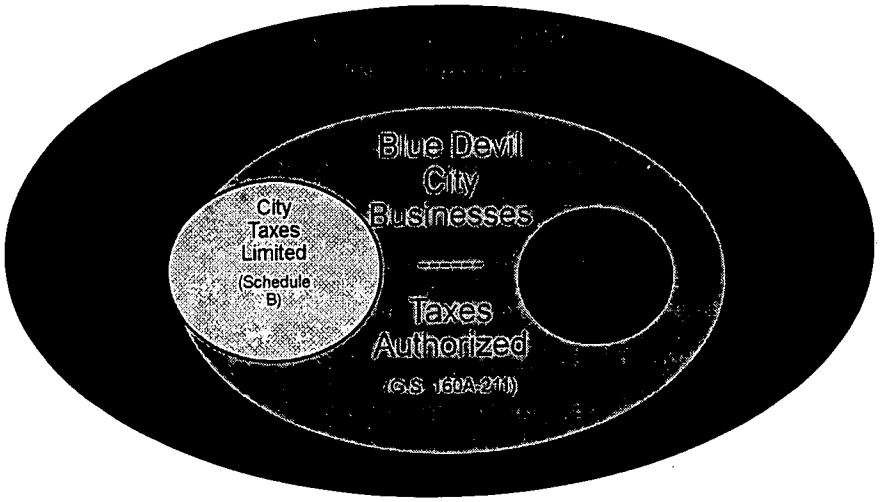
UNC SCHOOL OF GOVERNMENT

Local Privilege License Taxes In North Carolina



UNC

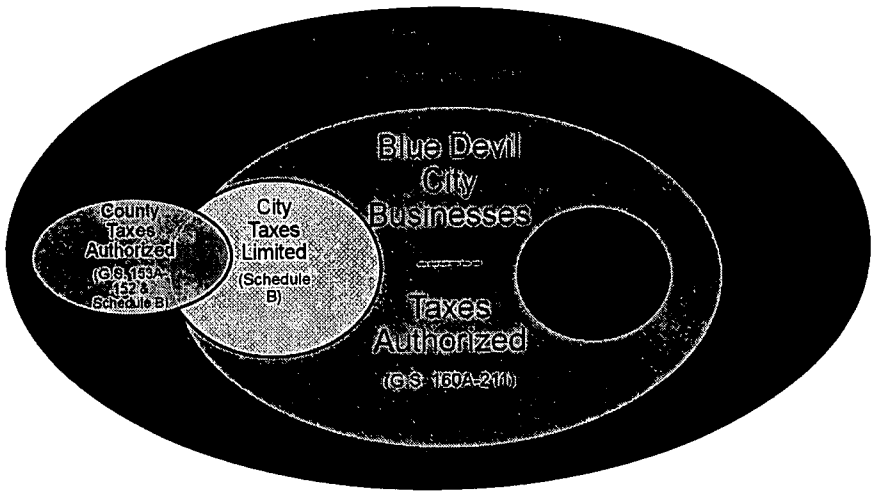
Local Privilege License Taxes In North Carolina



UNC

UNC
SCHOOL OF GOVERNMENT

Local Privilege License Taxes In North Carolina



Oddities from Schedule B

- Seasonal Christmas tree sales: $100 max
- Seasonal Christmas tree sales by grower: unlimited
- Vending Machines (< 5): $5 max
- Vending Machines (>=5): NO city PLT
- Vending Machines (>=5 at one location): Unlimited
- Vending Machines (milk): Unlimited
- Vending Machines (juice, >=5): Unlimited
- Selling Computers: NO city PLT
- Repairing Computers: Unlimited
- Selling/Repairing Record Players: NO city PLT
- Selling/Repairing DVD/CD Players: Unlimited

How to Tax Target?

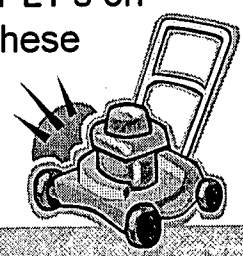
- **Gross Receipts on all sales . . . except**
  - Bicycles ($25 max)
  - DVDs ($25)
  - Computers, calculators (No tax)
  - Ice Cream ($2.50 max)
  - Motor Oil/Auto Accessories ($12.50 max)
- **Plus…**
  - Chain Store ($50)
  - Restaurant ($42.50)
  - Barber Shop/Beauty Salon ($2.50 per stylist)
  - Check Cashing ($100)
  - Vending Machines (????)

Sample City PLT Provisions For Retailers

- Gross Receipts
  - Durham: $50 up to $15,000, then 50¢ per $,1000; no max
  - Charlotte: 60¢ per $1,000; $10,000 max tax
- Flat Fee
  - Dunn: $30 per retailer
- Example: SuperTarget store with $100M receipts
  - Durham: $600,000
  - Charlotte: $10,000
  - Dunn: $30

Double Taxation?

- No statutory obligation to apportion gross receipts
- Landscaper based in Cary has clients in Cary, Raleigh, Durham, and Chapel Hill
  - Cary PLT on total revenues
  - Raleigh, Durham, and Chapel Hill PLT's on revenues generated in each city---these revenues are taxed twice

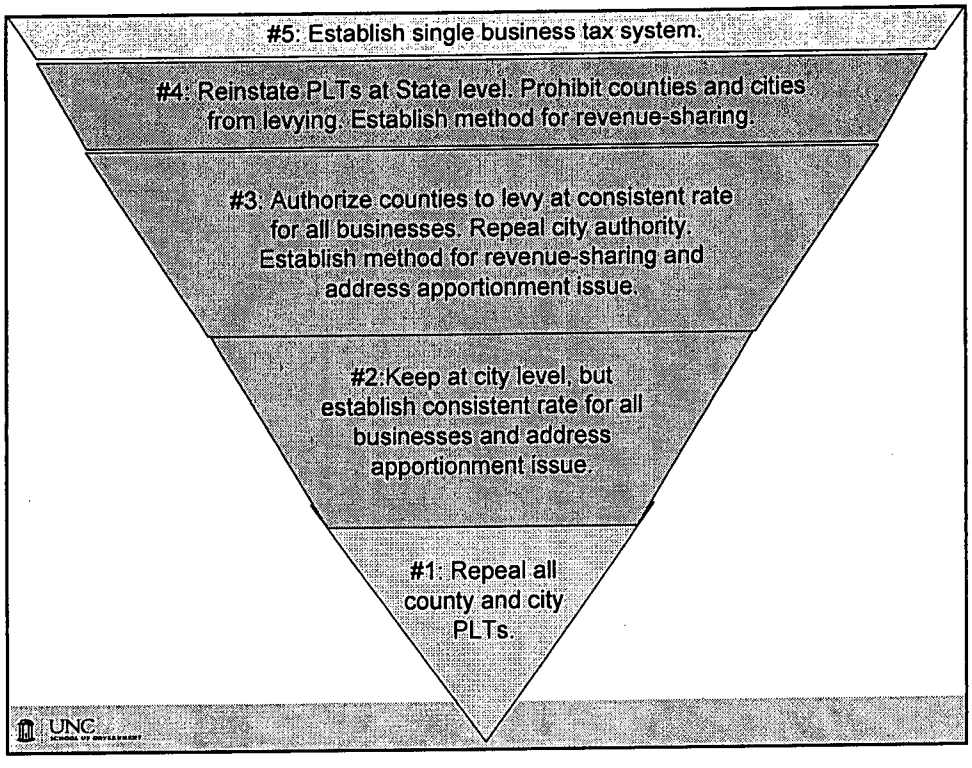


PLT Concerns

- Archaic Language (*Bagatelle tables*??)
- Repealed statutes
- Arbitrary distinctions between businesses
- Inconsistent application across NC
- Double taxation



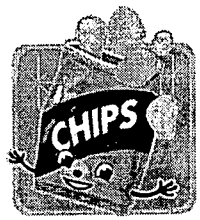
PLT Solutions?



Sales Tax Treatment of Food and Prepared Food

Revenue Laws Study Committee
November 19, 2008

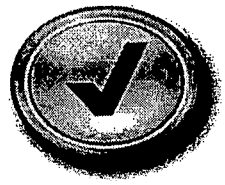
Sandra Johnson – Fiscal Research



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Overview

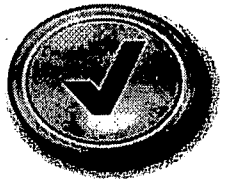
- The Small Business Protection Act, S.L. 2008-107 (Section 28.16)
- History of the Sales and Use Tax and Food
- Revenue and Recent Challenges
- Options
- Conclusion



FISCAL RESEARCH DIVISION

The Small Business Protection Act (SBPA)

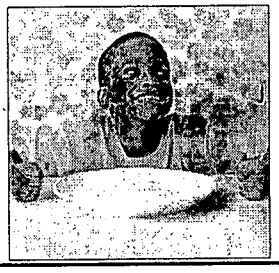
- Revenue Laws Study Committee:
  - Taxation of services
  - Differentiation between retailers and performance contractors
  - Distinction between food and prepared food



History of the Sales and Use Tax and Food

1933 → Exempts food for human consumption

1961 → Repeals food exemption



History of the Sales and Use Tax and Food

1998	Eliminates the State sales and use tax rate on food
2000	Enters Streamlined Sales Tax Project
2001	Redefines food into two types
2003	Determines prepared food is taxable by the state

FISCAL RESEARCH DIVISION
A staff Agency of the North Carolina General Assembly

Food for Home Consumption

- Definition—G.S. 105-164.13B
- Exempt unless it is defined as:
  - Dietary supplements
  - Vending machine items
  - Prepared food
  - Soft drinks
  - Candy



FISCAL RESEARCH DIVISION
A staff Agency of the North Carolina General Assembly

Food for Home Consumption

Fiscal Year 07-08

- Sales and use tax rate
  - State rate 0%
  - Local rate 2%
- Local Revenue $246 M

FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Prepared Food

- Definition—G.S. 105-164.3(28)
- Subject to the State and local sales tax if:
  - It is sold in a heated state
  - It consists of two or more foods mixed or combined by retailer
  - It is sold with eating utensils



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Prepared Food

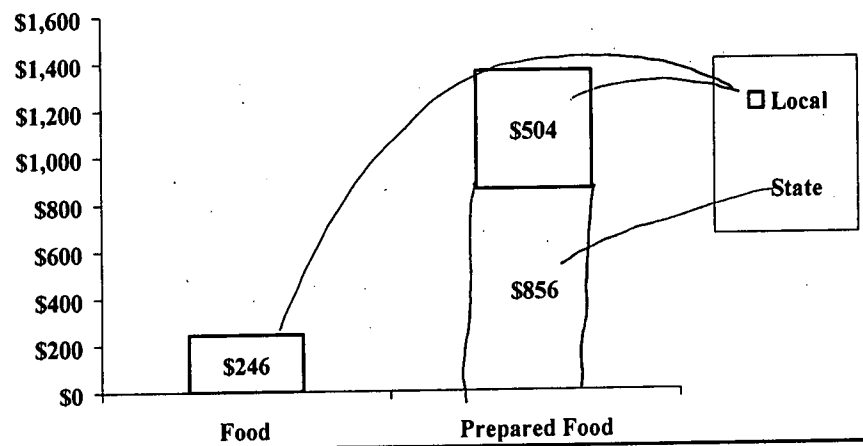
Fiscal Year 07-08

- Sales and use tax rate 6.75%
  - State 4.25%
  - Local 2.5%

- Revenue $1.4 Bill.
  - State $856 Mill.
  - Local $504 Mill.

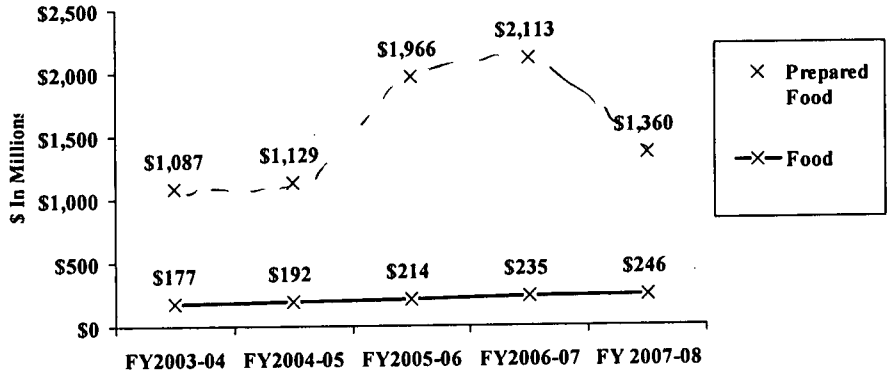
FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Tax Collections on Food and Prepared Food, FY07-08



FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Sales Tax Collections on Food and Prepared Food ($ In Millions)



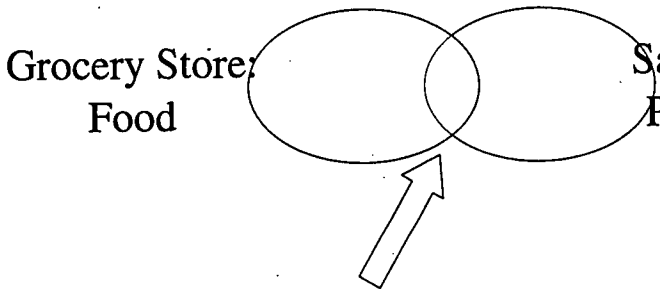
Source: 2004-2008 Statistical Abstract, North Carolina Department of Revenue, Tables 32, 56 and 57 in most publications

Recent Challenges

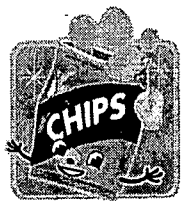
- Blurred line between food and prepared food
- Difficulty in administering different rates



A Day in the Life of a Bag of Potato Chips

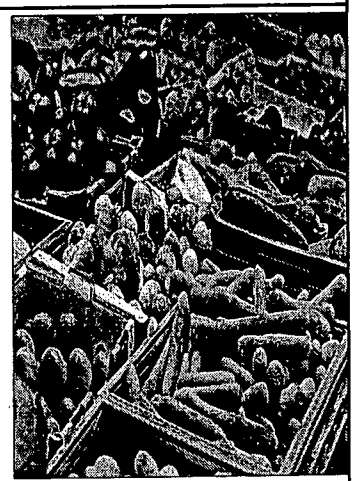


Area of Uncertainty

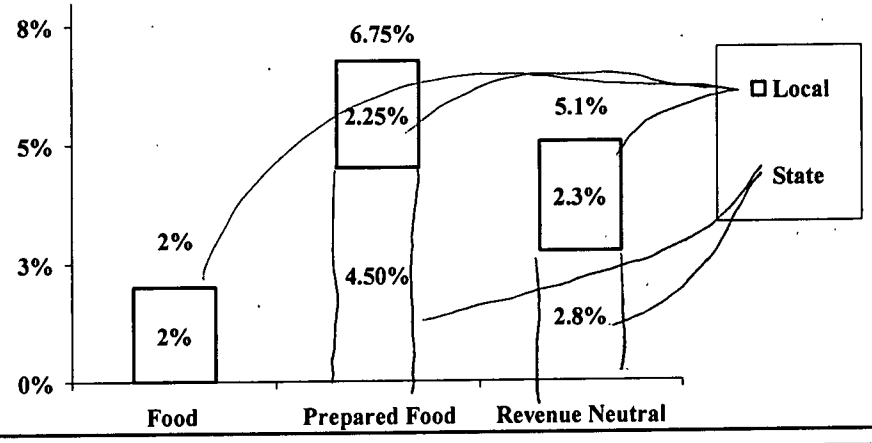


Options?

- Determine differences as they come
- Implement revenue neutral rate
- Other suggestions



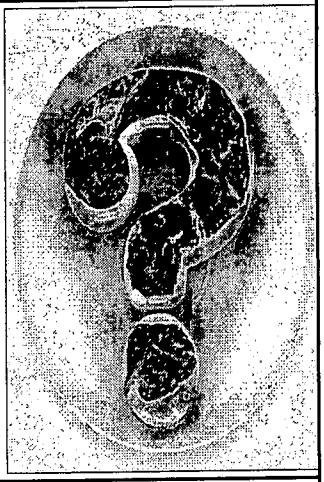
Revenue Neutral Rate for Food and Prepared Food



FISCAL RESEARCH DIVISION
A staff agency of the North Carolina General Assembly

Options?

- How other states tax food
  - U.S.
  - Streamlined Sales and Use Tax Project
- Past recommendations



FISCAL RESEARCH DIVISION
A staff agency of the North Carolina General Assembly

Other States Tax Treatment

U.S.

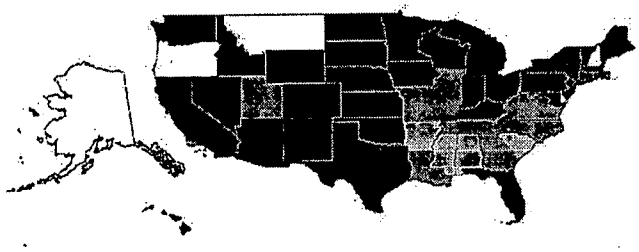
- Ten levy the full rate
- Five levy reduced rates
- Three apply local tax
- 27 states exempt food
- Five levy full rate but w/ caveats
- Five no sales tax

Streamlined

- 21 states
- 12 states exempt food
- One levies the full rate
- Four levy reduced rates or allow locals to tax
- Four levy full rate but w/ caveats

FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Tax Treatment of Food for Home Consumption, U.S.

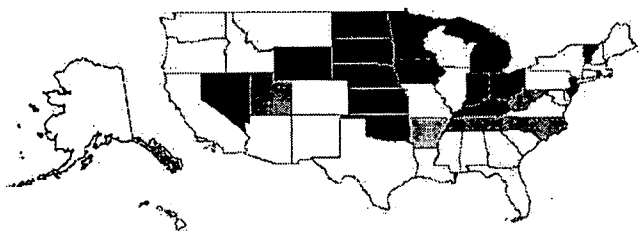


No State sales tax
Levy a State sales tax on food consumed at home at the full rate
Levy a State sales tax at a reduced rate, or food is only taxed by local governments
Exempts food from state sales tax
Levy a State sales tax on food, but provides relief to low-income tax payers through tax credits

Sources: Center on Budget and Policy Priorities and Federation of Tax Administrators

FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Tax Treatment of Food for Home Consumption, Streamlined States



Not a streamlined sales tax participating state
Levy a State sales tax on food consumed at home at the full rate
Levy a State sales tax at a reduced rate, or food is only taxed by local governments
Exempts food from State sales tax
Levy a State sales tax on food, but provides relief to low-income tax payers through tax credits

Sources: Streamlined Sales Tax Governing Board, Inc. and Federation of Tax Administrators

FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

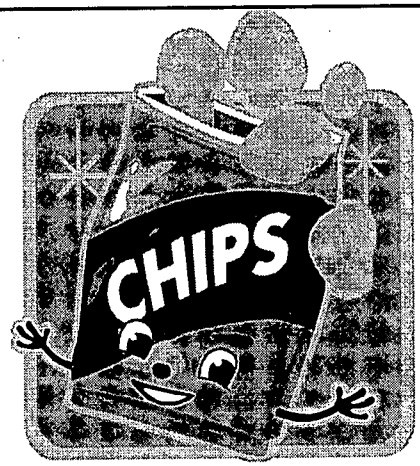
Past Recommendations on the Taxation of Food

1951	→	Eliminate food exemption
1984	→	Provide tax credit to low-income families
1991	→	Maintain tax on food
2008	→	Eliminate food exemption

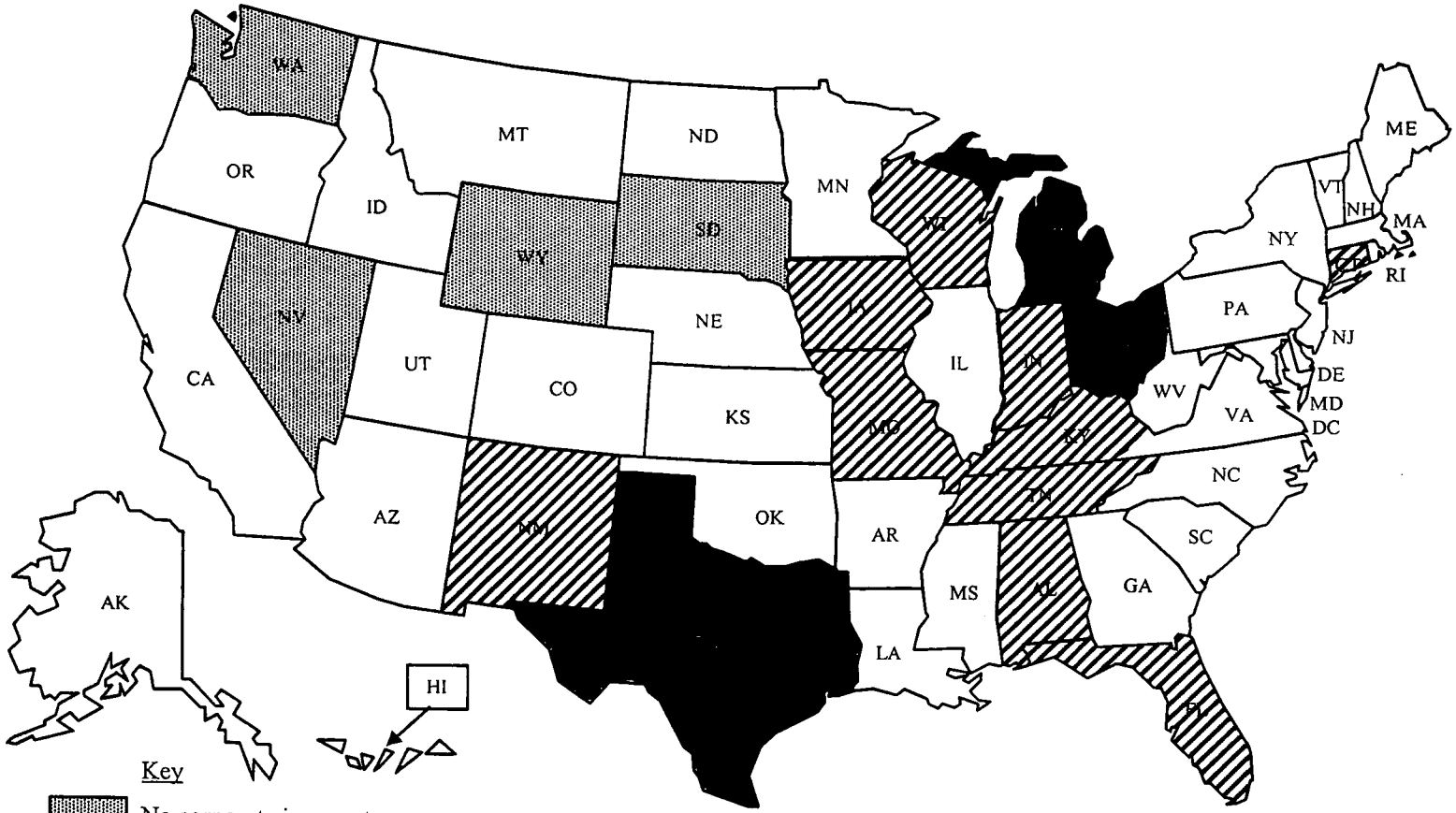
FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Conclusion

- Questions?
- Comments?
- Concerns?



Combined Reporting: 2008



Key

- No corporate income tax
- Mandatory unitary combined reporting (MA & WV law effective in 2009)
- Combined reporting based on "substantial intercorporate transactions"
- Provide for combined filing, but taxes are in the form of gross receipts or other hybrid taxes
- Rejected combined reporting legislation in 2008

Oppose SB244/HB462 Modernize Corporate Income Tax Filing

The following organizations and companies are opposed to the adoption of mandatory unitary combined reporting as reflected in SB244/HB462. Passage of this legislation would put the State out of step with a majority of states, particularly states in the southeast, and therefore would have a chilling effect on the State's economic development climate. It would particularly impact research and development, as well as distribution companies--a growing part of our economy.

Mandatory combined reporting is not necessary in North Carolina. The Secretary of Revenue currently has the tools necessary to combat abusive intercompany transactions designed only to evade tax. Pursuant to existing statutory authority, he has imposed tax on out-of-state companies to which income was transferred - which was upheld by the State Court of Appeals. In other cases, he has required out-of-state companies to file using a combined methodology with the in-state company. Another statute disallows deductions for royalty payments made to a related company not filing returns in the State.

Enacting mandatory unitary combined reporting would unfairly cast a net over taxpayers that accurately reflect income in the State without adding to the Secretary's ability to pursue those engaged in tax evasion. Moreover, not only do states with mandatory unitary combined filing spend enormous resources in auditing and litigating the application of unitary law, requiring corporate taxpayers to file their income tax return using the new mandatory combined reporting will create an uncertain environment for both the taxpayer and North Carolina as to the final tax liability.

In short, this drastic change in policy creates:

- An anti-competitive business environment. Only 18 states require unitary combined reporting. None of North Carolina's neighboring states and no states in the Southeast require it. Florida adopted the practice over 20 years ago but quickly repealed it because of the negative impact on jobs.

- Tax and revenue uncertainty for both the corporate taxpayer and the State. It is difficult to determine the fiscal impact of a change to unitary combination as there are so many variables.

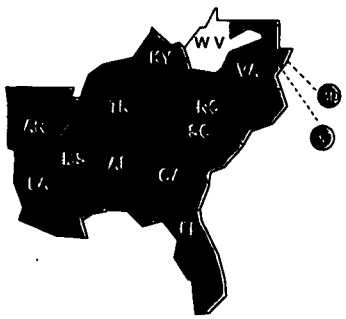
- A complex method of taxation which will lead to litigation and increased administrative and compliance costs for both the taxpayer and the State.

In summary, the adoption of "mandatory" combined reporting would place North Carolina "behind the curve" on state tax policy. It would create uncertainty for taxpayers and the state and would increase administrative and compliance costs. Most importantly, however, it causes a major setback in the state's efforts to attract and retain new jobs and investments in North Carolina.

AT&T
Abbott Laboratories
Alcoa
Amgen Inc.
Bank of America
Baxter HealthCare
Belk Stores
Charlotte Chamber of Commerce
CSX Transportation Inc.
First Charter Bank
Food Lion
General Electric
GlaxoSmithKline
Goodrich Corporation
Johnson & Johnson
Kimberly Clark
Raleigh Chamber of Commerce

LabCorp
Lorillard Tobacco
MCIC
Miller Brewing
National Gypsum
NC Bankers Association
NC Biosciences Organization
NC Retail Merchants Assoc.
Norfolk Southern Corp.
North Carolina Chamber
PepsiCo
Pfizer
Piedmont Natural Gas
Raleigh Chamber of Commerce
Reynolds American
Smithfield Foods
The Coca-Cola Company

Southeast States Mandatory Unitary Combined Reporting



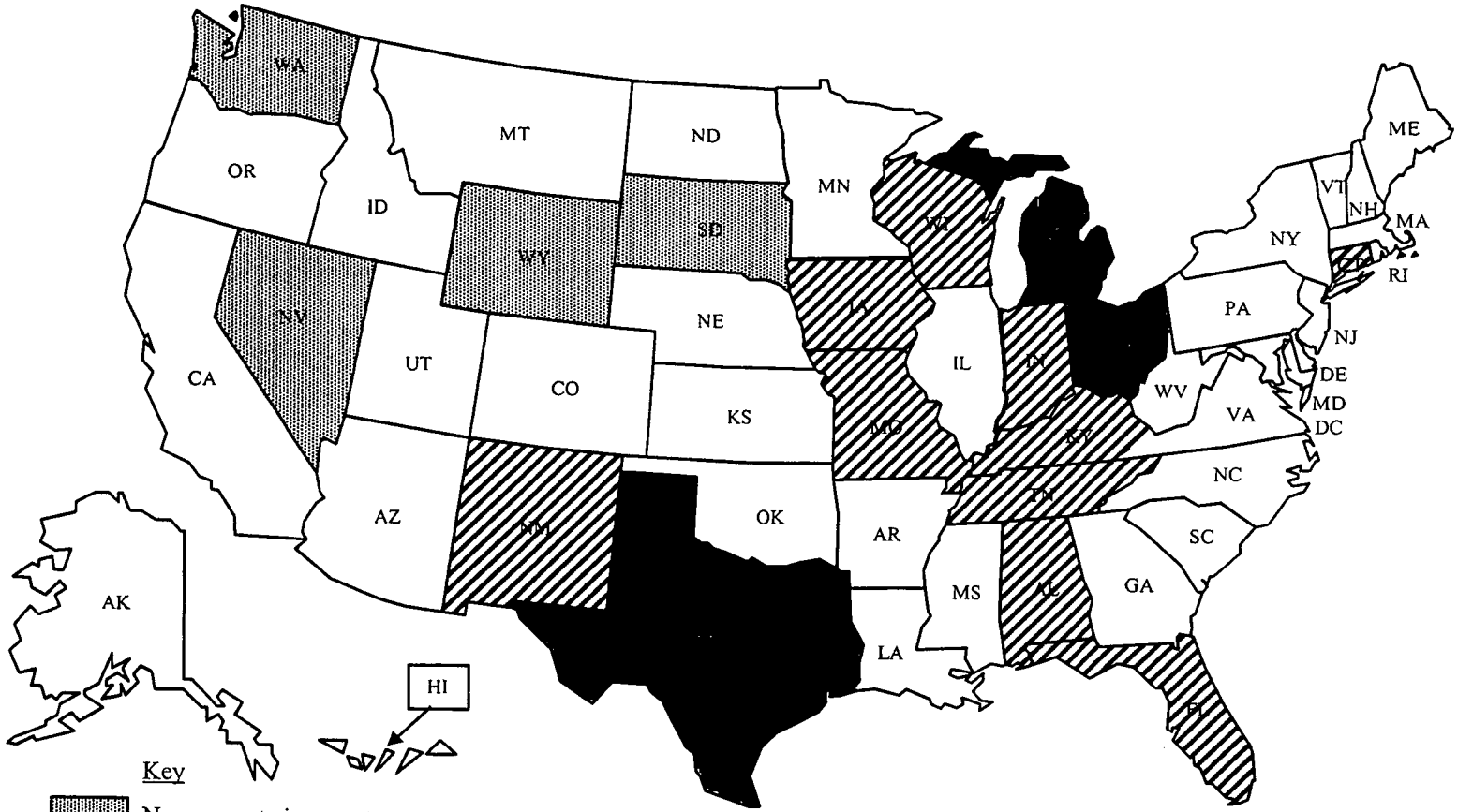
☐ Mandatory Unitary Combined Reporting States

(Revised: 6/7/07)

nc> North Carolina Chamber
A force for business.

Site Selection Top 25 (2008)	Combined Reporting
North Carolina	No
Tennessee	No
Alabama	No
Texas	Yes (but taxes are in the form of gross receipts or other hybrid taxes)
Indiana	No
Florida	No
Ohio	Yes (but taxes are in the form of gross receipts or other hybrid taxes)
Virginia	No
Illinois	Yes
Georgia	No
New York	Yes (but reporting based on substantial intercorporate transactions)
Kentucky	No
Missouri	No
South Carolina	No
Pennsylvania	No
Michigan	Yes (but taxes are in the form of gross receipts or other hybrid taxes)
Mississippi	No
Iowa	No
Maryland	No
Kansas	Yes
Louisiana	No
Arizona	Yes
Oklahoma	No
California	Yes

Combined Reporting: 2008



Key

- No corporate income tax
- Mandatory unitary combined reporting (MA & WV law effective in 2009)
- Combined reporting based on "substantial intercorporate transactions"
- Provide for combined filing, but taxes are in the form of gross receipts or other hybrid taxes
- Rejected combined reporting legislation in 2008

PROPOSAL FOR RESTRUCTURING REAL ESTATE PROPERTY TAXATION TO FREE UP MORE REVENUE AND STIMULATE DEVELOPMENT

PROPOSAL:

1) ELIMINATE PROPERTY TAX ON IMPROVEMENTS TO REAL ESTATE.
2) RESCALE PROPERTY TAX RATE TO GENERATE REVENUE FROM LAND ONLY.
3) MAINTAIN PROPERTY TAX DEFERMENT FOR AGRICULTURAL USE.
4) PERMIT ANNUAL REVALUATION OF PROPERTY TAX RATE ACCORDING TO LOCAL REVENUE NEEDS.

BENEFITS TO LOCAL GOVERNMENT:

5) SIMPLIFY TAXATION METHOD AND REDUCE VOLUMES OF PAPERWORK.
6) ELIMINATE FIELD WORK FOR REASSESSMENT OF IMPROVEMENTS.
7) ELIMINATE COSTS ASSOCIATED WITH FIELD REASSESSMENTS.
8) ELIMINATE BASIS FOR MOST REASSESSMENT APPEALS.
9) KEEP PROPERTY TAX REVENUE CURRENT WITH LOCAL REVENUE NEEDS.

BENEFITS TO THE PUBLIC AND THE ECONOMY:

10) REDUCE COSTS OF LOCAL GOVERNMENT AND FREE UP REVENUE.
11) ELIMINATE CONNECTION BETWEEN ASSESSMENTS AND MARKET VALUE.
12) ELIMINATE INFLUENCE ON PRIVATE REAL ESTATE APPRAISALS & MARKET.
13) SHIFT TAX BURDEN TO OWNERS OF LARGE, UNUSED PROPERTIES.
14) STIMULATE DEVELOPMENT & AGRICULTURAL USE OF "WASTED" LAND.
15) STIMULATE HOME REPAIR, IMPROVEMENTS, AND CONSTRUCTION, WITHOUT FEAR BY OWNERS OF INCREASED PROPERTY TAXES.

*Carol D. Dalenko, A.B.D.**
1709 Horton Rd, Knightdale, NC 27545-8577
(919) 217-0910, (mobile) 632-7700
E-mail: cdalenko@bellsouth.net

**B.S., M.S., A.B.D. in Physics from U-Michigan, former faculty at U-Illinois.*
Presently: Real Estate Broker, Property Owner, Small Business Retailer
Retired: Educator and Interactive Computer Graphics Analyst/Consultant

---

DISCLAIMER: This Proposal is made without prejudice to considering: (a) property ownership as an irrevocable right that cannot be taxed if it is lost by failure to pay, because then it becomes a privilege, not a right; (b) un-equalized tax burden on property owners instead of a *per capita* tax equalized over the population; and (c) land patent rights of property owners by direct decent from land grants from England, Spain, and France (e.g. Granville County). 11/08

REVENUE LAWS STUDY COMMITTEE
Monday, December 15, 2008
Room 544, Legislative Office Building
9:30 a.m.

MINUTES

The Revenue Laws Study Committee met at 9:30 a.m. on Monday, December 15, 2008, in room 544 of the Legislative Office Building. Twelve members of the committee were present. Representative Luebke presided as chair.

Approval of Minutes from the November 19 Meeting

Representative Brubaker motioned for the approval of the November 19, 2008 minutes and the motion carried. A copy of the minutes is attached.

Alternative Methods of Business Taxation

Cindy Avrette, a staff attorney with the Research Division, was recognized to review what the committee had done to date regarding business taxation. This included explanations of combined reporting and current statutory authority.

Karey Barton, Principal, Ryan, Austin Texas, was recognized to explain how and why Texas had enacted tax reform legislation. He discussed the background, the legislated taxes and its impacts, and possible future legislative actions. A copy of his presentation is attached.

Current Law on Combinations in North Carolina

Greg Radford, Director of the Division of Corporate Excise and Insurance Tax Division of the Department of Revenue (Revenue), was recognized to explain that current business tax law allows some large corporations to create subsidiaries which lead to lower taxes. A copy of his presentation is attached. Linda Millsaps, Assistant Secretary for Tax Administration, Revenue, and Barry Boardman, a fiscal analyst with the Fiscal Research Division, were recognized to answer questions. A copy of Mr. Radford's remarks is attached.

Bill Nelson, an attorney with Smith Anderson Blount Dorsett Mitchell & Jernigan, LLP, was recognized. He stated that the Revenue acted arbitrarily acted on enforcing the current combination law. He requested clarifying existing law to avoid future lawsuits. A copy of his remarks is attached.

Update on Privilege License Taxation Issue

Trina Griffin, an attorney with the Research Division, was recognized for a brief overview of Privilege License taxation.

Rodney Bizzell, a fiscal analyst with the Fiscal Research Division, outlined facts, figures, and language problems with the Privilege License Tax law. A copy of his power point is attached.

Karl Knapp, Director of Revenue, NC League of Municipalities, was recognized. He pointed out that the Privilege License Tax is a significant source of revenue for cities. He acknowledged that the General Statutes are archaic and too complex, but wants any changes to the laws to treat all taxpayers in different cities equally.

Jim Blackburn, Association of County Commissioners general counsel, agreed with Mr. Knapp's statements and offered staff any assistance in drafting clarifying language.

Overview of Issues Raised by Advancing the Reappraisal Schedule for Property Taxes

Martha Walston, a staff attorney with the Fiscal Research Division, was recognized. She outlined property tax reappraisal schedule current law, methods of revaluations, the advantages and disadvantages of advanced schedules, schedules of other states and possible recommendations. Jim Blackburn was recognized to answer questions. A copy of Ms. Walston's handouts is attached.

The meeting adjourned at 12:02 p.m.

Representative Paul Luebke, Presiding Chair
Revenue Laws Study Committee

DeAnne Mangum, Committee Clerk

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Monday, December 15, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from November 19 Meeting

II. Alternative Methods of Business Taxation

- *Cindy Avrette, Research Division*
- *Karey Barton, Principal, Ryan, Austin, Texas*

III. Current Law on Combinations in North Carolina

- *Greg Radford, Department of Revenue*
- *Bill Nelson, Attorney, Smith Anderson Blount Dorsett Mitchell & Jernigan, LLP*

IV. Update on Privilege License Taxation Issue

Update on Fiscal Estimates

- *Rodney Bizzell, Fiscal Research Division*

Response and Comments

- *League of Municipalities*
- *Association of County Commissioners*

V. Overview of Issues Raised by Advancing the Reappraisal Schedule for Property Taxes

– Martha Walston, Fiscal Research Division

VI. Sales Tax and "Digital Equivalents"

– Trina Griffin, Research Division

VII. Adjournment

Next Meeting Date: Wednesday, January 7, 2009
All meetings in Room 544, LOB at 9:30 a.m.

VISITOR REGISTRATION SHEET

Revenue Laws Study Comm — 12-15-08

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
TaNola Brown-Bland	City of Greensboro
Marty Bocock	EMBARQ
Steve Beewer	EMBARQ
Dona Sipes	Smith Myers
[signature]	JDNPA
Robin Rose	City of Raleigh
Edward Wyatt	Hunton + Williams
David Barnes	Poyner Spruill
[signature]	CAA
Thomas Moon	Ellis Stone & Welch
Brad Phillips	TWC

VISITOR REGISTRATION SHEET

Name of Committee | Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Jamie Fenwick	Time Warner Cable
Jack Stanley	Time Warner Cable
Debra Dew	AT+T
Sharon Miller	CUCA
Wm W Nelson	Smith Anderson
Ed Finlayson	Brooks Pierce
Paul Stock	NCBA
Sandy Sands	WCSR
Kelli LaFrance-Girard	Town of Cary
Karen Mills	Town of Cary
Erin McLaughlin	MHA-NC

VISITOR REGISTRATION SHEET

Name of Committee

Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
	Nelson Mullins
	" "
	NCFB
	Self
	WS
	BBCOR
	MFGS
	NCSA
	Electric Cities of NC
	NCRMA
	NCRMA

VISITOR REGISTRATION SHEET

Name of Committee | Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
John McCallister	NC Chamber

VISITOR REGISTRATION SHEET

Name of Committee

Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Mary Stratton	BPMH&C
Mark Prak	BPMH&C

VISITOR REGISTRATION SHEET

Name of Committee | Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Paul Mason	City of Durham 101 City Hall Plaza Durham, NC 27701
Karl Knapp	NCLM
Brenda Landes	Town of Morrisville P.O. Box 166 Morrisville NC 27560
Donna Powell	NCDOR
Michael Youth	NC Atty Gen's office
Kay Hobart	NC DOJ
Greg Rutford	NC DOR
John Mahler	Governing
Ken Melton	Ken Melton & Assoc.

VISITOR REGISTRATION SHEET

Name of Committee | Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Bill Spencer	NCDOR
Pam Meyer	NCACC
Pete Rodda	Forsyth Co Tax Assessor/Collector
Joe Lanier	520 Wicker
Linda Millsaps	NCDOR
Allison Walter	Charlotte Chamber
Chris McLaughlin	School of Government
Pat Goddard	Johnston County Tax Administrator
Kim Crouch	NC Bar Association

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — 12-15-08

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Ben Niolet	N+O / Charlotte - O
Joel Levy	City of Charlotte / Finance
Michelle Brooks	University Health Systems of Eastern Carolina
[illegible]	NCICU
Mitch Kokai	John Locke Foundation
David Baker	NC DOR
Bill Wilkes	NC DOR
Andy Sabol	NC DOR
Roland Haph	FEI
Michael Houser	NC D & R

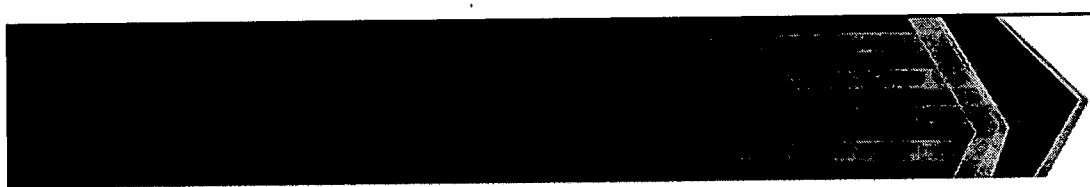


Tax Reform in Texas: Was it the Perfect Storm?

Karey Barton
Principal

December 15, 2008

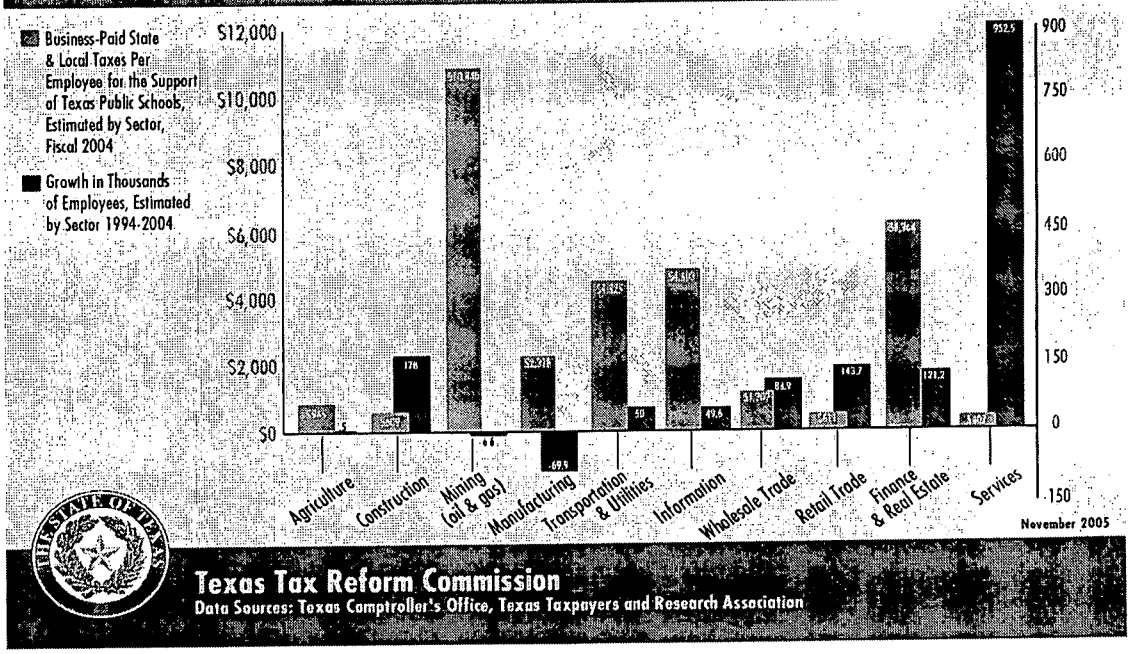
- The background:
  - What was the emphasis driving tax reform?
  - How did the process work?
- The basics:
  - Who is subject to the tax?
  - When is it due?
  - How is it calculated?
- Tax Impacts
- Future Legislative Actions



- Driving factors for tax reform include:
  - Increasing reliance on local Property Taxes.
    - State share of school funding continued to decrease.
  - "Voluntary" status of Franchise Tax.
    - Growth in Franchise Tax receipts was slower than all other state taxes over last decade.
  - Tax system that did not mirror state's economy.

Ryan

Business-Paid State & Local Taxes Per Employee and Growth in Thousands of Employees



Texas Tax Reform Commission

Data Sources: Texas Comptroller's Office, Texas Taxpayers and Research Association

- Previous Attempts:
  - Attempts prior to adoption of "revised" Franchise Tax included two regular sessions and three special sessions.
  - Timeline of attempts runs from 1986 to 2005.
    - Sales Tax – broaden base or tax all services (1986, 1996, 2003, & 2005)
    - Business Tax
      - Proposed BAT/VAT in 1991 & 1997
      - Modified Franchise Tax base in 1991 – earned surplus
      - Proposed payroll and gross receipts in 2005
      - Proposed modifications to Franchise Tax in 2005
      - Modified Franchise Tax base and reporting basis in 2006 – margin tax base and combined reporting
    - Property Tax
      - Split Rolls in 1993 & 1997

- West Orange Cove Litigation:
  - School districts challenged State on school finance structure
  - Supreme Court decision issued on November 2005.
    - Most recent decision over the last two decades.
    - State prevailed on all but one issue.
      - Statewide Property Tax.
      - June 1, 2006 deadline to address.

- Texas Tax Reform Commission:
  - Created by Governor Perry in September 2005
    - Named former Comptroller John Sharp as Chair
    - Named 23 additional members of the Commission in November 2005.
  - Commission held 18 meetings.
  - Commission presented plan to Governor on March 29, 2006
  - The Commission's plan was endorsed by more than 20 major business and trade organizations and Chambers of Commerce.

- Business and Chamber of Commerce support significant property tax rate reduction.

- School reforms were put on back burner.
  - Reforms were not added to legislation until after passage from the House.

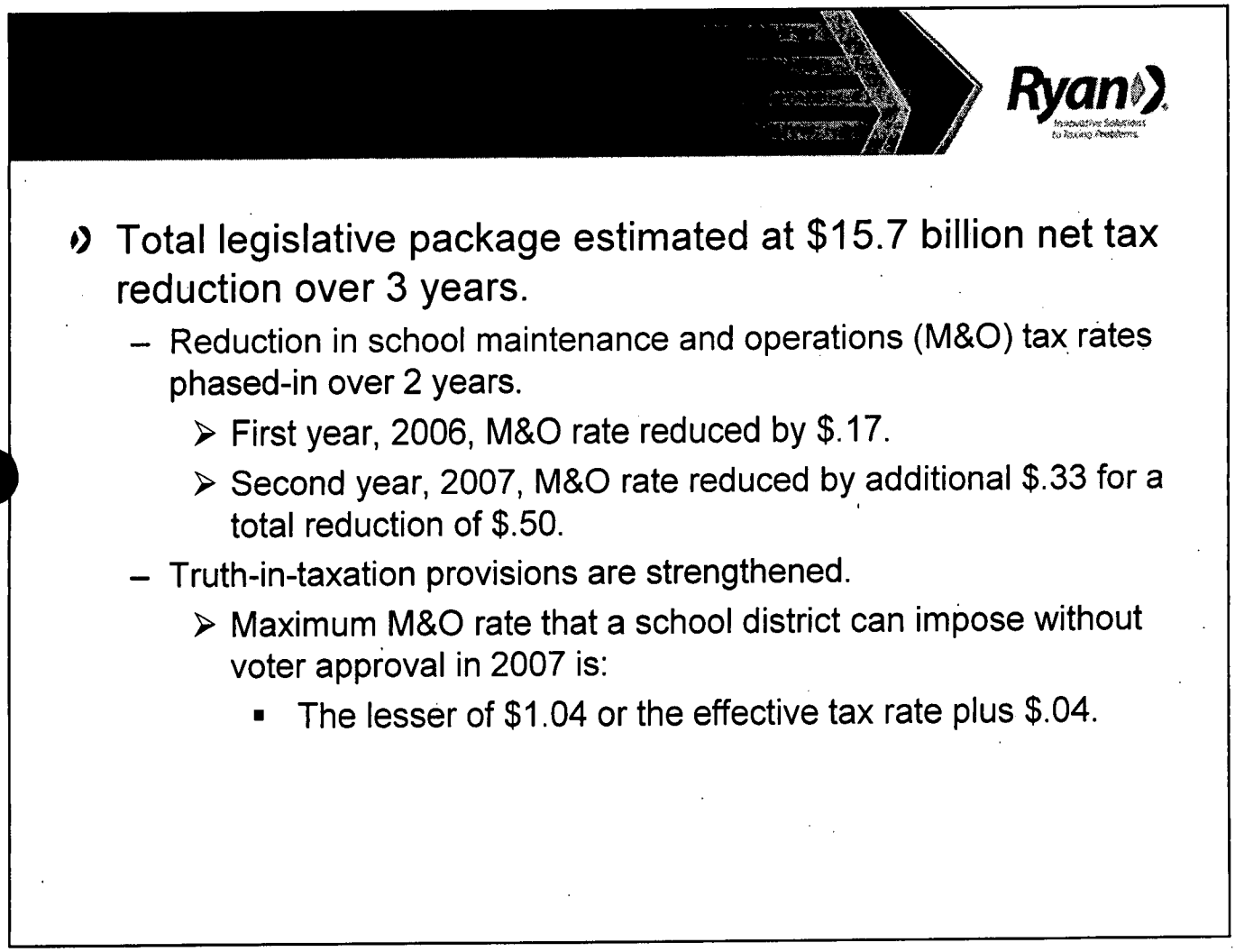
- Politically viable plan included:
  - Net tax cut.
  - No sales tax.

- Property Tax Relief:
  - HB 1 Property Tax rate reduction.
  - HB 2 Dedication of Revenue for Property Tax rate cuts.

- Funding for Property Tax Relief:
  - HB 3 "Revised" Franchise Tax.
  - HB 4 "Liar's Affidavit" Motor Vehicle Sales Tax.
  - HB 5 $1/pack increase in Cigarette Tax and increase in other tobacco products taxes.

- Net Tax Cut:
  - Surplus/future revenue growth.

- "Revised" Franchise Tax estimated to generate about $6 billion
  - Estimated to increase revenue base by $3 billion
  - Actual collections approximately $1.5 billion lower than estimate.
- Tobacco Taxes estimated to generate about $700 million
  - Actual collections higher than estimate
- Motor Vehicle Sales Tax change estimated to generate about $65 million



- Total legislative package estimated at $15.7 billion net tax reduction over 3 years.
  - Reduction in school maintenance and operations (M&O) tax rates phased-in over 2 years.
    - First year, 2006, M&O rate reduced by $.17.
    - Second year, 2007, M&O rate reduced by additional $.33 for a total reduction of $.50.
  - Truth-in-taxation provisions are strengthened.
    - Maximum M&O rate that a school district can impose without voter approval in 2007 is:
      - The lesser of $1.04 or the effective tax rate plus $.04.

- Broader Base and Lower Rate:
  - Applies to a broader range of business types.
  - The Capital and Earned Surplus Tax Bases are replaced with a Margin Tax Base.
  - The Tax Rates are changed to 1% and .5% for qualifying retailers and wholesalers.

- Timing – Reports due on or after January 1, 2008.

- Entities with liability protection include:
  - Limited liability partnerships.
  - Limited partnerships.
  - Business trusts.
  - Corporations.
  - Limited liability companies.
  - Professional associations.
  - Professional corporations.



- Certain entities are NOT subject to the tax, including:
  - Entities currently exempt from franchise tax.
  - Entities that qualify as passive.
  - Escrows.
  - Estates of natural persons.
  - Grantor trusts that qualify.
  - REITs that qualify.
  - REMICs.
  - Sole proprietorships and general partnerships owned by natural persons.
  - Taxable entities that owe less than $1,000 in tax.
  - Taxable entities with $300,000 or less in total revenue.

- The following entities may be exempt from the tax:
  - Entity subject to insurance premium taxes.
  - Entity organized for the exclusive purpose of promoting the public interest of any county, city, town, or other area within the state.
  - Certain nonprofit organizations:
    - Charitable.
    - Educational.
    - Home Owner's Association.
    - Religious.

- General, limited partnership, or non-business trust.
- Meets 90% passive income test.
  - 90% of income must be passive income.
  - Types of Passive income: dividends, mineral royalties, Limited Liability Corporation (LLC) income, interest, distributive shares of partnership income, net capital gains from sales of real property, and net gains from the sales of securities.
- No more than 10% of gross income from conducting active trade or business.
- Rental income not considered passive income.

- Scaled tax liability discount schedule for small businesses (House Bill 3928):
  - 100% discount for taxable entities with ***$300,000 or less*** in total revenue.
  - 80% discount for taxable entities with more than ***$300,000 but less than $400,000*** in total revenue.
  - 60% discount for taxable entities with ***$400,000 or more but less than $500,000*** in total revenue.
  - 40% discount for taxable entities with ***$500,000 or more but less than $700,000*** in total revenue.
  - 20% discount for taxable entities with ***$700,000 or more but less than $900,000*** in total revenue.



- Generally, the Margin Tax is effective for reports due on or after January 1, 2008.
  - First report due May 15, 2008.
  - Transition provisions for entities ceasing to do business.
    - Affected entities include:
      - Entities not previously subject to franchise tax.
      - Doing business after June 30, 2007, but not after January 1, 2008.
    - Entities must pay "Exit Tax."

- Taxable Margin Calculation:



- The election to deduct either Cost of Goods Sold (COGS) or Compensation is done on an annual basis and is irrevocable.

- General rule:
  - 1% tax rate for all entities.
- Exception:
  - .5% tax rate for entities primarily engaged in retail and wholesale trade (includes restaurants).
- Primarily engaged in retail and wholesale trade if:
  - Total revenue from retail and wholesale trade is greater than total revenue from non-retail and wholesale trade activities.
  - Less than 50% of the total revenue from retail and wholesale trade activities comes from the sale of products produced by the entity or an affiliated entity.
  - The entity does not provide retail or wholesale utilities such as telecommunications, electric, or gas.

- A taxable entity with $10 million or less in total revenue may choose an alternative calculation to determine tax liability.



  - Taxable entity choosing the EZ tax calculation may not take any credits authorized by the Margin Tax.
  - Taxable entity choosing the EZ tax calculation is eligible for the small business scaled discount schedule.



- Amounts reportable as income on Federal Income Tax returns:
  - Gross receipts or sales, less returns and allowances.
  - Dividends.
  - Interest.
  - Gross rents.
  - Gross royalties.
  - Net capital gains.
  - Other income:
    - Ordinary income from trade or business activities of a partnership, LLC, or S-Corporation.

- Specific allowable subtractions from total revenue:
  - Bad debt.
  - Foreign royalties and dividends.
  - Net distributive income from partnerships, LLCs, and S-Corporations (unless the income is from a passive entity).
  - Allowable deductions from Form 1120, Schedule C (dividends received deduction).
  - Income items from disregarded entities.
  - Dividends and interest from federal obligations.
- Specific situational and industry adjustments

- Statutorily defined:
  - Similar to federal definition.
- Cost of Goods Sold:
  - Deduction generally can only be taken by entities selling or producing goods it owns.
- Goods:
  - Includes tangible personal property and real property.



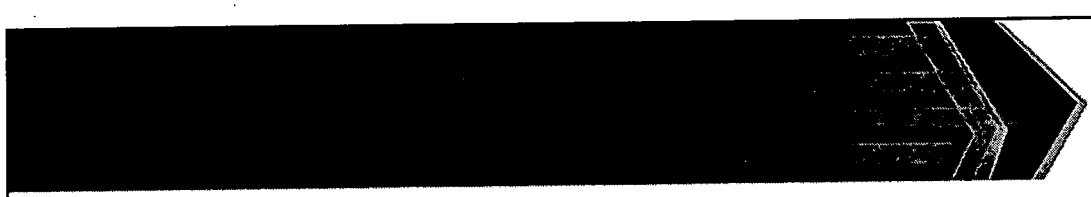
- COGS includes costs related to acquiring or producing goods.
  - Direct costs:
    - Labor directly related to production and acquisition of goods
    - Material costs (incorporated, consumed and acquired)
    - Production equipment costs
    - Research and Development cost related to production of goods
    - Utility costs consumed in production.
  - Indirect costs:
    - Limits indirect and administrative overhead costs that are allocable to the acquisition or production of goods to 4% of total indirect and administrative overhead costs.

- Certain expenses for mining industry, such as depletion or geological costs can be included in COGS.

- Interest expense is COGS for lending institutions.
  - Regulated entities making loans to the public.
  - Excludes entities primarily engaged in activities described by the 1987 Standard Industrial Classification Manual, Category 5932 (Rule 3.588).

- COGS deductions can be taken by certain rental or leasing businesses.
  - Entities renting or leasing motor vehicles.
  - Entities renting or leasing heavy construction equipment.
    - Rule 3.588 defines:
      - Self-propelled, self-powered, or pull-type.
      - Weighs more than 3,000 pounds.
      - Intended for use in construction.
  - Entities renting or leasing railcar rolling stock.

- Equipment costs not directly related to production:
  - Selling costs:
    - Employee expenses.
    - Sales commissions paid to third parties.
  - Advertising costs.
  - Bidding costs (successful or otherwise).
  - Interest costs.
  - Income taxes.
  - Officers' compensation.
  - Undocumented worker's compensation.



- Compensation is defined as wages and salaries and employee benefits.
  - Wages (Medicare wages and tips box on W-2), plus:
    - Distributions to a natural person from entities treated as partnerships and S-Corporations.
    - Federal tax deductible stock awards and options.
    - Limited to $300,000 per employee.
  - Benefits (federal tax deductible benefits not subject to $300,000 cap):
    - Health care expenses.
    - Retirement expenses.
    - Worker's compensation expenses.
- Undocumented worker's compensation cannot be deducted.



- Compensation deduction.
  - Compensation does not include:
    - Payments to independent contractors on Form 1099.
    - Anything excluded from revenue.
    - Employer's share of payroll tax.
    - Compensation paid to employee directly associated with operation of a facility located on military property.
    - Wages or cash paid to undocumented workers.
  - Benefits do not include:
    - Wages and cash compensation.
    - Discounts on the entity's merchandise or services.
    - Payroll taxes.
    - Working condition amounts provided to perform job (e.g., company car, education, and travel).



- Limited changes.
  - Current apportionment rules and policies are meant to apply to Margin Tax.
  - Single gross receipts factor remains the standard.
- No throwback rule.
  - Not a net income tax per statute.

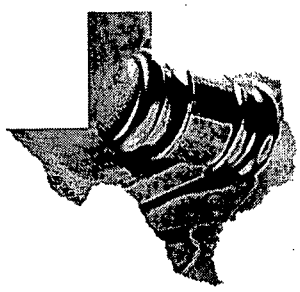


- Taxable entities in a unitary affiliated group must file a combined report.
  - An affiliated group is a group of one or more entities owned by common owner(s).
    - Controlling interest is more than 50% ownership.
  - Water's edge unitary combined reporting is required.
    - Excludes a taxable entity that conducts business outside of the United States and has 80% or more of its property and payroll outside the United States.
      - If the entity does not have property or payroll, then it is excluded if 80% or more of its gross receipts are outside the United States.

- All members of the combined unitary group must make the same election of COGS or compensation.
  - Each group member determines total revenue, COGS, and compensation as if filing separately.
    - Inter-entity COGS, compensation, and total revenue are eliminated.
    - Combined margin is pre-apportionment.

- Joyce rule for apportionment of a combined group:
  - Texas sales in the apportionment numerator include only those sales made by entities with nexus in Texas.

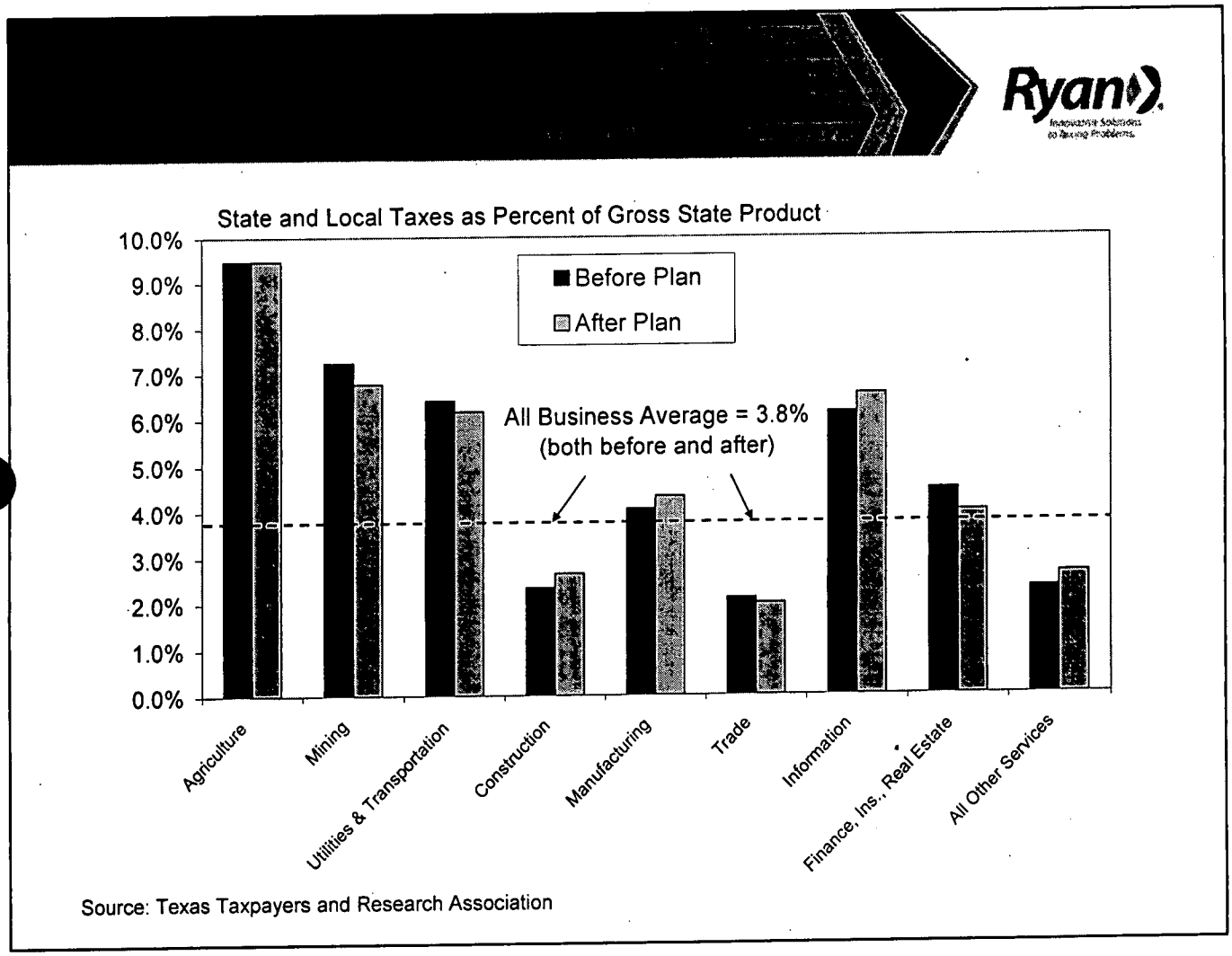
- Finnegan rule for information only (House Bill 3928):
  - The combined unitary group must report its Texas sales of the non-nexus members of the combined group.
  - No tax due based on Finnegan.



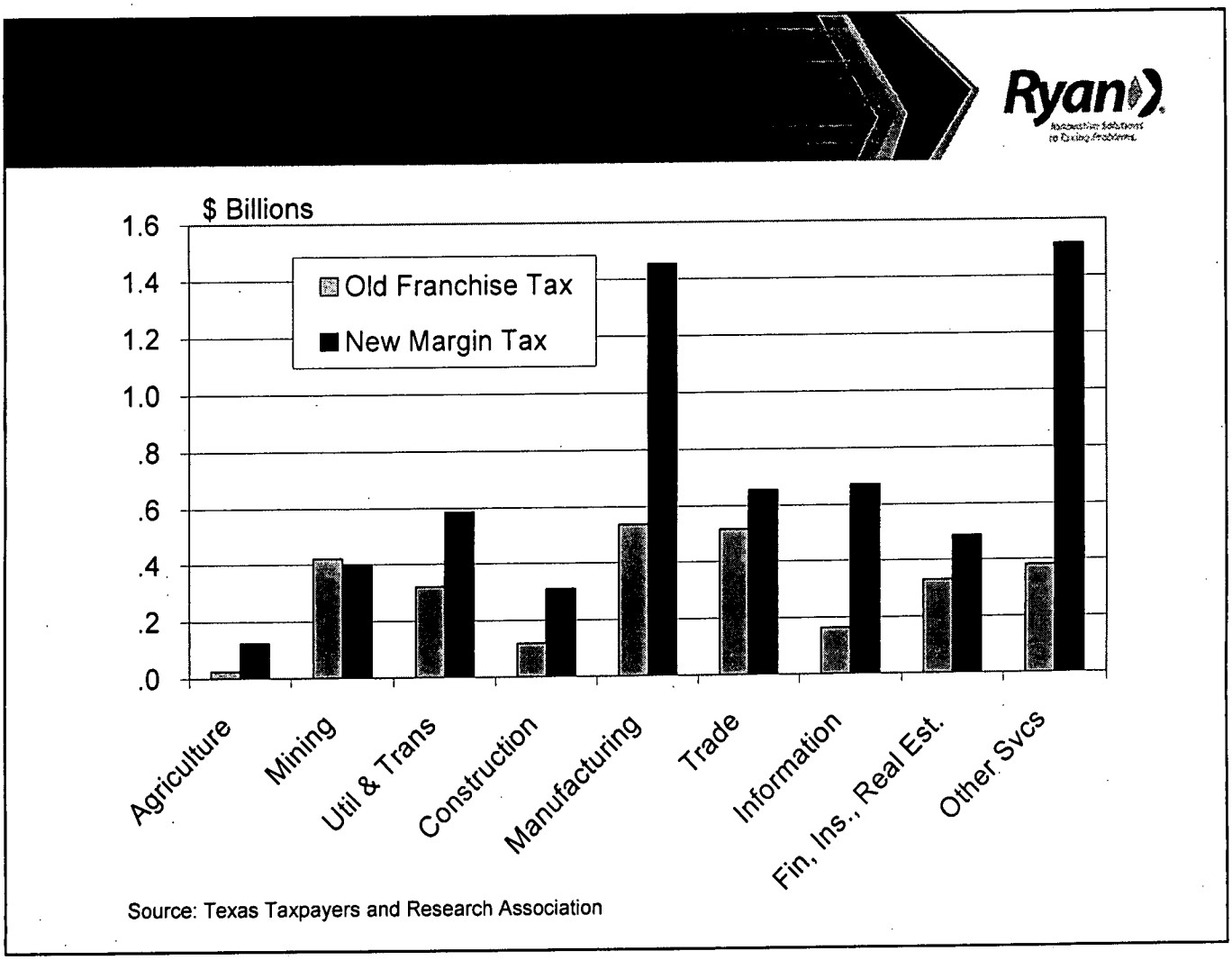
- To be unitary, entities must be sufficiently:
  - Interdependent.
  - Integrated.
  - Interrelated.

- Activities of the entities to be analyzed to determine if they are:
  - Entities in the same general line of business.
  - Steps in a vertically or horizontally structured process.
  - Functionally integrated (strong centralized management).
    - Authority of purchasing, financing, personnel, and marketing.

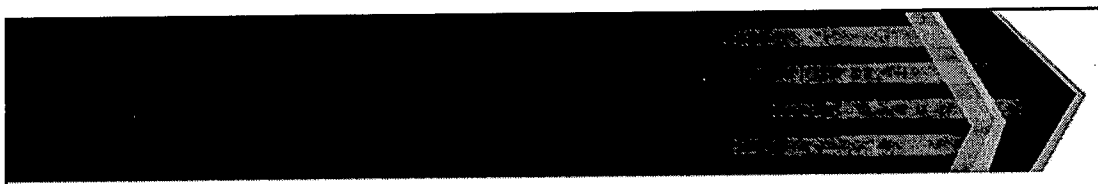
- Texas Unitary Groups may include non-corporate entities.
  - LLCs.
  - Partnerships.
  - Trusts, etc.
  - Taxpayers must analyze more business relationships for Texas than for other states to determine unity.



Source: Texas Taxpayers and Research Association



Source: Texas Taxpayers and Research Association



- Capital intensive service industries
  - Telecommunications
  - Transportation – Trucking
- Mixed Business entities
  - Service and Retail
  - Manufacturing and Service
- Taxpayers with non-profitable years still owe tax
- Size of the Texas Franchise Tax
- Small Businesses
- Taxpayer Compliance burdens and State administration

- Potential legislative changes to be considered during the 2009 legislative session:
  - Apportionment:
    - Which standard will be used for unitary combined reports?
      - Joyce or Finnegan.
      - Certain legislative leaders believe Joyce method is a "loophole."
      - Information from Finnegan reporting requirement.
  - Special deductions for certain industries.
  - Deductibility of 1099 payments.



Questions?

Department of Revenue Presentation to the Revenue Laws Study Committee

Combinations

December 15, 2008

The Problem

- North Carolina is a separate entity state
- Susceptible to Income-Shifting and Other Tax Avoidance Strategies
- Exploited by large multistate or multinational companies, in effect shifting the tax burden to taxpayers operating solely in NC or without the resources to engage in the strategies.

EXAMPLES OF TAXPAYER STRATEGIES – 1
Procurement Company
(Before)

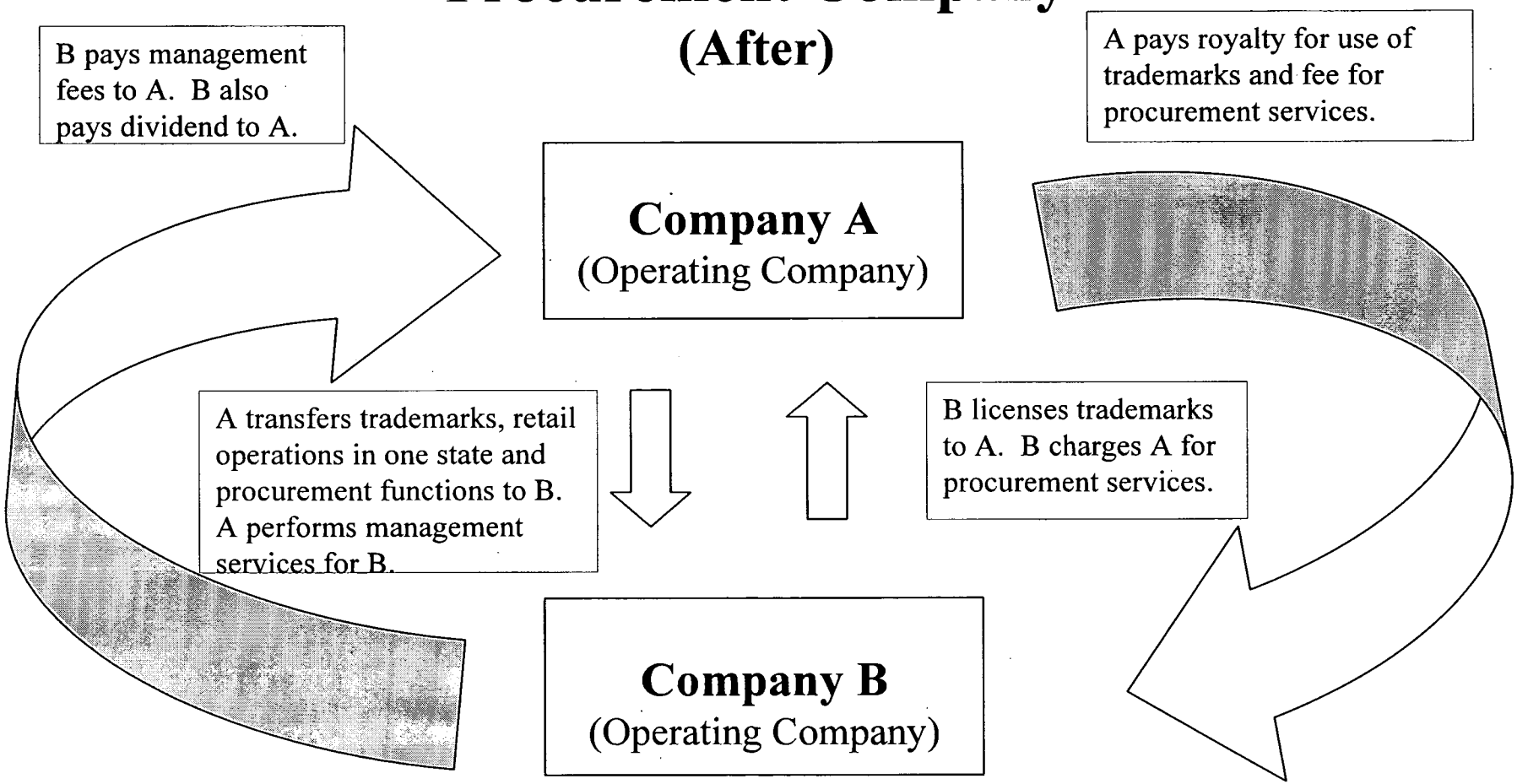
Company A
(Operating Company)

1. Multistate Retail Operations
2. Owns Trademarks
3. Procurement Functions

EXAMPLES OF TAXPAYER STRATEGIES – 1

Procurement Company

(After)



EXAMPLES OF TAXPAYER STRATEGIES – 2

Embedded Royalties

(Before)

Company A
(Operating Company)

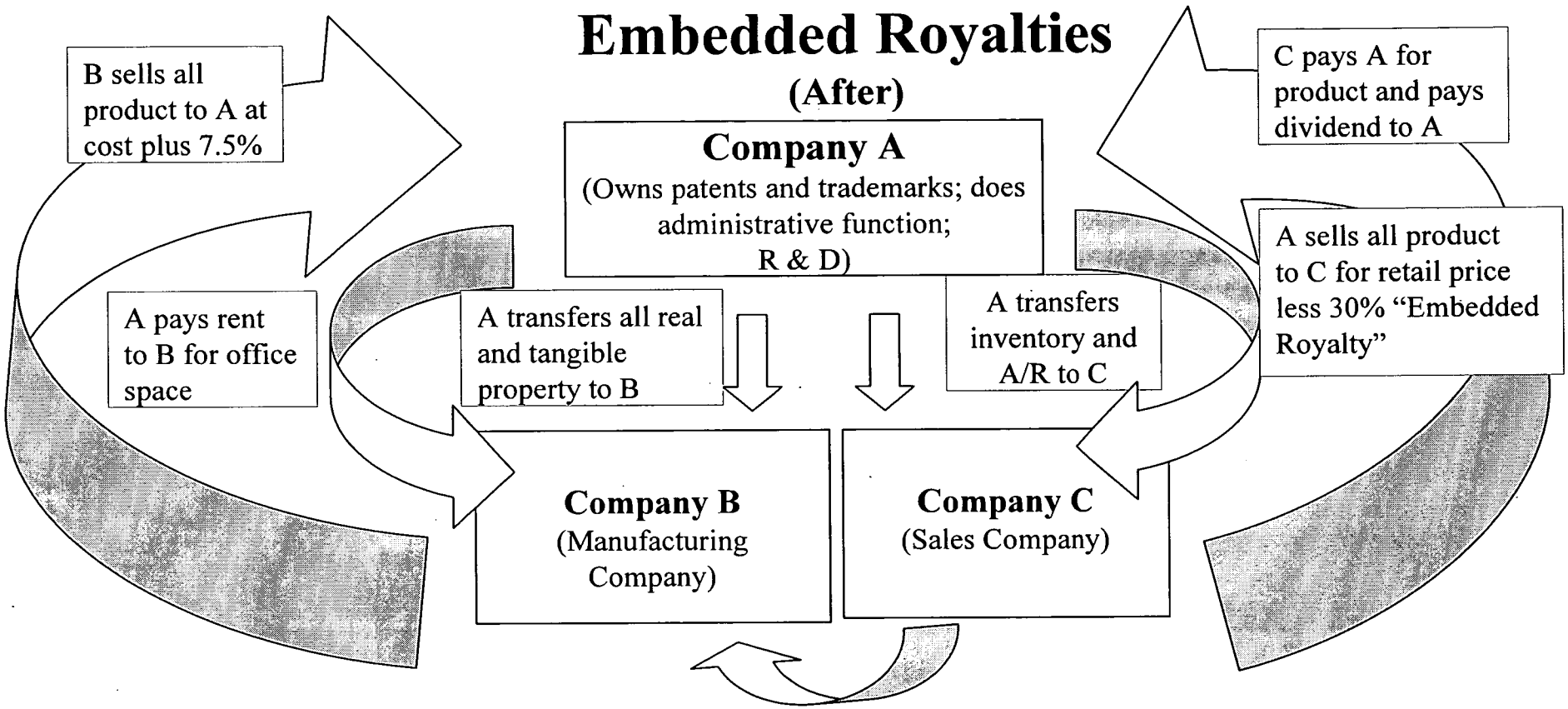
1. Manufactures Product
2. Sells Product Throughout the World
3. Owns Patents and Marks

COGS	$ 30,000,000
Retail Sales	$107,000,000
Profit	$ 77,000,000

EXAMPLES OF TAXPAYER STRATEGIES – 2

Embedded Royalties

(After)



C pays B rent for Office Space

		Profit
COGS to B	$ 30,000,000	B - $ 2,250,000
A pays B	$ 32,250,000	A - $ 42,750,000
C pays A	$ 75,000,000	C - $ 32,000,000
C Retail Sales	$ 107,000,000	Total - $ 77,000,000

Current Law on Combinations in North Carolina

- One of the tools available to the Department to combat tax avoidance strategies is the authority to require related members to file a combined return. That authority is found in four statutes.
  - G.S. 105-130.4;
  - G.S. 105-130.6;
  - G. S. 105-130.15; and
  - G.S. 105-130.16

The Department has used combinations for years

- Letter dated June 17, 1996 from a prior Director stated that the Department had used the combination authority in G.S. 105-130.6 for at least twenty years
- Hearing decision in 1990 related to combination assessment for tax years 1983 and 1984
- Two hearing decisions in 1997 affirming combination assessments for tax years 1987 – 1990 and 1989 – 1990

The Department has used combinations for years

- A & F decision in 2000 affirmed combination as a proper alternative to requiring the separate companies to file income tax returns. Affirmed by both the Tax Review Board and Wake County Superior Court.
- Dor's use of required combinations has identified over $370 million in additional taxes.

Current Litigation Regarding the State's Authority to Combine

- *Wal-Mart/Sam's* – on appeal to the Court of Appeals following summary judgment for the State in Superior Court.
- *Delhaize (Food Lion)* – pending in Business Court

Is the authority to require combination enough to deal with the issue?

- Tax avoidance strategies do not come in a "One size fits all" box. There are many strategies and variations, requiring detailed examination and analysis by the Department.
- We have several examples of a taxpayer unwinding one strategy and developing another after the first one is discovered. This suggests a "Catch Me if You Can" attitude.

Is the authority to require combination enough to deal with the issue?

- Significant resource drain on the DOR, the Attorney General, and the court system required to combat these strategies as well as on the taxpayer under audit.
- Resources do not permit DOR to audit every taxpayer and uncover every strategy.

Is the authority to require combination enough to deal with the issue?

- The result is higher taxes for businesses that cannot or do not participate in these strategies, giving taxpayers that participate in these strategies and do not get caught an unfair advantage.

"Vermont's separate accounting system is inadequate to measure accurately the income of a corporation with non-Vermont affiliates and creates tax disadvantages for Vermont corporations which compete with multistate and multinational corporations doing business in Vermont."

Vermont Legislature

Alternative Solution

Mandatory Combined Reporting

Previously advocated by the
Governor's Commission to
Modernize State Finances

"By moving to combined reporting... a comprehensive solution to end tax avoidance strategies can be achieved."

(Cameron & Mejia, North Carolina's Corporate Tax: Rate Cuts or Reform, 32 State Tax Notes 45, 47 (Apr. 5, 2004))

Mandatory combined reporting is therefore a fairer and more equitable system for all corporate taxpayers, both large and small.

Adopting mandatory unitary combined reporting has been called "the single most important state corporate tax reform."

(McIntyre & Nguyen, State Corporate Income Taxes 2001-2003, 35 State Tax Notes 685, 692 (Mar. 7, 2005)).

REVENUE LAWS STUDY COMMITTEE

PRESENTATION ON COMBINED REPORTING

December 15, 2008

Thank you Mr. Chairman. My name is Bill Nelson. I practice tax law with the Smith Anderson firm here in Raleigh. Let me say at the outset that, while I have experience with these issues, I am not involved in any way with the combined return cases that are currently in litigation and that I am not currently representing any clients in combination cases before the Department. Therefore, what I hope to offer is the perspective of corporate taxpayers and their advisers generally rather than the perspective of any particular taxpayer. Let me also say that I am not here to address the policy issue of whether NC changes from a separate return state to a mandatory combined reporting state but only the state of our existing laws on combined reporting.

While taxpayers recognize the need for the DOR to have tools to combat abuses, this need must be balanced against the honest taxpayer's need for certainty and for some reasonable restraints on administrative discretion.

The Multistate Tax commission, which as you know is an organization of taxing authorities rather than of taxpayers, has said that any combined reporting structure "must" answer three main questions:

When is combined reporting required
Who is required to be included in the combined report
How is the combination to be accomplished

[Huddleston & Sicilian, History and Considerations for Combined Reporting: Will States Adopt A Model Combined Reporting Statute?]

The MTC's own draft combination statute takes eight pages to address these issues while leaving many technical issues to be addressed by state rulemaking.

Section 130.6, at less than one printed page, fails to address these issues with any precision, with the result that the Secretary has almost unbridled discretion over how these issues are resolved. Let me add here that while the Secretary has stated that three other statutes also provide authority for combined reporting, these other statutes never mention the word combined reporting or consolidated returns, so there is a dispute on this point.

When is combination required?

The statute authorizes forced combination when a separate return does not "disclose the true earnings of the corporation on its business carried on in this State" but does not define "true earnings".

In the context of a separate return state, taxpayers can reasonably argue that true earnings are those that would be shown on a separate return if the taxpayer's dealings with related parties were entered into at arm's-length, so that combination is just an alternative means of eliminating excess intercompany payments.

The Secretary argues that its discretion is not limited by the arm's-length standard. In the Wal-Mart litigation the Secretary has suggested that he can require combination whenever a transaction lacks economic substance. This position is not grounded in the statutory language and hardly gives taxpayers much guidance. Moreover, anecdotal evidence suggests that the DOR has not always justified its demands for combined reports on a purported lack of economic substance. Moreover, the Secretary has not indicated that lack of economic substance is the sole predicate for requiring combination.

The worry among taxpayers is that if the Secretary prevails in decoupling forced combination from the arm's-length standard, that is, if he can require combination even where a taxpayer's returns fully disclose all related party transactions and all those transactions are conducted at arm's-length, then he will have essentially converted the state from a separate return state to a mandatory combination state without legislative action with the added wrinkle that unlike true mandatory combination states, taxpayers will not be entitled to file combined returns unless directed to do so by the DOR, thus giving the state the choice of demanding the return that produces the most revenue.

Who is required to be included?

The statute limits combination to corporations that are the parent, subsidiary or affiliate of the taxpayer and provides definitions of these terms – although those definitions are exceedingly broad.

It fails, however, to address some important questions, such as whether foreign corporations can be combined and whether a water's edge election is available.

More importantly, there is confusion over whether all domestic affiliates must be included in the return. The statute says that the Secretary can require a combined return "of the entire operations of the parent corporation and of its subsidiaries and affiliates" suggesting that all such subsidiaries and affiliates must be included – subject to constitutional limitations.

However, the DOR has publicly claimed the right to pick and choose the affiliates to be included. [The DOR's 2006 presentation to Revenue Laws stated that a combined return did not have to include all group members and Kay Hobart's 1994 presentation to SEATA (p. 13) makes this point clearly].

How is combination to be accomplished?

There are many technical issues that arise in preparing combined returns, such as how

deductions and credits are to be applied. Needless to say, the NC statute does not address any of these issues.

The DOR has not Offered Administrative Guidance.

Subject to limitations imposed by the Constitution and by principles of administrative law, the DOR could have filled some of the gaps in the statutory scheme, but it has not done so.

There are no administrative rules, directives or TAMs on forced combination. There is a very meager technical bulletin which does little more than repeat the statutory language. DOR representatives have made statements in the past that indicate that the lack of guidance represents a strategic choice on the part of the Department to maximize its power to combat unforeseen abuses.

While the Department's position is understandable, it keeps honest taxpayers in the dark about the Secretary's intentions.

There is also a dearth of any other interpretive guidance on forced combinations.

There is no legislative history of any substance available to elucidate the relevant statutes. Legislative history is, in any event, a very uncertain guide to meaning, and the Wal-Mart litigants plausibly follow all the legislative history to opposite conclusions.

There is some dicta in a handful of the Secretary's hearing decisions, but these decisions do not provide no rules of general application and were in any event decided on the nexus issues rather than forced combination.

There are no reported decisions construing the scope of the combined reported statutes. Although we will eventually have one or more reported decisions, judicial decisions do not usually advance the cause of clarity, are limited to the facts at issue and are not likely to answer all the questions.

Lack of Taxpayer Protections.

The imprecise statutory language and the poverty of interpretive guidance has served to stack the decks against the taxpayers by maximizing the scope of the discretionary powers the Secretary has claimed for itself.

The taxpayer's ability to challenge overreaching by the Department is severely limited by an odd provision in the statute that provides that the Secretary's determinations on forced combinations will be upheld unless "plainly wrong."

Other assessments can be overcome by a preponderance of the evidence, and the plainly wrong standard does not, to my knowledge, appear in any other tax statute.

This standard has been described by one knowledgeable commentator [Hannah, North Carolina's Next State and Local Tax Frontier: Forced Combination, Journal of Multistate Taxation and Incentives, January 2006] as the "guilty until proven innocent" standard and by another commentator [Miller, Consolidated and Combined Reporting in a Single Entity State: A North Carolina perspective (July 1994)] as equivalent to the "beyond a reasonable doubt" standard required to support a criminal conviction. It makes the meager opportunities afforded to challenge the Secretary's determinations largely illusory and makes even litigation of doubtful assistance.

Given the taxpayer's uncertainty about the circumstances in which the Secretary can require combination and the legal impediments to challenging the Secretary's determinations, taxpayers should at least not be subject to penalties when combination is required.

And yet the Secretary has asserted the right to impose significant penalties where the difference between the tax due on a separate return and that shown to be due on a combined return results in a large understatement.

The breadth of the discretion the vagueness of the statute has allowed the Secretary to claim together with the absence of any real taxpayer remedies is perhaps the best argument that the statute should be given a narrow interpretation since the legislature might be presumed not to put taxpayers in such an untenable position.

Perhaps better yet, in my opinion, it provides justification for a legislative overhaul of the statute to balance the Department's legitimate enforcement needs with taxpayer safeguards and certainty.

Update on Privilege License Taxation Issue

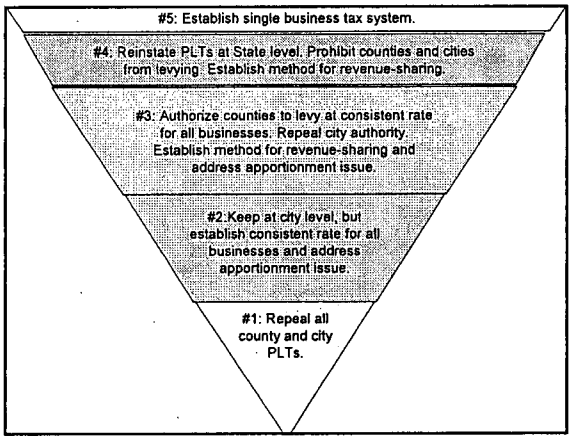
Revenue Laws Study Committee
December 15, 2008

PLT Concerns

- Archaic Language (*Bagatelle tables??*)
- Repealed statutes
- Arbitrary distinctions between businesses
- Inconsistent application across NC
- Double taxation



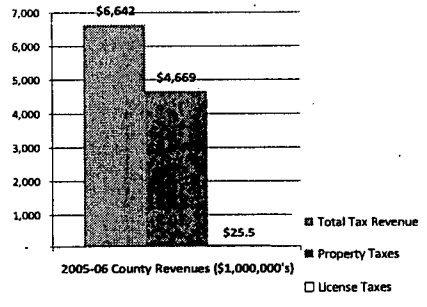
2



Update on PLT Revenues

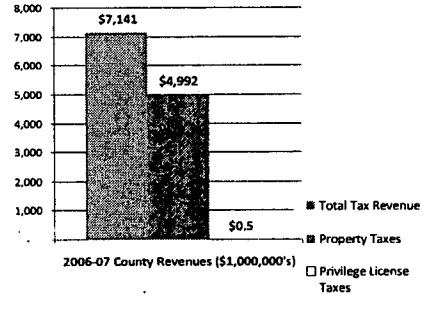
- Privilege license tax revenues reported at the last meeting included other several other local revenue sources categorized as "license taxes."
- Includes cable franchise taxes, beer and wine licenses, marriage licenses, etc.
- Actual privilege license tax revenue is much less.

County "License Tax" Revenues



5

County PLT Revenues

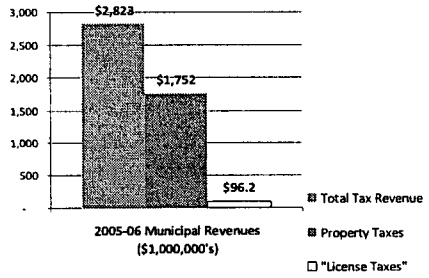


6

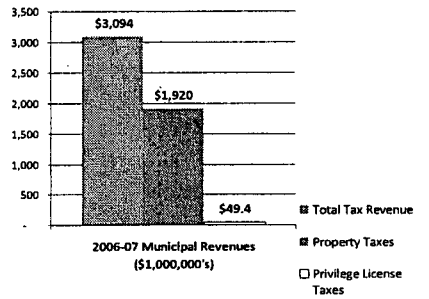
PLT Counties

- "License taxes" = $25.5 million
- Privilege license taxes = $500,000
- 0.008% of total county tax revenue
- 63 counties report no revenue

Municipal "License Tax" Revenues



Municipal PLT Revenues



PLT Municipalities

- "License taxes" = $96.2 million
- Privilege license taxes = $49.4 million
- 1.7% of total municipal tax revenue
- Over 70% from cities with > 100K population
- 301 cities levy privilege license taxes

ADVANCING REAPPRAISAL SCHEDULE FOR PROPERTY TAXES

1

Current Law

- Counties must reappraise real property at least every 8 years
- Counties are authorized to advance 8-year schedule
- Non-appraisal year revaluation allowed if value of property has changed for reasons other than economic conditions

2

4-year Schedule

Swain	Person	Stokes	Henderson
Tyrrell	Davie	Northampton	Iredell
Watauga	Forsyth	Wilkes	Rutherford
Orange	Gaston	New Hanover	Lee
Stanly	Moore	Alexander	Macon
Onslow	Burke	Rowan	Cleveland
Buncombe	Catawba	Brunswick	Cherokee
Haywood	Carteret	Surry	Lincoln
Yadkin	Pitt	Caswell	Jackson
Caldwell	Richmond	Cabarrus	Chatham

3

5-year schedule

Ashe	Robeson	Dare

4

6-year schedule

Hyde
Harnett
Rockingham
Randolph

Cumberland
Mecklenburg
Franklin

5

Method of revaluations

- In-house v. outsourcing
- Real property appraised at market or true value as of January 1
- Mass appraisal – assessor groups properties and prepares uniform schedule of values, standards and rules
- Three approaches to valuing real property: cost approach, sales comparison approach, and income approach

6

Sales Assessment (S/A) Ratio Studies

- S/A study used by assessor in general reappraisal year to ensure that tax values reflect fair market values
- S/A ratio study compares appraised value of parcels with sales price. The closer the comparison is to 100%, the closer the appraised value is to the fair market value of the parcel
- S/A ratio study for each county prepared yearly by Department, and county notified by April 15 following the study

7

S.L. 2008-146 history

- Revenue Laws Study Committee proposed a 4-year schedule to 2008 Session
- SB 1878 (Clodfelter) and HB 2476 (Brubaker and Hill) introduced proposal
- Senate version required advancing schedule if S/A ratio dropped below .90
- House version required advancing schedule if S/A ratio dropped below .70 or became greater than 1.10

8

Ratified

- Advanced schedule required only for county with population of 75,000 or greater and if S/A ratio dropped below .85 or became greater than 1.15
- New values must be implemented by January 1 of third year following notice of S/A ratio study by Department
- Other counties retain 8-year schedule

9

Counties with population of 75,000 or greater

Alamance
Brunswick
Buncombe
Burke
Cabarrus
Caldwell
Catawba
Cleveland
Craven
Cumberland
Davidson
Durham
Forsyth
Gaston
Guilford
Harnett
Henderson
Iredell
Johnston
Mecklenburg
Moore
Nash
New Hanover
Onslow
Orange
Pitt
Randolph
Robeson
Rockingham
Rowan
Union
Wake
Wayne
Wilson

10

Field Trips

- Large urban counties – met with tax assessors and staff from Mecklenburg and Cabarrus Counties
- Rural small counties – met with tax assessors from Hyde, Tyrrell, Chowan, Perquimans, Camden, Dare, Gates, Currituck, Bertie, Pasquotank, and Martin Counties

11

Advantages of Advanced Schedule

- Appraised value is more equivalent to fair market value
- There's not as much sticker shock because there's less difference in values between revaluations
- More frequent revaluations would result in appraised values reflecting an economic downturn in the housing market

12

Disadvantages of Advanced Schedule

- Revaluations are expensive
- Smaller counties do not have manpower or revenue for more frequent revaluation

13

Recommendations

- Require statewide sales disclosure form
- Provide funding for staff at the State level to assist smaller counties with revaluations
- Update schedules of values in the fourth year instead of conducting full revaluation

14

Schedules of other States

- Alabama - four year cycle
- Florida – annual cycle
- Georgia – based on level of assessment
- Kentucky – annual cycle
- West Virginia – three year cycle
- South Carolina – four year cycle
- Louisiana – four year cycle
- Tennessee – counties choose, four, five, or six year cycle
- Virginia – counties larger than 50,000 every four years, counties under 50,000 may delay until fifth or sixth year. Cities over 30,000 every two years, and cities under 30,000 may delay until fourth year

15

SALES RATIO (Shaded Counties are Impacted By 2008 Legislation)						
County	2007 Population Estimates	2008 Sales Ratio	Parcel Count	Last Reval	Current Cycle Length	Next Reval
[illegible]tes	11,819	0.4350	9,000	2001	8	2009
[illegible]amlico	12,947	0.4841	14,300	2004	8	2012
Graham	8,144	0.5164	8,675	2002	8	2010
Mitchell	15,950	0.5419	16,300	2001	8	2009
Clay	10,326	0.5549	15,500	2002	8	2010
Pender	50,430	0.5566	43,500	2003	8	2011
Warren	19,919	0.5996	22,200	2001	8	2009
Polk	19,040	0.6080	15,500	2001	8	2009
Madison	33,626	0.6546	20,000	2004	8	2012
Craven	96,406	0.6615	52,600	2002	8	2010
Swain	13,889	0.6629	11,250	2005	4	2009
Anson	25,332	0.6769	19,500	2002	8	2010
Beaufort	46,070	0.6802	43,000	2002	8	2010
Avery	18,292	0.7107	23,295	2006	8	2014
Montgomery	27,588	0.7200	30,500	2004	8	2012
Hyde	5,447	0.7243	8,500	2003	6	2009
Martin	20,495	0.7291	15,500	2001	8	2009
Edgecombe	51,813	0.7597	30,000	2001	8	2009
Duplin	53,133	0.7800	36,500	2001	8	2009
Tyrrell	4,290	0.7834	5,000	2005	4	2009
Watauga	44,696	0.7838	44,600	2006	4	2010
Ashe	26,003	0.7896	36,500	2006	5	2011
Orange	127,344	0.7933	52,500	2005	4	2009
Transylvania	30,758	0.7971	31,000	2002	7	2009
McDowell	23,906	0.8000	27,000	2003	8	2011
[illegible]mpson	64,522	0.8160	49,500	2003	8	2011
Cumberland	313,616	0.8172	129,000	2003	6	2009
Stanly	59,158	0.8191	37,500	2005	4	2009
Nash	92,915	0.8192	49,300	2001	8	2009
Harnett	106,506	0.8198	57,000	2003	6	2009
Onslow	169,302	0.8270	62,665	2006	4	2010
Wayne	115,225	0.8281	62,000	2003	8	2011
Mecklenburg	863,147	0.8290	322,000	2003	6	2009
Hertford	23,730	0.8324	15,500	2003	8	2011
Buncombe	225,609	0.8360	110,000	2006	4	2010
Haywood	57,031	0.8415	48,500	2006	4	2010
Robeson	129,425	0.8440	73,000	2005	5	2010
Columbus	54,460	0.8466	41,700	2005	8	2013
Currituck	23,731	0.8537	23,500	2005	8	2013
Yadkin	37,850	0.8542	28,000	2005	4	2009
Johnston	157,296	0.8555	81,000	2003	8	2011
Pasquotank	40,880	0.8578	20,113	2006	8	2014
Caldwell	79,376	0.8585	51,500	2005	4	2009
Washington	13,214	0.8607	9,800	2005	8	2013
Granville	55,667	0.8610	27,800	2002	8	2010
Halifax	55,352	0.8624	38,237	2007	8	2015
Alamance	143,154	0.8708	67,200	2001	8	2009
Jones	10,315	0.8744	8,500	2006	8	2014
Rockingham	91,646	0.8808	52,000	2003	6	2009
[illegible]tie	19,971	0.8809	18,000	2004	8	2012
[illegible]otland	36,830	0.8820	23,500	2003	8	2011
Chatham	59,168	0.8863	36,200	2005	4	2009
Person	37,640	0.8903	28,100	2005	4	2009

County	2007 Population Estimates	2008 Sales Ratio	Parcel Count	Last Reval	Current Cycle Length	Next Reval
Alleghany	11,088	0.8909	16,200	2007	8	2015
Stokes	46,257	0.8947	29,000	2005	4	2009
Greene	21,110	0.8981	11,000	2005	8	2013
Franklin	56,456	0.9013	37,500	2004	6	2010
Bladen	32,500	0.9069	31,213	2007	8	2015
Henderson	102,142	0.9075	72,000	2007	4	2011
Davie	40,447	0.9094	23,700	2005	4	2009
Lenoir	57,642	0.9105	34,500	2001	8	2009
Guilford	460,780	0.9160	200,000	2004	8	2012
Northampton	21,235	0.9180	19,700	2007	4	2011
Iredell	150,421	0.9210	89,000	2007	4	2011
Forsyth	338,679	0.9210	132,000	2005	4	2009
Randolph	139,422	0.9243	80,000	2007	6	2013
Dare	34,272	0.9246	41,700	2005	5	2010
Wilkes	67,182	0.9297	50,000	2007	4	2011
Rutherford	62,926	0.9324	53,500	2007	4	2011
Gaston	200,972	0.9327	102,523	2007	4	2011
New Hanover	189,922	0.9369	93,000	2007	4	2011
Lee	56,376	0.9394	30,531	2007	4	2011
Camden	9,519	0.9411	8,000	2007	8	2015
Moore	83,932	0.9412	66,654	2007	4	2011
Alexander	36,656	0.9474	23,000	2007	4	2011
Chowan	14,660	0.9516	12,100	2006	8	2014
Hoke	42,932	0.9556	22,000	2006	8	2014
Macon	44,064	0.9588	43,000	2007	4	2011
Burke	88,439	0.9641	55,000	2007	4	2011
Union	182,344	0.9645	86,500	2008	8	2016
Rowan	136,486	0.9672	81,200	2007	4	2011
Cleveland	97,144	0.9785	54,200	2008	4	2012
Catawba	153,404	0.9794	85,000	2007	4	2011
Brunswick	99,440	0.9807	130,000	2007	4	2011
Cherokee	27,026	0.9820	31,500	2008	4	2012
Carteret	63,294	0.9840	57,381	2007	4	2011
Surry	73,150	0.9878	39,800	2008	4	2012
Lincoln	72,776	0.9919	45,500	2008	4	2012
Pitt	151,970	0.9944	72,500	2008	4	2012
Yancey	18,550	0.9974	15,500	2008	8	2016
Wake	832,590	0.9991	314,000	2008	8	2016
Davidson	156,400	0.9998	92,000	2007	8	2015
Perquimans	12,722	1.0000	13,600	2008	8	2016
Caswell	23,508	1.0000	14,500	2008	4	2012
Jackson	36,815	1.0000	37,000	2008	4	2012
Vance	43,583	1.0000	25,000	2008	8	2016
Richmond	46,672	1.0000	30,500	2008	4	2012
Wilson	77,970	1.0000	36,500	2008	8	2016
Cabarrus	164,384	1.0000	77,500	2008	4	2012
Durham	254,740	1.0000	105,000	2008	8	2016

COUNTIES					
County	2007 Population Estimates	2008 Sales Ratio	County	2007 Population Estimates	2008 Sales Ratio
Alamance	143,154	0.8708	Lincoln	72,776	0.9919
Alexander	36,656	0.9474	Macon	44,064	0.9588
Alleghany	11,088	0.8909	Madison	33,626	0.6546
Anson	25,332	0.6769	Martin	20,495	0.7291
Ashe	26,003	0.7896	McDowell	23,906	0.8000
Avery	18,292	0.7107	Mecklenburg	863,147	0.8290
Beaufort	46,070	0.6802	Mitchell	15,950	0.5419
Bertie	19,971	0.8809	Montgomery	27,588	0.7200
Bladen	32,500	0.9069	Moore	83,932	0.9412
Brunswick	99,440	0.9807	Nash	92,915	0.8192
Buncombe	225,609	0.8360	New Hanover	189,922	0.9369
Burke	88,439	0.9641	Northampton	21,235	0.9180
Cabarrus	164,384	1.0000	Onslow	169,302	0.8270
Caldwell	79,376	0.8585	Orange	127,344	0.7933
Camden	9,519	0.9411	Pamlico	12,947	0.4841
Carteret	63,294	0.9840	Pasquotank	40,880	0.8578
Caswell	23,508	1.0000	Pender	50,430	0.5566
Catawba	153,404	0.9794	Perquimans	12,722	1.0000
Chatham	59,168	0.8863	Person	37,640	0.8903
Cherokee	27,026	0.9820	Pitt	151,970	0.9944
Chowan	14,660	0.9516	Polk	19,040	0.6080
Clay	10,326	0.5549	Randolph	139,422	0.9243
Cleveland	97,144	0.9785	Richmond	46,672	1.0000
Columbus	54,460	0.8466	Robeson	129,425	0.8440
Craven	96,406	0.6615	Rockingham	91,646	0.8808
Cumberland	313,616	0.8172	Rowan	136,486	0.9672
Currituck	23,731	0.8537	Rutherford	62,926	0.9324
Dare	34,272	0.9246	Sampson	64,522	0.8160
Davidson	156,400	0.9998	Scotland	36,830	0.8820
Davie	40,447	0.9094	Stanly	59,158	0.8191
Duplin	53,133	0.7800	Stokes	46,257	0.8947
Durham	254,740	1.0000	Surry	73,150	0.9878
Edgecombe	51,813	0.7597	Swain	13,889	0.6629
Forsyth	338,679	0.9210	Transylvania	30,758	0.7971
Franklin	56,456	0.9013	Tyrrell	4,290	0.7834
Gaston	200,972	0.9327	Union	182,344	0.9645
Gates	11,819	0.4350	Vance	43,583	1.0000
Graham	8,144	0.5164	Wake	832,590	0.9991
Granville	55,667	0.8610	Warren	19,919	0.5996
Greene	21,110	0.8981	Washington	13,214	0.8607
Guilford	460,780	0.9160	Watauga	44,696	0.7838
Halifax	55,352	0.8624	Wayne	115,225	0.8281
Harnett	106,506	0.8198	Wilkes	67,182	0.9297
Haywood	57,031	0.8415	Wilson	77,970	1.0000
Henderson	102,142	0.9075	Yadkin	37,850	0.8542
Hertford	23,730	0.8324	Yancey	18,550	0.9974
Hoke	42,932	0.9556			
Hyde	5,447	0.7243			
Iredell	150,421	0.9210			
Jackson	36,815	1.0000			
Johnston	157,296	0.8555			
Jones	10,315	0.8744			
Lee	56,376	0.9394			
Lenoir	57,642	0.9105			

Marcy Mann
Dare County
Transfer Tax
P O Box 1000
962 Marshall Collins Dr.
Manteo NC 27954
(252) 475-5956

AFFIDAVIT OF CONSIDERATION OR VALUE

TAX OFFICE USE ONLY

**COMPLETE ALL SECTIONS OF THIS AFFIDAVIT OR IT MAY BE REJECTED. AN AFFIDAVIT MAY BE REQUIRED WITH ANY INSTRUMENT CONVEYING REAL PROPERTY.

1. TRANSFER DATA

GRANTOR _____ GRANTEE _____
ADDRESS _____ ADDRESS _____
CITY, STATE _____ CITY, STATE _____

2. PROPERTY LOCATION

TAX DISTRICT _____ TAX PARCEL ID _____

SUBDIVISION _____ SECTION _____ BLOCK _____ LOT _____

PROPERTY DESCRIPTION CHECK ONE

Vacant Residential	Improved Residential	Condominium	Timeshares
Vacant Commercial	Improved Commercial	Townhouse	Co-ownership

3. CONSIDERATION OR VALUE DATE (ITEMS 1-5 MUST BE COMPLETED)

1. ACTUAL CASH CONSIDERATION _____
2. OTHER CONSIDERATION _____
3. TOTAL CONSIDERATION _____
4. FAIR MARKET VALUE _____
5. EXPLANATION OF ABOVE OR LEASE VALUE COMPUTATION

4. SIGNATURE AND NOTARY

Under the penalties of law, I declare that I have examined this Affidavit, including accompanying statements, and to the best of my knowledge and belief, it is true, complete and correct. I do declare that the above real estate has been reported at true market value.

SIGNATURE OF AFFIANT _____ (SEAL) DATE _____

SWORN TO AND SUBSCRIBED BEFORE ME THIS _____ DAY OF _____, 20____ _____ (NOTARY PUBLIC)

NOTARY SEAL

MY COMMISSION EXPIRES _____

PERQUIMANS COUNTY, NC
AFFIDAVIT
REGARDING CONVEYANCE
OF REAL PROPERTY

P.O. Box 7
Hertford, NC 27944
Effective Date: October 10, 1992
Revised: May 23, 2007

FOR TAX OFFICE ONLY

I, the undersigned, being duly sworn says that the information set out below is true and correct to the best of my knowledge and belief.

1. GRANTOR(S) _____

2. GRANTEE(S) _____
ADDRESS: _____
_____
PHONE #: _____

3. TOWNSHIP _____
4. SUBDIVISION _____
5. STATE ROAD _____
6. LOT SIZE _____
7. BUILDINGS _____
8. PARCEL NUMBER _____
9. TRANSFER:
STRAIGHT/COMPLETE _____
SPLIT/PARTIAL _____
10. ACREAGE
CLEARED _____
WOODED _____

11. CONSIDERATION/VALUE
CASH CONSIDERATION $ _____
OTHER CONSIDERATION $ _____
TOTAL CONSIDERATION $ _____

FOR TAX OFFICE USE ONLY
TRANSFER TAX
X 1% = $ _____

12. Who will assume the taxes for the current year? GRANTEE GRANTOR
13. Have any lots previously been conveyed from the tract from which this lot is being conveyed? (Since 01/01/76) YES NO
14. Has the subdivision of land been approved by the Perquimans County Planning Board or Subdivision Review Officer? YES NO
15. How was this property acquired? DEED BOOK _____ PAGE _____
WILL FILE _____ - E - _____
16. Does this transaction involve family members or between known affiliated companies? YES NO
17. Does this transaction include conveyance of personal property (mobile homes, household goods, machinery, equipment, etc.)? YES NO
18. Was this transaction as a result of a forced sale? YES NO

DATE: _____ SIGNATURE: _____

Sworn to and subscribed before me this _____th day of _____, year _____

_____
Notary Public

SEAL

_____/_____/_____
My commission expires

June 14, 2007

«M_2_____»
«M_3_____»
«M_4_____»
«M_5_____»
«M_6_____»«M_7_» «M_8_____»

Parcel Number:«M_10_____» Acct #:«M_1_____» Township:«M_24»
Legal Description: «M_11_____»«M_12_____»
Deed Book/Page:«M_26___»/«M_27__» Sales Date:«M_29»/2007

Congratulations on your recent purchase of real property. We extend our invitation to you to contact us or visit our office if you have any questions regarding your new property. In turn, we would appreciate your help. North Carolina law requires each county to conduct a sales-assessment ratio study that measures the sales price of real property in relation to the county's assessed value. This information is then used to adjust public service company values for taxation, determine funding for school facility needs and contribute to the fair and equitable assessment of all properties.

This questionnaire is strictly confidential and NOT open to public inspection. Please confirm the preprinted information above, complete the remainder of the form and return it within ten (10) days. We have enclosed a self-addressed, stamped envelope for your convenience. Please contact our Real Estate Appraisal Department at (704)920-2178 if you have any questions. Thank you for your assistance.

Cabarrus County Real Property Manager

Name of person completing form:_____

Daytime Telephone Number:(____)_____

1. Total Purchase Price:_____

2. Is this sale between relatives/related businesses? Yes___ No___

3. Was this an auction/foreclosure sale? Yes___ No___

4. Is the property being rented? Yes___ No___ Rent per month $_____

5. Was any personal property exchanged in this sale (mobile home, furniture, machinery, etc.)? Yes___ No___ If so, what? _____

6. Do you consider the total sales price to be the fair market value of the real estate on the date of the sale? Yes___ No___ If no, explain:

---

7. At the time of purchase, was the property vacant land or was the home already built? (circle one)

8. Type of financing? Conventional ___ FHA ___ VA ___ Owner ___ Other ___ explain

---

Signature:_____ Date:_____

PROPERTY TAX BULLETIN NUMBER 144 | MARCH 2008

A Citizens' Guide to the Revaluation and Assessment of Property by North Carolina Counties

by Shea Riggsbee Denning

These days, any discussion of the process of appraising land, homes, and other buildings for tax purposes, particularly if the property is located at the coast, on a lake, in the mountains, or in the fast-growing Triangle (in other words, pretty much anywhere in North Carolina) is likely to include the term "sticker shock." Unfortunately, such discussions also frequently include taxpayers' expressions of frustration with, confusion about, and mistrust of the assessment process. More than half of North Carolina counties revalue land, homes, buildings, and other structures, defined as *real property*, only once every eight years, and many taxpayers have limited knowledge of the laws and procedures governing the valuation and assessment of this property for local government[1] taxation. Infrequent revaluations in high-growth areas can result in individual valuations that double, triple, or even quadruple from one revaluation to the next. In contrast, business personal property and motor vehicles are assessed for taxation every year by North Carolina counties, and that process generally attracts little notice—let alone sticker shock. The differences in taxpayer sentiment may be attributed to several factors, among them the varying ways in which real and personal property are added to the tax rolls (the former by the tax assessor and the latter generally by the taxpayer), the shorter cycle for revaluation of personal property as compared to real property, and the depreciation of personal property over time as contrasted with the typical appreciation of real property. Certainly the exclusion from taxation of nonbusiness personal property (other than classified motor vehicles) plays a role since taxes on property used to produce income are likely to be considered a cost of doing business rather than an unavoidable, burdensome obligation imposed on a citizen's home or land.

This bulletin explains the legal framework underlying the assessment of property by North Carolina counties as well as the laws and procedures governing review and appeal of these assessments. This bulletin may be of particular interest to local officials and citizens in the thirty-eight counties in which new countywide real property valuations became effective January 1, 2008, or will become effective January 1, 2009. For a list of these counties, see Table 1.

1. Real property includes land, buildings, and permanent fixtures, as well as rights and privileges pertaining to land, such as mineral or forestry rights. Personal property includes all other property, both tangible and intangible, that is not permanently affixed to land.

Table 1. Counties with Revaluations of Real Property in 2008 and 2009

Effective January 1, 2008	Effective January 1, 2009
Cabarrus	Alamance
Caswell	Caldwell
Cherokee	Chatham
Cleveland	Davie
Durham	Duplin
Jackson	Edgecombe
Lincoln	Forsyth
Perquimans	Gates
Pitt	Harnett
Richmond	Hyde
Surry	Lenoir
Union	Martin
Vance	Mecklenburg
Wake	Mitchell
Wilson	Nash
Yancey	Orange
	Person
	Polk
	Rockingham
	Stanley
	Stokes
	Swain
	Transylvania
	Tyrrell
	Warren
	Yadkin

The Role of the County Assessor

The county assessor appraises and assesses all property in the county in accordance with the Machinery Act, Subchapter II of Chapter 105 of the North Carolina General Statutes. The assessor creates an abstract or property record card for all real property in the county.[2] This process is referred to as a "permanent listing system" and its implementation, which began in the 1990s, marked a departure from traditional listing methodology in which the duty to list property subject to taxation was borne by the owners of real and personal property. Even in a permanent listing system, however, owners of real property remain responsible for listing buildings and other improvements valued at more than $100 that have been acquired, begun, erected, damaged, or destroyed since the time of

2. N.C. GEN. STAT. § 105-303(b) (hereinafter G.S.).

the last appraisal.[3] The listing abstract or property record card reflects the owner of record as of the listing date, which generally is January 1.[4] The term "owner of record" denotes ownership as reflected in a document of public record—that is, a deed, judgment, probated will, or other document reflecting ownership filed in the official record maintained by the clerk of superior court or the register of deeds.

Unlike assessors in most other United States jurisdictions[5] county assessors in North Carolina are appointed rather than elected. And unlike most county employees, tax assessors are appointed by the county board of commissioners rather than by the county manager.[6] The term of office is two years, beginning on July 1 of odd-numbered years.[7] An assessor who has completed a two-year term and has been certified by the Department of Revenue may be reappointed for a four-year term, at the discretion of the board. During his or her appointed term, an assessor is not an employee at will, whose employment may be terminated at any time. Instead, an assessor may only be removed from office for "good cause,"—that is, for a reason that affects the assessor's performance of the duties of the office, is substantial, and directly affects the public interest.[8] Before an assessor is removed from office for such a reason, the board of commissioners must provide the assessor notice in writing of the reasons for the impending dismissal and provide the assessor an opportunity to appear and be heard at a public session of the board.

A person appointed as assessor must be at least twenty-one years old as of the date of employment and have a high school diploma or certificate of equivalency or, alternatively, have five years employment experience in a vocation reasonably related to the duties of a county assessor.[9] Within two years of the date of appointment, an assessor must pass courses approved by the Department of Revenue covering the following topics: (1) state law governing the listing, appraisal, and assessment of property for taxation; (2) the theory and practice of estimating the fair market value of real property for ad valorem tax purposes; (3) the theory and practice of estimating the fair market value of personal property for ad valorem tax purposes; and (4) property tax assessment administration.[10] As a practical matter, these requirements are satisfied by completing and passing the examination in the following courses: (1) Property Tax Listing and Assessing in North Carolina, a course co-sponsored by the UNC School of Government and the Department of Revenue; (2) Real Property Appraisal, International Association of Assessing Officers (IAAO) Course 101; (3) Personal Property Appraisal, a Department of Revenue course; and (4) Assessment Administration, IAAO Course 400. After completing and passing these four courses and exams, the assessor must also pass a comprehensive examination in

---

3. G.S. 105-303(b)(2); G.S. 105-309(c)(3), (4).

4. G.S. 105-285. An exception applies to exempt real property transferred after January 1 but before July 1. This property is listed in the name of the new owner of record.

5. Gary C. Cornia & Lawrence C. Walters, *Full Disclosure: Controlling Property Tax Increases During Periods of Increasing Housing Values*, 59 National Tax Journal, No. 3, 2006, at 736.

6. *See* G.S. 153A-82 (providing that manager shall appoint all employees except those who are elected or whose appointment is otherwise provided by law). The county tax collector, county attorney, county manager, and county clerk also are appointed by the board of commissioners. See G.S. 105-349 (county tax collector); G.S. 153A-114 (county attorney); G.S. 153A-81 (county manager); G.S. 153A-111 (county clerk).

7. Assessors must, on occasion, be appointed during even-numbered years if there is a vacancy in the office. Given that the Machinery Act sets forth a reappointment schedule based upon odd-numbered-year reappointments, boards of commissioners appointing assessors in even-numbered years should make these appointments effective through June 30 of the next odd-numbered year. The board may then resume the Machinery Act schedule of appointments July 1 of the odd-numbered year.

8. 63C American Jurisprudence, Public Officers and Employees, § 183 (2d ed. 2005).

9. G.S. 105-294(b).

10. G.S. 105-294(b)(3).

property tax administration given by the Department of Revenue. Until an assessor completes these requirements, the assessor is deemed to serve in an "acting capacity."[11] Once an assessor meets these requirements, the assessor is certified by the Department of Revenue. An acting assessor who fails to qualify for certification within two years of appointment may not be reappointed until all of the certification requirements are met.[12] Once certified, an assessor must complete at least thirty hours of instruction in the appraisal or assessment of property every two years to remain eligible for reappointment.

Upon appointment, an assessor must take the oath constitutionally required of all persons elected or appointed to office and also must promise not to allow his or her "actions as assessor to be influenced by personal or political friendships or obligations."[13] This additional oath requirement emphasizes the necessity of impartiality on the part of the assessor.

The assessor cannot, of course, single-handedly fulfill the duties of the office. Accordingly, the assessor is authorized "within budgeted appropriations" to "employ listers, appraisers, and clerical assistants necessary to carry out the listing, appraisal, assessing, and billing functions required by law."[14] Each person employed by an assessor as a real property or personal property appraiser must, during the first year of employment and every other year thereafter, attend a course of instruction in the employee's area of work.[15] In addition, at the end of the first year of employment, the appraiser must pass a comprehensive examination in property tax administration conducted by the Department of Revenue. The Department of Revenue has adopted regulations that permit waiver of the comprehensive exam requirement if the appraiser completes and passes the examination in Property Tax Listing and Assessing in North Carolina and the basic appraisal course for either real or personal property, IAAO Course 101, or Personal Property Appraisal, depending upon the appraiser's area of specialty.[16] The department also may waive the examination requirement if the appraiser has been designated a North Carolina Certified Appraiser by the North Carolina Association of Assessing Officers (NCAAO) or a Certified Assessment Evaluator (CAE) by the IAAO.[17]

County boards of commissioners also are authorized, upon recommendation of the assessor, to appoint one or more assistant assessors.[18] Boards seldom exercise this authority. Boards also may, and frequently do, employ appraisal firms, mapping firms, and other outside contractors to assist appraisers in performing their duties. The most common situation in which such outside contractors are employed is when a county revalues its real property. Any person employed by an appraisal firm whose duties include the appraisal of property for the county must pass a comprehensive exam administered by the Department of Revenue.[19] In hiring an appraisal firm, a board of commissioners must give primary consideration to firms registered with the Department of Revenue.

---

11. G.S. 105-204(c).
12. G.S. 105-294(c).
13. G.S. 105-295.
14. G.S. 105-296(b).
15. *Id.*
16. N.C. Department of Revenue, Property Tax Division, Regulation for Training and Certification of County Assessors, County Appraisers, and Appraisal Firm Appraisers in North Carolina (2006).
17. *Id.*
18. G.S. 105-297.
19. This exam differs from the comprehensive exam for county appraisers. If an appraiser for an appraisal firm passes the School of Government and Department of Revenue Property Tax Listing and Assessing in North Carolina course along with either IAAO 101, for real property appraisers, or the Department of Revenue's business personal property course, for personal property appraisers, the comprehensive exam requirement is waived. N.C. Department of Revenue, Property Tax Division, *supra* note 16.

Revaluation of Real Property

North Carolina counties must conduct a countywide revaluation of all real property within the county at least every eight years.[20] Revaluation is a labor- and time-intensive process. The typical county has about forty thousand parcels, all of which must be separately appraised. Many of these parcels include buildings, structures, and fixtures that must be appraised along with land.[21] Counties must accomplish this task for each parcel at a fraction of the cost of a single-property or "fee" appraisal. On average, counties spend less than $20 per parcel in a revaluation.[22] About half of the state's counties have shortened the number of years between revaluations to periods ranging from four to seven years. In addition, real property may be reappraised in a non-revaluation year if the value of the property has changed for some reason other than an economic condition affecting the county in general, such as a rezoning of the property.[23] Personal property, as noted above, is appraised for taxation every year based on its value on January 1.[24]

Valuation Standard

The uniform standard governing the county assessor's appraisal of all property, real and personal, is that property be *appraised* at its market value—that is, the price at which it would change hands between a willing and financially able buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all the uses to which the property is adapted and for which it is capable of being used.[25] Property is, in turn, *assessed* for taxation based on its appraised value, with the exception of agricultural, horticultural, or forestry property that qualifies for taxation based upon its present-use value and public service company system property assessed by the Department of Revenue based in part on the effective rates of taxation in a given county.[26]

To accomplish the task of valuing tens of thousands of parcels as of the January 1 revaluation date, a county must utilize the methodology of mass appraisal rather than the methodology employed in single-property appraisals, which are commonly performed at the behest of financial institutions.[27] Mass appraisal is the systematic appraisal of groups of properties, commonly referred to as neighborhoods, as of the controlling date (January 1 of the year of reappraisal) using standardized procedures and statistical testing.[28] A large urban city, for example, may stratify property among thousands of neighborhoods for purposes of conducting a countywide revaluation.[29] In a mass appraisal

---

20. G.S. 105-286.

21. According to data maintained by the Department of Revenue, Property Tax Division, as of September 2007, the mean number of parcels per county was 50,845 and the median was 37,250.

22. G.S. 153A-150 requires each county to report to the Department of Revenue the terms of the county's eight year reappraisal budget, which includes information on estimated costs per parcel. The average amount budgeted per parcel for revaluation years 2008 and later is $18.46.

23. G.S. 105-287.

24. G.S. 105-285. The value of a registered motor vehicle is determined annually as of January 1 of the year the taxes become due. G.S. 105-330.2. Taxes on registered motor vehicles are due the first day of the fourth month following the date the registration expires. G.S. 105-330.4(a).

25. G.S. 105-283.

26. G.S. 105-284.

27. Property Assessment Valuation Ch. 13, at 285 (IAAO, 2d ed. 1996).

28. Property Assessment Valuation, *supra* note 27, at 285.

29. *See, e.g.*, Wake County Government, What's Your Property Worth? The ABCs of Wake County's 2008 Property Revaluation Project (2007) (stating that Wake County designated 4,200 appraisal neighborhoods in its 2008 revaluation).

system, the assessor must make valuation judgments about *groups* of properties rather than *single* properties and "must be able to develop, support, and explain standardized adjustments in a valuation model among use classes, construction types, neighborhoods, and other property groups."[30]

There are three generally recognized methodologies for valuing property, commonly referred to as "approaches to value": the cost approach, the sales comparison approach, and the income approach.[31] The cost approach estimates value as the sum of the depreciated improvement cost and the value of the site, or land, as if vacant and available for development at its highest and best use.[32] The sales comparison approach, as its name indicates, compares the property being appraised with similar properties that have recently sold.[33] This approach is most applicable when sufficient sales data is available for similar properties. It is commonly used to appraise single-family residences and land, but it also is an effective approach for valuing multi-family and commercial properties where sufficient sales data for these types of properties is available.[34] The third approach, the income approach, defines value as the present worth of future benefits arising from ownership of a property. The income approach to value is based on the principle that something is worth what it will earn.[35] To value property under the income approach, the assessor must analyze the income stream in terms of quantity, quality, and duration and apply an appropriate capitalization rate to convert the stream to market value.[36] Stated in terms of an equation, value equals income divided by rate.[37] Thus, "the capitalized value of a given income stream varies directly with the amount of income and inversely with the capitalization rate" and even "[s]light variations in the capitalization rate can result in large variations in value."[38]

Schedule of Values

The assessor's first step in conducting a countywide revaluation is to prepare uniform schedules of values, standards, and rules to be used in appraising real property at its true value and at its present-use value.[39] These schedules serve as the county's mass appraisal model and are implemented by means of a computer assisted mass appraisal system (CAMA). The schedules incorporate building cost figures derived from national data that have been adjusted to reflect local costs, sales data based upon qualifying arms-length sales of property grouped by appraisal neighborhood, and income and expense formulas applicable to commercial property and derived from local and national sources. The schedule of values, standards, and rules sets forth values per appropriate unit of measurement for use in appraising land and buildings. For example, the value of a dwelling typically is based on an established amount per square foot, while the value of land is based upon a set amount per square foot, lot, acre, or homesite, depending upon the highest and best use of the land. The land value per appropriate unit of measurement also will vary depending on the neighborhood in which the land is situated. The schedule of values, standards, and rules also sets forth factors warranting adjustments

30. PROPERTY ASSESSMENT VALUATION, *supra* note 27, at 285.
31. *Id.* at 42.
32. *Id.* at 43–44.
33. *Id.* at 45.
34. *Id.*
35. *In re* Southern Ry., 313 N.C. 177, 328 S.E.2d 235 (1985).
36. PROPERTY ASSESSMENT VALUATION, *supra* note 27, at 46.
37. *In re* Southern Ry., 313 N.C. at 185, 328 S.E.2d at 241.
38. *Id.*
39. G.S. 105-317(c).

in valuations for various types of property. For example, a schedule may provide for adjustments to the base value of dwellings for square footage of an upper story, based upon grade of construction, to account for depreciation, and to include the value of items such as fireplaces, finished basements, and air conditioning. A county's schedule also typically authorizes adjustments to land value based on factors such as homesite size, excess acreage, road frontage, topography, zoning, the presence of easements, and other factors. A schedule also typically prescribes ranges of characteristics and corresponding percentage adjustments for recognized factors.

The schedules of values, standards, and rules must be reviewed and approved by the board of county commissioners before January 1 of the year they are applied, though the assessor may collect data needed to apply the schedules before they are adopted by the board.[40] The assessor must submit the proposed schedules, standards, and rules to the board at least twenty-one days before the meeting at which the board will consider the schedule.[41] On the same day the schedules are submitted to the board, the assessor must file a copy of the proposed schedules in the assessor's office to be available for public inspection. Upon receipt of the schedules, the board of commissioners must publish a statement in a newspaper with general circulation in the county stating that the schedules have been submitted and are available for inspection.[42] The newspaper notice also must specify the time and place of the public hearing regarding the proposed schedules.[43] The board must hold this public hearing at least seven days before adopting the final schedules.[44] The true value and present-use value schedules may be approved separately or simultaneously, in the board's discretion.[45]

When the board approves the final schedules of values, standards, and rules, it must issue an order adopting the schedules.[46] Notice of the order must be published once a week for four consecutive weeks in a newspaper with general circulation in the county, with the last publication taking place at least seven days before the last day for challenging the validity of the schedule through an appeal to the Property Tax Commission, the statewide board of equalization and review.[47] The published notice must state that the schedules have been adopted and are open to examination in the office of the assessor and that a property owner who asserts that the schedules are invalid may appeal to the Property Tax Commission within thirty days of the first publication of the notice.

Notification of the Appraised Value of Real Property

Before the first meeting of the board of equalization and review, the assessor must provide written notice of a change in the appraisal of real property to the taxpayer[48]—that is, the owner of the property—at the owner's last known address.[49] This notice must be provided for appraisal changes

40. *Id.*
41. G.S. 105-317(c)(1).
42. G.S. 105-317(c)(2).
43. *Id.*
44. *Id.*
45. G.S. 105-302(c).
46. G.S. 105-317(c)(3).
47. *Id.*
48. The term *taxpayer* is defined as "any person whose property is subject to ad valorem property taxation by any county or municipality and any person who, under the terms of this Subchapter, has a duty to list property for taxation. For purposes of collecting delinquent ad valorem taxes assessed on real property under G.S. 105-366 through G.S. 105-375, 'taxpayer' means the owner of record on the date the taxes become delinquent and any subsequent owner of record of the real property if conveyed after that date." G.S. 105-273(17).
49. G.S. 105-296(i).

applicable to real property in revaluation and nonrevaluation years. Though the Machinery Act does not require it, most assessors provide an informal appeal process to afford taxpayers an opportunity to inform the assessor of their objections to an appraisal or assessment or to the denial of a request for exemption. If the assessor finds the taxpayer's objection well-founded, the assessor may correct the error in the property assessment before the board of equalization and review convenes.

Review of Appraisals and Assessments

Each county has a board of equalization and review responsible for reviewing tax lists and hearing taxpayer appeals. The board of commissioners serves as the county board of equalization and review unless it appoints by resolution a special board to carry out these duties.[50] Many boards of commissioners find that appointing a separate board of equalization and review permits review of county assessments by a more representative cross-section of the community. For instance, the board of equalization and review might be made up of of private appraisers, real estate professionals, and others with a particular expertise in the valuation of property. The appointment of a separate board also shields the review process from political pressures. In a handful of counties, boards of equalization and review were created and continue to operate pursuant to the provisions of a local act enacted by the General Assembly.[51] The board of equalization and review must convene no earlier than the first Monday in April and no later than the first Monday in May. While the Machinery Act provides that the board, in a non-revaluation year, "shall complete its duties on or before the third Monday following its first meeting unless . . . a longer period of time is necessary," the Act is not explicit about the shortest amount of time the board may meet.[52] In some counties, the board convenes and adjourns the same day. The Machinery Act's reference to meetings held "[f]rom the time of [the board of E & R's] first meeting until its adjournment"[53] appears to contemplate that there will be more than one meeting. It bears noting that the very purpose of the board is to provide taxpayers an opportunity for a meaningful hearing and review of the assessment of their property. Convening and adjourning on the same day is not a practice designed to meet that objective. The author's interpretation of the statute, in light of its vague language and its underlying purpose, is that the board must have at least two meetings, though a contrary interpretation certainly is plausible. In revaluation years, the board must adjourn by December 1; in other years it must adjourn by July 1. This adjournment signals the end of the appeal period for real property, but not the end of the board's work. The board may remain in session after adjournment to consider appeals filed before adjournment and timely appeals from valuation changes made by the board itself, notice of which was mailed fifteen days before the board's adjournment.[54] A taxpayer may appeal to the board by submitting a written request for a hearing or by personally appearing before the board at one of its sessions.[55]

---

50. G.S. 105-322.

51. *See, e.g.*, 1991 N.C. Sess. Laws ch. 871 (Durham County); 1989 N.C. Sess. Laws ch. 606 (Cumberland County); 1981 N.C. Sess. Laws ch. 509 (Mecklenburg County).

52. G. S. 105-322(e).

53. *Id.*

54. The board also may consider appeals relating to discovered property and certain other appeals not related to the appraisal and revaluation of real property discussed here. G.S. 105-322.

55. Notice of the date, hours, place, and purpose of the board's first meeting must be published at least three times in a newspaper with general circulation in the county, with the first publication at least ten days before the first meeting. The notice also must state the dates and hours of the board's subsequent meetings and the date on which it expects to adjourn. G.S. 105-322(f).

Standing

Consideration of taxpayer appeals comprises the lion's share of the work of all boards of equalization and review, or "boards of E&R," as they are commonly termed. Boards of E&R are required by statute "to hear appeals from any taxpayer who owns or controls property taxable in the county with respect to the listing or appraisal of the taxpayer's property or the property of others."[56] While the statute is broadly written, the courts have determined that the legal doctrine of standing permits a taxpayer to contest the valuation of property of others *only* when the appellant taxpayer is in some way aggrieved by that valuation.[57] Given that "'[t]he purpose of the statutory requirement that all property be appraised at its true value in money is to assure, as far as practicable, a distribution of the burden of taxation in proportion to the true values of the respective taxpayers' property holdings,'" a taxpayer is only aggrieved by the valuation of another's property when that property has been undervalued or underassessed by the county assessor, thereby resulting in the taxpayer bearing a disproportionately greater share of the overall tax burden.[58] The overvaluation of another's property, which would lessen the tax burden borne by other property owners, including the taxpayer, is not a matter that aggrieves the taxpayer and, as such, is not a matter that the taxpayer may appeal.[59]

In *In re Whiteside Estates*,[60] a Jackson County taxpayer filed an appeal with the county board of equalization and review challenging the classification of a 227-acre parcel owned by Whiteside Estates, a family corporation, for taxation based on its present-use value as forestland. The board determined that the property did not meet present-use value requirements and notified Whiteside of its right to a hearing. At Whiteside's request, the board conducted another hearing and again determined that the property had been improperly classified as forestland qualifying for present-use-value taxation. The board ordered the property assessed at its market value of $719,000 rather than its present-use value of $102,800. Whiteside appealed to the Property Tax Commission, contending that the initial appeal to

56. G.S. 105-322(g)(2).

57. *In re* Whiteside Estates, 136 N.C. App. 360, 525 S.E.2d 196 (2000).

58. *Id.* (quoting *In re* King, 281 N.C. 533, 189 S.E.2d 158 (1972)).

59. *See* Brock v. Property Tax Comm'n, 290 N.C. 731, 228 S.E.2d 254 (1976). Brock and several unidentified property owners appeared before the Jones County Board of Equalization and Review to request a 25 percent reduction in the appraised values of all farm property in Jones County. When their request was denied, Brock and eleven other taxpayers appealed to the Property Tax Commission. Brock later sought to have ninety-nine additional landowners added to the complaint. The Property Tax Commission dismissed all of the appeals on the basis that the taxpayers sought to attack the schedule of values rather than the appraised value of their own property and thus lacked standing to pursue the appeal. The taxpayers appealed to Wake Superior Court, which was, at that time, the body to which Property Tax Commission appeals were filed. The superior court affirmed the Property Tax Commission decision. The taxpayers then appealed to the Court of Appeals, which also affirmed the Property Tax Commission's decision, though one judge dissented from the opinion. The taxpayers appealed to the North Carolina Supreme Court, which reversed the lower court's decision, determining that the initial complainants had challenged the appraisal of their property rather than the schedule of values and, as such, were entitled to a full hearing on the merits before the Property Tax Commission. The Supreme Court held, however, that the Property Tax Commission had properly dismissed the appeal as to the ninety-nine property owners who sought to join the appeal in process. Noting that the Machinery Act permitted *any* property owner to appeal an order of the county board of equalization and review to the Property Tax Commission, the court held that this statutory provision presupposed a ruling by the county board adverse to the appellant taxpayer with respect to the listing or appraisal of his property or the property of others, after a hearing requested by the taxpayer. Since the additional taxpayers had not requested a hearing before the county board or filed a timely notice of appeal, the dismissal of the case was proper. The original eleven appellants argued that even if the ninety-nine additional plaintiffs lacked standing, they could appeal the appraisal of this additional property under the authority to appeal the appraisal of others' property. The court rejected this argument on the basis that there had been no showing that the original eleven appellants had been aggrieved by those appraisals.

60. 136 N.C. App. 360, 525 S.E.2d 196 (2000).

the county board should have been dismissed because the taxpayer who challenged the classification had no standing to do so. The Property Tax Commission denied Whiteside's motion to dismiss and heard the merits of the case regarding the property's present-use classification. The commission affirmed the county board's decision taxing the property at market value. Whiteside appealed to the court of appeals on the basis that the appealing taxpayer, as a general taxpayer in Jackson County who did not own property in the present-use program or that adjoined the Whiteside property, had no standing to appeal the classification of the Whiteside property. The court of appeals rejected Whiteside's contention. The court reasoned that as the owner of property in Jackson County, the appellant taxpayer was aggrieved by the reduction in assessed value of the Whiteside property (from market to present-use) that resulted from the allegedly improper classification of the property as forestland. Thus, the court concluded that the taxpayer had standing to appeal to the county board for a revaluation of the Whiteside property. Upon consideration of the merits of the classification issue, the court affirmed the Property Tax Commission's determination that the property was not eligible for appraisal at present-use value.

Given that someone other than the property owner may appeal the undervaluation or exemption of property, the property owner must be notified of the challenge to the value or assessment and provided an opportunity to be heard in a new (or "de novo") hearing in which none of the board's previous judgments are binding. This may require the board of E&R to conduct two hearings—an initial hearing to hear the party bringing the appeal and a subsequent hearing in which the property owner may be heard.

When property in a county appreciates rapidly from one revaluation year to the next, towns within the county sometimes join taxpayers' refrain by objecting to increases in appraised value of real property. In these cases towns or their representatives may attempt to appeal the valuation of all property within the town limits on behalf of the town's taxpayers. Given that no property owned by the town is taxable, by virtue of the exemption granted in the state constitution for property owned by municipalities [codified in North Carolina General Statutes § 105-278.1 (hereinafter G.S.)], towns have no standing to appeal the valuation of their own property or the property of others. Likewise, an individual property owner in the town lacks standing to challenge the valuation of *all* property within the town on behalf of all of the owners of such property since, as previously noted, a taxpayer may only contest the valuation of others' property when the taxpayer is in some way aggrieved by that valuation.[61]

Proceedings before the Board of Equalization and Review

The procedures generally followed by the board of equalization and review are relatively informal, at least when compared to proceedings before the Property Tax Commission or courts of general justice. Unlike the Property Tax Commission, whose deliberations as a quasi-judicial state agency are exempt from the open meetings law,[62] county boards of E&R, as quasi-judicial local agencies, must hear taxpayer appeals and deliberate in open session.[63]

Boards of E&R have discretionary authority to examine any witnesses and documents and to place witnesses under oath and may subpoena witnesses or documents on its own motion.[64] The board *must* subpoena witnesses or documents if an appellant taxpayer so requests and there is a reasonable basis for believing that the witnesses have or the documents contain information relevant to the decision of the appeal.

---

61. *Id.*

62. G.S. 143-318.18(7).

63. *See* David M. Lawrence, Open Meetings and Local Governments in North Carolina: Some Questions and Answers, Question 140 at 32 (6th ed. 2002).

64. G.S. 105-322(g)(3)(b).

The board may appoint committees composed of its own members or other persons to assist it in making necessary investigations.[65] The board also may employ expert appraisers on its own motion or upon the demand of the appealing taxpayer.[66] If experts are employed upon a taxpayer's demand, the board may require the taxpayer to reimburse the county for the expense if the expert's appraisal does not result in a material reduction of the value of the property by the local board or by the Property Tax Commission upon appeal.[67]

The county assessor serves as clerk to the board of E&R.[68] The assessor must be present at all board of E&R meetings and must maintain accurate minutes of the board's actions.[69] In addition, the assessor must provide the board with all information related to the listing and valuation of taxable property in the county. At the hearing, the board of E&R may receive and consider evidence offered by the taxpayer, the assessor, and other county officials.[70]

As previously noted, the board may examine witnesses and documents, may place witnesses under oath, and may subpoena documents on its own motion.[71] The board must subpoena witnesses and documents upon request of the taxpayer if there is a reasonable basis for believing that the witnesses have, or the documents contain, information relevant to the appeal.[72] The willful failure to appear, produce documents, or testify when appearing in response to a subpoena is a Class 1 misdemeanor.[73] The board must enter into its minutes any order reducing, increasing, or confirming an appraisal and must notify the taxpayer by mail as to the action taken on an appeal no later than thirty days after the board adjourns.[74]

All changes in listings, names, descriptions, appraisals, and assessments made by the board of E&R must be noted in the tax records, which then must be totaled. A majority of the board of E&R then must sign the following statement to be included at the end of the tax records:

State of North Carolina

County of _____

We, the undersigned members of the Board of Equalization and Review of _____ County, hereby certify that these tax records constitute the fixed and permanent tax list and assessment roll and record of taxes due for the year ____ , subject to only such changes as may be allowed by law.

_____

_____

Members of the Board of Equalization and Review of County

65. G.S. 105-322(g)(3)(a).

66. *Id.*

67. *Id.*

68. G.S. 105-322(d).

69. *Id.*

70. G.S. 105-322(g)(2)(c). Ethical concerns may arise when persons other than attorneys seek to represent parties in connection with an appeal to the board of E&R. This issue arises in the context of appeals filed by corporations as well as individuals, particularly elderly individuals who may wish to have a younger relative explain or articulate the basis for the appeal. The North Carolina State Bar issued an advisory opinion concluding that only lawyers may represent a party before a planning board, board of adjustment, or other government body conducting quasi-judicial hearings since the representation of another person at a quasi-judicial hearing constitutes the practice of law. N.C. State Bar, Formal Ethics Opinion 2007-3.

71. A subpoena issued by the board must be signed by the chair of the board, directed to the witness or to the person having custody of the document, and served by an officer authorized to serve subpoenas. G.S. 105-322(g)(3)(b).

72. G.S. 105-322(g)(2)(c).

73. G.S. 105-322(g)(3)(b).

74. G.S. 105-322(g)(3)(d).

Post-Adjournment Changes

After the board of E&R certifies the fixed and permanent tax list and assessment roll and record, the board of county commissioners has sole authority to authorize changes to the abstracts and tax records.[75] A board of county commissioners may authorize changes for several purposes, two of which are relevant to the discussion here: (1) to correct appraisals, assessments and tax amounts resulting from clerical or mathematical errors and (2) to appraise or reappraise property when the assessor reports that since adjournment of the board of E&R, certain circumstances warrant changing the appraisal of property in the current calendar year.[76] The board of commissioners may delegate to the assessor the authority to make changes for the first purpose, but only the board of commissioners may make changes for the second purpose; moreover, the board may only make such a change if the change could have been made by the board of E&R had the same facts been brought to its attention. The board of county commissioners may not appraise or reappraise property to account for changes that have occurred since the listing date. If a reappraisal demonstrates that property was listed at a substantial understatement in value, quantity, or other measurement, the provisions of G.S. 105-312 providing for a discovery of property listed at a substantial understatement in value apply. To *discover property* means to determine that it has not been timely listed, that a taxpayer made a substantial understatement of listed property, or that the property was granted an exemption or exclusion for which it did not qualify.[77]

The taxpayer must be provided written notice of any appraisal or reappraisal that will adversely affect the taxpayer's interests and must be afforded an opportunity to be heard before any such appraisal becomes final. Orders of the board of county commissioners and actions of the assessor on delegation of the board's authority[78] may be appealed to the Property Tax Commission.

Appeals from the Board of Equalization and Review to the Property Tax Commission

A county board of commissioners may by resolution permit a taxpayer to appeal a decision of a separate board of E&R to the board of commissioners.[79] If the board of commissioners also serves as the board of E&R or if the board of commissioners elects not to provide this appeal route, a taxpayer may appeal a decision of the board of E&R to the Property Tax Commission, which functions as the state board of equalization and review.[80] Only a *taxpayer* may appeal a decision of the board of E&R. If the board of E&R reduces the valuation of property or grants an exemption or exclusion upon the taxpayer's appeal, the county may not seek review of that determination by the Property Tax Commission. A notice of appeal to the Property Tax Commission from an order of the county board of commissioners or board of E&R must be filed with the commission within thirty days of the date the county board mailed its notice of decision to the property owner.[81] The property owner must also send a copy of the notice to the county assessor. The grounds for appeal must be stated in the notice.[82] A notice of appeal is considered filed on the date postmarked by the United States Postal Service or,

75. G.S. 105-325(a).
76. G.S. 105-325.
77. G.S. 105-273(6b).
78. See G.S. 105-325.
79. G.S. 105-322(a).
80. G.S. 105-290.
81. G.S. 105-290(e).
82. G.S. 105-290(f).

if there is no such postmark, on the date received in the office of the Property Tax Commission.[83] A property owner bears the burden of proving that the appeal is timely.[84]

The Property Tax Commission consists of five members, three appointed by the Governor and two appointed by the General Assembly.[85] Of the two appointments made by the General Assembly, one is made upon the recommendation of the Speaker of the House of Representatives and the other is made upon the recommendation of the President Pro Tempore of the Senate.[86] For all appointments to the commission made after July 1, 2007, each member has a four year term. Formerly the term of the commission member appointed upon recommendation of the Speaker of the House of Representatives was two years, while other members served four year terms, two of which expired on June 30 of each odd-numbered year. The Property Tax Commission is required to meet at least once in each quarter and may hold special meetings at any time and place within the state at the call of the chair or upon the written request of at least three members.

Joint owners of property may file separate appeals or may jointly appeal the listing, appraisal, or assessment of property. In addition, a taxpayer may file a single appeal to contest the listing or valuation of more than one item of personal property or more than one tract or parcel of real property.[87] Upon receiving an appeal filed by a taxpayer, the Property Tax Commission must provide a hearing before one or more representatives of the commission[88] (followed by a review of the representative's findings of fact and conclusions of law by the full commission) or, alternatively, before the full commission.[89] The commission sets the time and place for the hearing of an appeal and, at least ten days before the hearing, must provide written notice of either type of hearing to the taxpayer and to the clerk of the board of commissioners of the county from which the appeal arises. At the hearing the commission or its representative(s) must hear evidence and affidavits offered by the appellant taxpayer and the county. The commission must determine the weight and sufficiency of the evidence and the credibility of the witnesses, draw inferences from facts, and analyze conflicting and circumstantial evidence.[90]

The Property Tax Commission is not bound by findings and conclusions of the county board of E&R; instead, the hearing before the commission is "de novo," meaning that it is based solely on the record before the commission. Nevertheless, the court of appeals held in *MAO/Pines Assoc. Ltd. v. New Hanover County Board of Equalization*[91] that the Property Tax Commission is not required to consider evidence of a factor affecting the value of a taxpayer's property unless the taxpayer alerts the county assessor of the factor within the tax year in question, alerts the board of E&R of the factor upon appeal, or states the factor in the application for hearing to the Property Tax Commission. In other words, a taxpayer may not withhold material information from the county assessor and the local board of equalization and review with plans to present the information to the commission in an appeal from the local decision. In *MAO/Pines*, the taxpayer learned of asbestos contamination before the board of

83. G.S. 105-290(g).
84. *Id.*; G.S. 105-290(g).
85. G.S. 105-288.
86. G.S. 105-290.
87. *Id.*
88. G.S. 105-290(b)(2)(a) (permitting the commission to authorize one or more members of the commission or employees of the Department of Revenue to hear an appeal, make examinations and investigations, have made a record of the evidence offered at the hearing, and make recommended findings of fact and conclusions of law).
89. G.S. 105-290(b)(2).
90. *In re* McElwee, 304 N.C. 68, 87, 283 S.E.2d 115, 126-27 (1981).
91. 116 N.C. App. 551, 449 S.E.2d 196 (1994).

E&R heard the valuation appeal. The taxpayer did not alert the board or the county assessor of the presence of asbestos on the property and appealed the board's decision affirming the county's appraisal to the Property Tax Commission on the basis that "'excessive expenses and low rents'"[92] warranted a reduction in value. The taxpayer later moved to amend its petition to the commission to introduce an appraisal that took into account the presence of asbestos on the property, though the motion itself did not specifically refer to asbestos. The commission affirmed the county's valuation, declining to consider the asbestos contamination. The court of appeals affirmed the commission, holding that company representatives' statements to the county assessor regarding asbestos contamination nearly sixteen months after the effective date of the appraisal and almost four months after the end of the calendar year of the appraisal as well as the proffer to the commission regarding asbestos contamination "came too late to qualify as proper and timely notification."[93] The court explained that the Machinery Act provides for appeal to a local board to "provide opportunity at the local level to deal with taxpayer-presented information and to modify appraisals as such information requires before any appeal need be heard by the Commission."[94]

The taxpayer must appear in person at the hearing or be represented by an attorney.[95] While individuals may represent themselves before the commission, corporate taxpayers and counties must be represented by an attorney.[96] The commission and its individual members as well as Department of Revenue employees so authorized by the commission may subpoena witnesses and documents upon a subpoena signed by the chairperson of the commission. Proceedings before the commission are governed by the rules of evidence that apply in the courts of general justice.[97] The Property Tax Commission must make findings of fact and conclusions of law and, based upon these findings and conclusions, enter an order reducing, increasing, or confirming the valuation appealed or listing or removing the property from the tax lists. A certified copy of the order must be delivered to the appellant and to the clerk of the board of commissioners of the county from which the appeal was taken, and the abstracts and tax records of the county must be corrected to reflect the commission's order.[98] When the Property Tax Commission reduces the valuation of property or removes the property from the tax lists and, based on the commission's order, the taxpayer is owed a refund, the taxpayer is entitled to receive the overpayment with interest.[99] Overpayments bear interest at the rate set pursuant to G.S. 105-241.1(i) from the date interest begins to accrue until a refund is paid.[100] Interest accrues from the later of the date the tax was paid or the date the tax would have been considered delinquent.[101] Thus, an overpayment of a 2007 tax made on December 20, 2007, begins to accrue interest on January 8, 2008, the date the tax would have been delinquent.[102] An overpayment for a 2007 tax bill made on February 1, 2008, would, in contrast, bear interest from the date of

92. *Id.* at 552, 449 S.E.2d at 197.
93. *Id.* at 560, 449 S.E.2d at 202.
94. *Id.* at 558, 449 S.E.2d at 201.
95. 17 NCAC 11.0217.
96. 17 NCAC 11.0216.
97. 17 NCAC 11.0216.
98. G.S. 105-290(b)(3).
99. G.S. 105-290(b)(4).
100. *Id.*
101. *Id.*
102. Taxes are payable at par—that is, without interest—until January 5 of the fiscal year for which they are levied. When the last day for a taxpayer to accomplish a particular act falls on a weekend or holiday, the taxpayer has until the next business day to perform the required act. Because January 5, 2008, falls on a Saturday, taxpayers may pay at par the next business day, Monday, January 7, 2008. Thus, interest does not accrue and 2007–8 taxes are not delinquent until January 8, 2008.

payment, since payment was made after taxes became delinquent. A refund is considered paid on a date determined by the governing body of the taxing unit that is no sooner than five days after a refund check is mailed.[103]

Standard Governing Review of Assessment

There is a well-established presumption under North Carolina law that the county tax assessor has acted in good faith and that the assessor's assessments are correct.[104] Because of this presumption, a taxpayer seeking to challenge an assessment must produce evidence that the assessment is erroneous.[105] Without this presumption of correctness, every taxpayer would have an unlimited ability to attack the assessment of property. The administrative and fiscal burden imposed upon local governments in a system permitting unbridled taxpayer challenges would be insurmountable.[106] To say, however, that the county's assessment is presumed correct does not imply that a taxpayer may never demonstrate otherwise. A taxpayer may rebut the factual presumption that the county's assessment is valid by producing competent, material, and substantial evidence that tends to show that (1) the tax assessor used an arbitrary or illegal method of valuation and (2) the assessment substantially exceeded the true value in money of the property. In other words, the resulting value is more important than the methodology used to establish the value. To prevail on appeal, the taxpayer must produce evidence demonstrating that flawed methodology resulted in an assessment that substantially exceeded the property's true value in money. Once the taxpayer produces such evidence, the presumption of correctness is rebutted. The taxing unit then must produce evidence and persuade the finder of fact that its methods will produce true values.[107]

In re Amp Inc.

The leading case on the standard of review of assessments is *In re Amp Inc.*[108] Although the case arose from a taxpayer challenge to the assessment of personal property, the standards of review established by the court also apply to appeals of the assessment of real property. Amp owned and operated a plant in Greensboro where it manufactured electronic parts and components. Amp filed business property abstracts with the Guilford County tax supervisor (the title held by a county assessor before 1987) for 1964-68, which included values for its inventories.[109] In August 1969, the tax supervisor notified Amp of a discovery resulting from Amp's undervaluation of inventory from 1964 to 1968. Thus, the tax supervisor advised Amp of his intent to increase the valuation of Amp's inventories for those years. Based on these adjustments to value made through the discovery process, additional taxes and penalties were assessed against Amp. Amp appealed the discovery to the county board of commissioners, which approved and confirmed the assessment. Both the tax assessor and the county board valued the inventories based on the values reported on Amp's state income tax returns. The assessor and board

103. G.S. 105-290(b)(4).
104. *In re* Amp, Inc. 287 N.C. 547, 215 S.E.2d 752 (1975).
105. *Id.*
106. *Id.*
107. *In re* Southern Ry. Co., 313 N.C. 177, 182, 328 S.E.2d 235, 239 (1985); *In re* IBM Credit Corp., ___ N.C. App. ___, 650 S.E.2d 828 (2007), *aff'd*, No. 520A07, 2008 WL 616118 (N.C. S. Ct. March 7, 2008) (per curiam).
108. 287 N.C. 547, 215 S.E.2d 752 (1975).
109. Inventories are now excluded from taxation by G.S. 105-275(33).

subtracted inventories reported to Forsyth, Mecklenburg, and Wake counties (where other Amp facilities were located) from the total value reported for income tax purposes, thereby attributing the remaining value to Guilford County. Amp appealed to the State Board of Assessment (the predecessor to today's Property Tax Commission).

The manager from the Greensboro Amp plant testified that Amp manufactured connections for the electronics industry, which were used to terminate wires contained in various types of electronic equipment. Amp received at its Greensboro plant metals in strips which it then processed through machines to make a specific type of electrical terminal. Substantial scrap material was generated in this process. Amp sold this scrap material along with damaged raw material to the mills from which it purchased raw materials. Amp's tax manager testified that the book values recorded by Amp exceeded the true cash values of its inventories because Amp could only sell in-process inventory for scrap prices. Since Amp had no finished goods on hand as of January 1 of any of the listing years at issue, Amp's tax manager testified that all of his computations for those years included in-process and raw material inventories, all of which were valued as scrap. The tax manager testified that if Amp had finished goods as of January 1, 1968, the book value of such goods would have equaled their true value. Indeed, the values testified to by Amp's tax manager before the State Board of Assessment were lower even than the values listed by Amp for the years in question. Amp explained that its outside accountant had improperly overvalued its inventory for the years in question.

The Guilford County tax supervisor (now, the tax assessor) testified that he believed the values of inventory listed with the county should match the taxpayer's books as well as the values reported on a taxpayer's state income and franchise tax returns. The tax supervisor testified unequivocally as to his "assumption" that there was no difference between the amount to be reported as ad valorem tax value and the amount reported on state corporate income and franchise tax returns, though he conceded he had made no inquiry to determine the correctness of this view.[110] The State Board of Assessment determined that the value of Amp's inventories for property tax purposes was represented by the values reported in its books for the years in question. The difference between book value and the value reported by Amp thus constituted unlisted property subject to discovery and assessment of additional taxes and penalties. Amp appealed the State Board of Assessment's decision to the Superior Court Division of Guilford County,[111] which reversed the State Board's determination, finding that (1) Amp in good faith listed its inventory at what it believed to be its true cash value; (2) Amp produced competent, material evidence to justify its method of valuation, and there was no competent, material evidence that Amp's valuations were understated; and (3) the evidence before the State Board contradicted the board's findings that Amp's inventory figures for income and franchise tax purposes (that is, book value) equaled the "true cash value" of the inventory for property tax purposes. The superior court thus determined that the State Board erred in concluding that the valuation of inventory was to be determined by inventory records maintained for income tax purposes (in other words, book value). The superior court ruled, therefore, that the difference between the values included in Amp's books and the values listed by Amp on property tax abstracts was *not* the proper subject of a discovery. Guilford County appealed the superior court's decision to the court of appeals, which reversed the superior court. Amp then appealed to the state supreme court.

110. *In re* Amp, 287 N.C. at 564, 215 S.E.2d at 762-63.

111. Decisions of the Property Tax Commission are now appealed directly to the Court of Appeals rather than to Wake County Superior Court.

The supreme court began its analysis by reciting the appropriate standard of review for decisions by the State Board of Assessment and noting that "no court of the General Courts of Justice could weigh the evidence presented to the State Board and substitute its evaluation of the evidence for that of the Board."[112] The court then recognized the factual presumption that property tax assessments are presumed to be correct and held that in order to rebut the presumption, the taxpayer had to produce competent, material, and substantial evidence tending to show that the county tax assessor used an arbitrary or illegal method of valuation and that the assessment substantially exceeded the true value in money of the property.

The court noted that the record demonstrated that the tax supervisor had used an illegal method of valuation given his erroneous assumption that the true value of property equaled its book value. The court then addressed the question of whether Amp produced competent, material, and substantial evidence demonstrating that Guilford County's assessment increasing the value of its inventories from 1964 to 1968 was substantially greater than the true value in money of the property.

The court noted that Amp's tax manager testified that Amp hired an outside accounting firm to prepare its abstracts for the years in question because it did not know how to compute the true cash value of its inventories. Moreover, Amp's tax manager testified that when Amp figured out how to compute the value of its inventory, it concluded that the calculations of the outside accounting firm were incorrect. Thus, the court concluded, there was no evidence to substantiate the values reported by Amp from 1964 through 1968. The court further determined that Amp's subsequently calculated values were unreasonable, since Amp valued all of its material as scrap. The court rejected Amp's interpretation that its property was to be valued as if the company had to sell all of its inventory on January 1 of each year, whether such material was raw or in process, so that the only potential buyers would be scrap mills. The court noted that property was to be valued at its true value in money rather than its value in a forced sale.

The court then analyzed the three types of property other than finished goods that constituted Amp's inventories: (1) scrap metal and damaged raw material, (2) nondefective in-process inventory, and (3) nondamaged raw material inventory. Though the court concluded that the true value of scrap metal and damaged raw material did equal the scrap prices paid by the supplying mills to repurchase such material rather than the book value, it determined that AMP failed to prove that its inventories on the relevant dates included scrap metals. Thus, the court reasoned that Amp's proof that such property was properly valued at scrap prices was of no consequence. As for the second category—nondefective in-process inventory—the court pointed to the obvious fact that no ongoing business entity would sell its in-process inventory for scrap prices. Amp's assertion that it could only realize scrap value from the sale of such uncompleted items failed to recognize the assumption that the entity was ongoing, thereby contradicting the purpose of the statutory requirement that all property be valued at its true value in money. Because the evidence Amp presented was based upon the theory that all of its in-process inventory had to be valued as scrap, the court concluded that the company failed to produce the evidence necessary to show that the assessment substantially exceeded the true value in money of the property. The court noted that the mere fact that there was no market for particular property did not deprive it of market value, which could be established by reference to factors other than sales. The proper standard for valuing such property, according to the court, was replacement cost plus labor and overhead. The court likewise rejected scrap pricing for items in the final category, nondamaged

112. *In re* Amp, 287 N.C. at 562, 215 S.E.2d at 761.

raw material inventory, noting that Amp's methodology required it to assume that such property lost about 60 percent of its value upon entering Amp's warehouse. As with nondefective in-process inventory, the court concluded that the appropriate formula for valuing raw material inventory was replacement cost.

The court then considered whether the Machinery Act permitted a county assessor, as a per se rule, to equate the book value of property as listed on a state income tax return with the true value in money of such property for purposes of property taxation. The court concluded that such a rule was not statutorily sanctioned. Nevertheless, the court noted that book value was the appropriate measure of value for certain property such as business inventories and that the resulting values were more important than the method used to determine valuation. The book values used by Guilford County were based on figures Amp itself furnished to the state for income and franchise tax purposes. Amp defined book value as the lower of cost or market; thus, by its own definition, the reported values adopted by the county did not exceed market value. Moreover, the expert accountant testifying for Amp before the State Board explained that Amp based book value on replacement cost plus labor and overhead. Thus, the court agreed with the State Board's conclusion that, in this case, book value was evidence of the property's true value in money and concluded that the differences between the values originally listed by Amp and book value was subject to discovery.

Two-part test for challenging assessment

A North Carolina Court of Appeals decision involving the assessment of property in a country club community in Davie County further demonstrates why proof of an improper appraisal methodology alone will not satisfy a taxpayer's burden on appeal.[113] Persons who purchased property in several subdivisions in Davie County were required by the terms of restrictive covenants encumbering their properties to join the Bermuda Run Country Club. The covenants provided that country club membership was not a personal right "'but shall run with the ownership of a Dwelling Unit.'"[114] The initiation fee for the country club was due at the time title to an encumbered parcel of property was transferred. The purchaser received a credit toward the total initiation fee in the amount of the fee in effect at the time the previous owner acquired the property. The new purchaser was then obligated to pay the difference, if any, between the previous and current initiation fees. The Davie County tax assessor included $10,000 in the appraised value of each parcel of residential real estate to represent the initiation fee as of the date of the county's last revaluation. Several property owners objected to the inclusion of this amount and appealed the valuations to the county board of E&R and then to the Property Tax Commission, both of which affirmed the county's assessments. The property owners then appealed to the court of appeals, arguing that the county improperly included the values of the country club memberships in the assessment of their property given that the memberships were intangible personal property not subject to taxation. The court never addressed this issue; instead it concluded as a preliminary matter that the appellants failed to produce any evidence that the county's assessments exceeded the true value in money of the properties. The property owners conceded in their written brief to the court of appeals that, while they objected to the inclusion of the initiation fees in the valuation of their properties, they were "'not otherwise contesting the appraised value of their real property.'"[115] The taxpayers' attorney affirmed at the hearing before the Property Tax

113. *In re* Bermuda Run Property Owners, 145 N.C. App. 672, 551 S.E.2d 541 (2001).
114. *Id.* at 673, 551 S.E.2d at 542.
115. *Id.* at 677; 551 S.E.2d at 545.

Commission that he planned to present no evidence as to the value of the specific properties. The attorney explained that since he was representing more than eighty taxpayers, the presentation of such valuation evidence was "'just not practical.'"[116] Based on the lack of evidence that the specific properties had been substantially overvalued by the tax assessor, the court held that the taxpayers failed to carry their burden to demonstrate that the assessments were invalid. Thus, the court affirmed the order of the Property Tax Commission upholding the county's assessments.

Immaterial Irregularities

Akin to the principle that taxpayers may not invalidate a county's assessment merely by attacking the methodology of assessment—without showing a corresponding unwarranted increase in value—is the notion that an assessment will not be invalidated because of a procedural irregularity in the assessment process. The Machinery Act provides that such "immaterial irregularities," which range from clerical errors by the assessor to failure to advertise, list, appraise, or assess any property for taxation, do not invalidate the tax imposed on any property.[117]

Property "not properly listed" during the regular listing period, property listed at a substantial understatement in value, and property granted an exemption or exclusion for which it did not qualify are subject to discovery under G.S. 105-312, which permits the property to be taxed for the current and five previous years. Sometimes, however, property may escape assessment and taxation without meeting any of these criteria. For instance, a taxpayer may properly list property, but the assessor may inadvertently neglect to assess such property. A question then arises as to whether the omitted assessment and resulting taxes may be imposed at a later date under the theory that the failure to timely assess the property was an immaterial irregularity.

The North Carolina Court of Appeals addressed such a situation in *In re Notice of Attachment and Garnishment Issued by Catawba County Tax Collector Against Nuzum-Cross Chevrolet Inc.*[118] Nuzum-Cross Chevrolet timely listed its business personal property with the Catawba County tax supervisor (now, the tax assessor) in 1976, 1977, and 1978. The tax department transposed numbers when calculating the total assessment. As a result, Nuzum-Cross Chevrolet was taxed on a lower figure than it should have been in 1976, 1977, and 1978. The county tax supervisor discovered the error in September 1978 and billed Nuzum-Cross for the unpaid taxes. When Nuzum-Cross did not pay, the tax collector attached one of the company's bank accounts for $5,087.67, the amount of the additional taxes plus interest.

At a hearing a district court judge ordered the bank to remit the total taxes due, minus penalties and interest. The taxpayer appealed to the court of appeals. The appellate court held that the tax supervisor's error was an immaterial irregularity under G.S. 105-394 that did not invalidate the tax imposed. Recognizing that its holding permitted the county to "go back two years (from 1978 to 1976) to correct its error," the court noted that under the Machinery Act "all property is subject to taxation unless subject to an exemption."[119] The appellate court acknowledged the taxpayer's argument that a taxpayer who intentionally fails to list property might be better off than one whose property is not assessed due to an immaterial irregularity since discoveries cannot go back more than five years, while

116. *Id.*
117. G.S. 105-394.
118. 59 N.C. App. 332, 296 S.E.2d 499 (1982).
119. *Id.* at 334; 296 S.E.2d at 501.

the immaterial irregularities clause contains no such time limitation. But the court noted that it was the role of the legislature, not the court, to impose these time limits. Thus the court of appeals affirmed the district court's order, which, as previously mentioned, did not award interest or penalties.

Another case significant for its role in setting parameters for application of the immaterial irregularities clause is *In re Dickey*, which involved an appeal from a Forsyth County assessment.[120] The Dickeys purchased a new home in Forsyth County in October 1988 for $272,500. In January 1989 the Dickeys submitted a listing form on which they listed their house on a portion of the form separated by a perforation. When tax office personnel received the form, someone threw away the perforated portion, which was the proper procedure if nothing was listed on that portion of the form. That, of course, was not the case on the Dickeys' form. The Dickeys received a 1989 tax bill imposing taxes only on the value of their unimproved lot, $37,500. In June 1990 the assessor's office realized its mistake and discovered $185,500 in value. The assessor then billed the Dickeys for an additional $2,094.30 in taxes. The Dickeys alleged that the assessment was untimely and appealed to the county board of E&R, which dismissed their appeal. The Dickeys then appealed to the Property Tax Commission, which concluded that the value of the Dickeys' house was not discoverable pursuant to G.S. 105-312, as the Dickeys had properly listed the house with the tax office. The commission further concluded that the assessor had "appraised" the house at a value of $0 for 1989. While the assessor could reappraise the house for 1990–91 and subsequent tax years,[121] the commission concluded that this value was not retroactive. The commission ordered the assessor to revise its tax records to reflect a value of $0 for the Dickey's house in 1989. The county appealed the commission's decision to the court of appeals. While the court of appeals agreed with the commission that discovery of property listed by the taxpayer was improper, the court disagreed with the commission's conclusion that the assessor had appraised the house at a value of $0 in 1989. The court cited the lack of evidence that the assessor had attempted to determine the value of the Dickeys' home before 1990 and noted that no one contended the home purchased by the Dickeys for more than $250,000 was actually worth nothing. Instead, the court noted that the record demonstrated the assessor was unaware that the house existed because a portion of the Dickeys' listing form was inadvertently removed and destroyed. Because the assessor could not have appraised a house that he did not know existed, the court determined that the provisions of G.S. 105-287 prohibiting retroactive increases in appraised property values did not preclude the assessor from levying the challenged tax. Furthermore, the court held that the administrative error that resulted in the failure to assess the Dickeys' house for 1989 taxes was an "immaterial irregularity," within the meaning of G.S. 105-394. The court concluded that such an irregularity did not invalidate the taxes owed by the Dickeys for 1989 and levied by the assessor in 1990 and reversed the decision of the Property Tax Commission. The court further noted that G.S. 105-394 imposed no time restriction on the correction of immaterial irregularities from previous years, noting that the imposition of time limits were the exclusive province of the legislature.

The North Carolina Court of Appeals in *In re Morgan*[122] clarified that the immaterial irregularities clause allows the tax assessor to correct clerical and administrative errors only—not errors that result from an assessor's failure to carry out assigned duties. Tyleta Morgan and her husband owned property in Henderson County and in 1986 began to build a home on the property.

120. *In re* Dickey, 110 N.C. App. 823, 431 S.E.2d 203 (1993).
121. G.S. 105-287.
122. ___ N.C. App. ___, 652 S.E.2d 655 (2007).

Construction of the house was not completed until 1993. Mr. Morgan, who died before the house was assessed, obtained all required building permits from the county. The county inspected the home in 1986. In 1993, when the house was 80 percent complete, Mr. Morgan listed the house with the Henderson County tax assessor. The county performed a countywide reappraisal effective January 1, 1999, and another effective January 1, 2003. An appraiser for the county visited the Morgan's property during both reappraisals, yet the Morgans' house was not assessed. In 2004 the county assessed taxes on the residence and informed Mrs. Morgan that she owed taxes and interest totaling $8,533.61 for tax years 1995 through 2003. The Property Tax Commission determined that the county should have assessed the property before 2004 and that its failure to do so was not an immaterial irregularity. Thus, the commission barred the county from attempting to collect the back taxes.

The Court of Appeals, in an opinion joined by two of three panel judges, reviewed the commission's decision under the "whole record test," considering only whether the commission's decision had a rational basis in the evidence. Because legal issues are subject to de novo review in the court of appeals, the court's application of this deferential standard of review signaled its approval of the commission's view that only clerical and administrative errors may be corrected pursuant to G.S. 105-394. The appellate court held that the commission's conclusion was supported by substantial evidence that, for more than a decade, the county botched multiple opportunities to assess the residence after it was properly listed by Mr. Morgan. The court rejected the dissenting judge's argument that G.S. 105-394 authorized the county to collect taxes for past years plus interest. The majority opined that even if G.S. 105-394 permitted the levy of taxes for past years, the county could not recover interest in addition to the taxes "when non-payment was due to the gross and repeated failures to assess by the County Tax Assessor's Office."[123]

Judge Geer dissented on the basis that "the Commission and majority opinion have improperly imposed their view of appropriate public policy—fairness to individual taxpayers—to override other public policies promoted by the statute's plain language such as equality of taxation and reduction of tax rates." Noting that G.S. 105-394 defines "immaterial irregularity" as a "'failure to assess any property for taxation . . . within the time prescribed by law'" and does not explicitly require that this failure result from a clerical or administrative error, the dissent concluded that the county's failure to assess Mrs. Morgan's residence fell squarely within the statutory definition of immaterial irregularity. Moreover, the dissent concluded that because interest automatically applies to taxes paid after the date they became due, interest also applies to taxes assessed after their due date due to an immaterial irregularity. The dissent cited public policy in support of its determination, namely the inequity of one property owner being taxed on all of his or her property and another only being assessed on a portion of her property due to a tax office error. The full assessment of all property, noted the dissent, permits the tax rate to be set as low as possible.

The county appealed the court of appeals' decision to the state supreme court, which has not yet issued an opinion.

Settlement of Property Tax Appeals

Occasionally a taxpayer proposes to settle a matter appealed to the Property Tax Commission by paying some portion of the tax owed before the case is heard by the commission. A taxpayer might, for instance, offer to withdraw the appeal and pay the principal amount of taxes owed on the condition

123. *Id.* at ___, 652, S.E.2d at 657.

that the board commissioners waive accrued interest. In such a circumstance, a governing board might wish to enter into the agreement and save the costs of litigation.

While normally a county board of commissioners has no authority to compromise interest or any other portion of a tax absent a showing that the tax was imposed through clerical error, the tax was illegal, or the tax was levied for an illegal purpose,[124] a board is implicitly empowered to settle pending litigation.[125] Notwithstanding this power, a board of commissioners does not have unfettered authority to enter into such settlements with respect to taxes that are the subject of an appeal to the Property Tax Commission. If the board had unlimited discretion to settle appeals, the mere filing of an appeal with the Property Tax Commission would provide the taxpayer and the board with a convenient method to evade the Machinery Act's prohibition against compromising taxes.

Given that a provision of state law prohibits a local governing body from compromising taxes (including accrued interest), a board may not circumvent that prohibition through its power to settle pending litigation.[126] Governing boards are, however, authorized to appraise or reappraise property in the current calendar year upon the assessor's report that, since adjournment of the board of E&R, facts have come to the assessor's attention that warrant raising or lowering the value of property.[127] If a governing board finds that reduction in the value of the property is authorized to comport with the market value standard or other provisions of the Machinery Act, it is authorized to enter into a settlement agreement that alters the property's assessed value as provided by law.

A staff member of the Property Tax Division of the Department of Revenue reviews all appeals filed with the Property Tax Commission.[128] This entails reviewing the issues on appeal with the taxpayer, the counsel for the taxpayer, the county assessor, and the county attorney. These discussions sometimes result in an agreement about the appropriate valuation or exempt status of the property, which may be formalized in a settlement agreement prepared as a consent order signed by the director of the Property Tax Division of the Department of Revenue or as a formal order signed by the chairperson of the Property Tax Commission. Such settlement agreements are afforded the same status as a post-hearing decision by the commission; thus, the refund and release provisions of G.S. 105-380 and G.S. 105-381 do not apply.

Tax receipts for assessments appealed to the Property Tax Commission are delivered to the tax collector along with all other tax receipts, but the tax collector may not use enforced collection remedies to collect such taxes nor advertise the taxes as delinquent until the appeal is resolved.[129]

Appeal to the Court of Appeals from the Decision of the Property Tax Commission

Either the taxpayer or the county, or both, may appeal to the North Carolina Court of Appeals from an adverse decision rendered by the Property Tax Commission.[130] A party seeking to appeal an order

124. G.S. 105-380; 105-381.

125. G.S. 153A-11 sets out the corporate powers of counties, which include the power to sue and be sued and to contract and be contracted with. G.S. 153A-12 gives the board of commissioners authority to exercise the corporate powers of the county. The authority to settle a claim is implicit in suing or being sued.

126. *See, e.g.*, Cleveland County Ass'n for Gov't by the People v. Cleveland County Bd. of Comm'rs, 142 F.3d 468 (D.C. Cir. 1998) (holding that a North Carolina county could not enter into a consent decree that circumvented state elections law).

127. G.S. 105-325(a)(6).

128. North Carolina Department of Revenue, Property Tax Division, Property Tax Appeals Manual, 21 (2006).

129. An appeal is resolved when all rights to appeal are exhausted or the time for filing an appeal has expired.

130. G.S. 105-345.

of the Property Tax Commission must file with the commission a notice of appeal and exceptions setting forth the basis on which the order is unlawful, unjust, unreasonable, or unwarranted and citing errors alleged to have been committed by the commission. The notice of appeal must be filed within thirty days after entry of the Property Tax Commission's final order.[131] The Property Tax Commission may then, upon its own motion or the motion of any party, set a hearing on the exceptions to the final order on which the appeal is based. If the commission does not set such a hearing, the appeal proceeds directly to the North Carolina Court of Appeals for hearing and determination. The appellant may not rely on any grounds for relief on appeal that are not set forth in the notice of appeal filed with the Property Tax Commission.

The appellate court considers questions of law under the standard of de novo review, pursuant to which the court "consider[s] the matter anew and freely substitute[s] its own judgment for that of the Commission."[132] Other issues, such as sufficiency of the evidence to support the commission's decision, are reviewed under the "whole record test," which requires the appellate court to determine whether the commission's decision has a rational basis in the evidence.[133] The whole record test does not permit the reviewing court to replace its judgment for that of the Property Tax Commission where both views are reasonable, regardless of whether the court justifiably could have reached a different result had the matter been before it under the de novo standard. Instead, the whole record rule requires the court, in determining the substantiality of the commission decision, to consider items in the record that detract from the weight of the evidence supporting the commission's decision below. Under the whole evidence rule, the court must consider the evidence that justifies the commission's decision along with contradictory evidence.[134] By applying this analysis, a reviewing court can determine whether the commission's decision has a rational basis in the evidence.[135]

The court of appeals bases its determination upon the record and proceedings of the Property Tax Commission and may not receive additional evidence. If a party can demonstrate to the court that it discovered evidence after the Property Tax Commission hearing that it could not through reasonable efforts have obtained for use at the commission hearing and the evidence will materially affect the merits of the case, the court of appeals may remand the record and proceedings to the Property Tax Commission for consideration of the new evidence.[136]

The court of appeals must review the record and exception and assignments of error in accordance with the Rules of Appellate Procedure. The appellate court must decide all questions of law presented by the appeal, interpret constitutional and statutory provisions, and determine the meaning and applicability of the terms of any commission action.[137] The court may affirm, reverse, or declare null and void the decision of the Property Tax Commission or may remand the case for further proceedings.

The appellate court may reverse or modify the Property Tax Commission's decision regarding a disputed assessment if it determines that the substantial rights of the appellants have been prejudiced because the commission's findings, inferences, conclusions, or decisions are (1) in violation of constitutional provisions; (2) in excess of the commission's jurisdiction or statutory authority; (3) made

131. *Id.*
132. *In re* Greens of Pine Glen, 356 N.C. 642, 647, 576 S.E.2d 316, 319 (2003) (internal quotations omitted).
133. *Id.*
134. *In re* McElwee, 304 N.C. 68, 87–88, 283 S.E.2d 115, 127 (1981).
135. *In re* Owens, 132 N.C. App. 281, 511 S.E.2d 319 (1999).
136. G.S. 105-345.1.
137. G.S. 105-345.2.

upon unlawful proceedings; (4) affected by other errors of law; (5) not supported by competent, material, and substantial evidence in view of the entire record; or (6) arbitrary or capricious.[138]

The taxpayer, the county, or both may appeal an adverse decision by the court of appeals to the North Carolina Supreme Court if the case directly involves a substantial question arising under the state or federal constitution (this might be the case, for example, if the issue involved an attempt to tax property within the exclusive jurisdiction of the federal government) or in a case in which a dissent is filed by a court of appeals judge.[139] In cases in which there is no appeal of right from the court of appeals decision, a party may petition the supreme court for discretionary review after the court of appeals renders its decision.[140] The supreme court may only agree to review the case if it determines that the subject matter of the appeal has significant public interest, the case involves legal principles of major significance to the jurisprudence of the state, or the court of appeals decision conflicts with a supreme court decision.[141] A petition for appeal of right to or for discretionary review by the state supreme court must be filed within fifteen days after the mandate of the court of appeals has been issued to the Property Tax Commission.[142] The mandate of the court consists of certified copies of its judgment and opinion, which are issued by the clerk of the court to the clerk of the Property Tax Commission.[143] The clerk of court enters judgment and issues the mandate twenty days after the written opinion of the court is filed with the clerk.[144]

Recall that a tax collector may not seek to collect taxes or enforce a tax lien resulting from an assessment appealed to the Property Tax Commission until the appeal is finally adjudicated.[145] Though various arguments could be raised regarding the time at which the appeal is "finally adjudicated,"[146] the most conservative and prudent course of action for tax collectors is to refrain from enforcing payment of taxes subject to an appeal until either the entry of an opinion by the state supreme court or upon expiration of the time to file an appeal as of right or a petition for discretionary review to either the state court of appeals or state supreme court.

Adjustment of Real Property Values in Nonrevaluation Years

As noted earlier, the Machinery Act provides for annual appraisal of personal property and octennial appraisal of real property. Yet for the sake of equity and uniformity, some parcels of real property must be reappraised in a year in which general revaluation of real property is not undertaken. Property may be rezoned from residential to commercial, bringing about a change in its highest and best use and the resulting valuation. Buildings may be constructed, improved, or expanded, and portions of existing parcels may be transferred, which can result in a change in the portion of property valued as residual acreage.[147] While most of the aforementioned changes increase the value of property in a nonrevaluation year, property also must be reappraised for qualifying changes that

138. *Id.*
139. G.S. 7A-30.
140. G.S. 105-345.4.
141. G.S. 7A-31.
142. Rules 14, 15, Rules of Appellate Procedure.
143. Rule 32, Rules of Appellate Procedure.
144. *Id.*
145. G.S. 105-378(d).
146. N.C. R. Civ. P. 54.
147. *See In re* Corbett, 355 N.C. 181, 558 S.E.2d 82 (2002) (approving the reappraisal of residual acreage from a larger parcel as a residential homesite after transfer of that acreage to a new owner in a nonrevaluation year).

reduce its value, such as damage or destruction of property by tornados, floods, or fires. Property may also be reappraised to correct errors in the initial appraisal, which can result in an increased or lowered valuation, depending upon the circumstances. G.S. 105-287 directs the assessor in a nonrevaluation year to reappraise specific parcels in order to correct clerical or mathematical errors in the former appraisal; to correct appraisal errors resulting from misapplication of the county's appraisal manual; or to recognize an increase or a decrease in value resulting from some factor other than normal depreciation, economic changes affecting property in general, or certain listed improvements such as repainting and landscaping. If the circumstance that causes the increase or decrease in valuation is not specifically excluded from reappraisal, the assessor is required to reappraise the property to recognize the impact of that circumstance.[148]

An appraisal change may only be made based on a factor that has affected the property by January 1 of the year in which the property is reappraised. Thus, if a county conducts a countywide reappraisal effective January 1, 2007, and a house is destroyed by fire on January 2, 2008, the property may not be reappraised until 2009.

Reappraisals made under the authority of G.S. 105-287 must conform to the appraisal manual adopted in the last revaluation year so that they will represent the property's market or present-use value as of January 1 of the revaluation year rather than its current value. A fee appraiser's independent determination of value may only be relied upon to the extent that it correlates to the applicable schedule of values.[149] Thus, in the example above in which a house is destroyed by fire on January 2, 2008, the reappraisal of the affected parcel in 2009 will be based upon the 2007 schedule of values. Nonrevaluation year appraisals take effect as of January 1 of the year in which they are made and do not affect previous tax years.

Property may not be reappraised in a nonrevaluation year based on an increase or decrease in value evidenced by a sale that occurs after the January 1 revaluation date.[150] While the transfer of some portion of a larger parcel requires reappraisal to assign value to the resulting parcels, the sale of an entire parcel does not, since such a sale is not a factor from which the increase or decrease in value results.[151]

The county assessor must complete all reappraisals warranted under G.S. 105-287 before the board of E&R convenes. Once the board is in session, reappraisal may only occur at its direction. Any reappraisal by the board of E&R must conform to the standards and procedures set forth in G.S. 105-287. The Property Tax Commission's authority to change property valuations is limited to the same extent as the assessor's; thus any reappraisal ordered by the commission must likewise conform to G.S. 105-287.[152]

After adjournment, the authority of the board of E&R is largely limited to considering appeals filed before adjournment. At this stage in the assessment cycle, only the board of county commissioners may make or authorize changes to the tax records, including reappraisal.[153] The board of county commissioners may authorize the reappraisal of property when the assessor reports that, since the adjournment of the board of E&R, facts have come to the assessor's attention rendering it advisable to raise or lower the appraisal of property in the current calendar year. The assessor has discretion over whether to make such a report to the board.

---

148. *Id.* at 185, 558 S.E.2d at 84.

149. *In re* Allred, 351 N.C. 1, 10, 519 S.E.2d 52, 57 (1999).

150. *In re* Allred, 351 N.C. 1, 519 S.E.2d 52 (1999).

151. *Compare In re* Corbett, 355 N.C. 181, 558 S.E.2d 82 (nonrevaluation year reappraisal affirmed when parcel split into two smaller buildable lots) *with In re* Allred, 351 N.C. 1, 519 S.E.2d 52 (holding that a sale after January 1 of the revaluation year is not a factor from which an increase of decrease in value results within the meaning of G.S. 105-287(a)(3)).

152. *In re* Allred, 351 N.C. at 3; 519 S.E.2d at 53.

153. G.S. 105-325.

The Property Tax Calendar

Many citizens and local government officials are surprised to learn that property taxes are levied for a *fiscal year* that begins on July 1 and concludes the following June 30. This confusion is likely caused by several factors. First, North Carolina real estate attorneys routinely prorate taxes between buyers and sellers in real estate closings on a calendar year basis. Second, the January 1 date of assessment and the January 6 delinquency date the following year roughly follow a calendar year cycle. In addition, property taxes levied for the 2008–9 year generally are referred to simply as "2008 taxes."[154] Anyone familiar with local government finance and budgeting will recognize, however, that property taxes, which are the bread and butter of local government finance, could be levied on nothing other than a fiscal year basis. After all, county commissioners and city council members adopt their budgets and set the property tax rate by July 1 of each year.[155] Bills for property taxes, the payments for which supply the revenue for budgeted expenditures, are mailed to taxpayers as soon as possible after July 1. Taxes are due September 1 (a date that is widely ignored by taxpayers in all taxing jurisdictions that do not offer a discount for early payment of taxes) and are payable without interest at any time through the following January 5.[156] Most taxpayers, and all mortgage companies paying on behalf of homeowners, pay property taxes before January 1 so that the amount paid may be deducted as an itemized deduction from the property owner's income tax return for the current calendar year. Thus, midway through the fiscal year, the local government unit receives most of its revenues from current fiscal year property taxes.

In order to estimate the probable revenues from property taxes levied at a given rate, the local governing board must know the total assessed value of property subject to taxation in its jurisdiction as well as the jurisdiction's collection percentage in the current year. So that the board may determine the assessed value, the Machinery Act requires that all appeals of the taxation or assessment of real property (in years in which there is no countywide revaluation of real property) be filed by July 1—the date by which the tax levy must be established.[157] In revaluation years, these appeals must be filed no later than December 1.[158]

Setting the Tax Rate

The tax rate is determined by dividing the budgeted revenue by the total value of assessed property—in other words, the tax base.[159] If budgeted property tax revenue is B, total assessed value is V, and the tax rate is R, this may be stated as the following formula: $R = B / V$. This is, of course, an overly simplified formula given that no taxing unit collects 100 percent of the property taxes levied. Thus, in setting the rate, the Budget and Fiscal Control Act prohibits the taxing unit from estimating a percentage of collection of property taxes greater than the percentage collection for the preceding

154. This differs from the state treasurer's convention of referring to fiscal years by the year in which they end. Thus "2007 taxes" are levied for the 2008 fiscal year in the nomenclature of the state treasurer.

155. G.S. 159-13.

156. G.S. 105-360.

157. G.S. 105-322(e).

158. *Id.*

159. *See, e.g.*, Nathan B. Anderson, *Property Tax Limitations: An Interpretive Review*, 59 National Tax Journal, No. 3, 2006.

fiscal year.[160] The rate derived from the above calculation (R) must be divided by the appropriate collection percentage to arrive at the actual tax rate, R_1.

An example may help illustrate the manner in which this calculation is made. Suppose that the total assessed value of all taxable property (V) in Carolina County for the 2008–9 fiscal year is $3 billion. Carolina County has budgeted revenues of $19.5 million ($B$) from property taxes. Applying the simple formula stated above, R = B [$19,500,000] / V [$3,000,000,000], the tax rate (R) equals .0065 per $1. Carolina County's collection percentage for 2007–8 is 97 percent, and the county cannot assume a higher rate of collection for 2008–9. If the county levies a tax at the rate of .0065, it must presume that it will not receive B [$19,500,000], but instead will receive no more than 97 percent of B, or no more than $18,915,000. If the tax rate is set at .0065, the county may experience a shortfall of $585,000 (or more, if the collection rate falls below 97 percent). The collection percentage may be factored into the tax rate calculation in one of two ways. First, B [$19,500,000] may be divided by the collection percentage [.97], resulting in B_1 [$20,103,092.78]. The resulting formula is R_1 [.006701] = B_1 [$20,103,092.78] / V [$3,000,000,00]. The tax rate, rounded to the nearest ten thousandth, is .0067. Multiplying R_1 [.0067] by V [$3,000,000,000] and multiplying the result by .97 results in budgeted revenue B [$19,500,000]. Another way to reach the same result is to divide the rate R [.0065], resulting from the simple formula, by the collection percentage rate, .97. The quotient is R_1 [.006701].

The tax rate stated in Carolina County's budget will be $.67 or 67 cents, rather than .0067. This is because, in North Carolina, property tax rates are stated in terms of dollars per hundred. Thus the calculated rate of .0067 per dollar equals a rate of .67 per hundred dollars. A taxpayer in Carolina County with property assessed at $100,000 in value will owe $670 in taxes at this rate. This figure may be derived by multiplying $100,000 by .0067 or by dividing $100,000 by 100 and multiplying the result by .67.[161]

Actual versus Effective Tax Rates

In its annual report on city and county management of cash and taxes, the North Carolina Department of State Treasurer lists actual and effective tax rates for each city and county. Obviously, the actual tax rate is the rate set by the governing body of a taxing unit for a particular year. Effective tax rates, in contrast, illustrate the manner in which increases in property values lower the stated tax rate applicable to a parcel of property.

For example, a tax rate of 50 cents applied to a tax base of $10 billion results in a tax levy of $50 million. If the market value of taxable property increases to $12 billion, but the assessed value remains $10 billion, the effective tax rate is approximately 42 cents. This is because the taxing unit is imposing $50 million in property taxes on a tax base of $12 billion. The property tax paid divided by the actual market value of the property equals 42 cents—the effective tax rate. Because taxing units revalue property on differing schedules and experience different levels of economic growth, the publication of an effective tax rate facilitates comparison of the tax rate imposed by one governmental unit to that imposed by other governmental units.

160. G.S. 159-13(6).

161. Some other states express property tax rates as mills per dollar. There are 1,000 mills in a dollar (10 mills to a penny). A decimal rate tax of .0067 would be expressed as 6.7 mills per $1 (.0067 / 1,000).

Revenue-Neutral Rate

A new term was introduced into the tax lexicon in 2005: the revenue-neutral tax rate. Unlike the effective tax rate, which facilitates comparison of the tax rate set by different jurisdictions, the revenue-neutral rate provides a comparison of the tax burden borne by property owners within a particular taxing unit before and after revaluation. The revenue-neutral rate is the rate for the fiscal year after revaluation that, taking into account expected rates of growth in the tax base and excluding increases in market value recognized by the revaluation, would produce revenue that equals the current year's tax levy.[162] The expected rate of growth in the revaluation year is based upon an average of increases or decreases to the assessed value since the last revaluation. This growth or decline is based on additions to or reductions in a taxing unit's base of taxable property rather than on the increases and decreases in market value that are accounted for by the effective tax rate but are not recouped by the taxing unit in nonrevaluation years. Changes to the real property tax base in nonrevaluation years result from the construction of new homes and businesses, improvements to existing structures, divisions and conveyances of land, rezoning, and other occurrences unrelated to economic conditions affecting the taxing unit in general. Changes in the personal property base occur each year because personal property is valued on an annual basis; moreover, personal property generally depreciates, or decreases in value from one year to the next. G.S. 159-11(e) provides that the growth factor used in calculating the revenue-neutral rate is based on the average increase in the tax base "due to improvements since the last general reappraisal."[163]

Adoption of a revenue-neutral rate in the year of a revaluation will not, however, prevent taxes assessed against real property from increasing.[164] This is because, in a revaluation year, a realignment occurs in the tax burden imposed upon real and personal property. In a revaluation year, the assessed value of real property equals its market value as of January 1 of that year. In each subsequent year, the assessed value of real property (other than new construction) remains constant, though its market value typically increases. Personal property, in contrast, is valued at its market value every year. Because real property is assessed at less than its current market value in the years subsequent to a revaluation and the assessed value of personal property equals its market value in those years, personal property bears a greater portion of the overall tax burden in relation to its true value. That imbalance is corrected in a revaluation year, when real property again shares equitably in the tax burden imposed. This realignment almost always results in real property comprising a larger percentage of the overall tax base in a revaluation year. Thus, even under a revenue-neutral rate, a larger portion of revenue is generated from real property in a revaluation year than from personal property. As a result, many individual real property owners receive increased tax bills in revaluation years.

A sample calculation may assist in illustrating this point. Assume that Carolina County has a $3 billion tax base and a tax rate of $.70 in the 2006–7 fiscal year. Seventy-eight percent of this base value ($2.34 billion) is derived from the assessed value of taxable real property; ten percent ($300 million) is derived from the valuation of personal property other than registered motor vehicles; ten

162. G.S. 159-11(e).

163. For a detailed discussion of the method for calculating a revenue-neutral tax rate, see Shea Riggsbee Denning and William C. Rivenbark, *Statement of Revenue-Neutral Tax Rate and Provision for Mid-Year Property Tax Rate Change*, Local Finance Bulletin No. 32 (Chapel Hill: UNC School of Government, November 2004).

164. Forsyth County published an explanation of the impact of a revenue-neutral rate on real property taxes in conjunction with its last revaluation. See Technical Discussion–Revenue Neutral Tax Rate, www.co.forsyth.nc.us/tax/reval.pdf (last visited March 31, 2008).

percent ($300 million) is derived from the valuation of registered motor vehicles; and two percent ($60 million) is derived from the valuation of public service company system property.

The 2006–7 tax levy totals $21,000,000 ($3,000,000,000 *x* $.0070). Assume that 2007 is a revaluation year and that the rate of growth in the tax base in each year since Carolina County's last revaluation averages 3 percent. If the tax base after revaluation increases by 15 percent, to $3.45 billion, the revenue-neutral rate for 2007–8 will be $.63 cents.[165] Assuming that the value of all personal property and public service company property increases by 3 percent in the revaluation year, real property values as a percentage of the total tax base will increase from 78 to 80.3 percent. Thus, taxes assessed on real property at the revenue-neutral tax rate will increase from $16.38 million in 2006–7 to $17,367,949.57 in 2007–8. Taxes assessed on personal property, registered motor vehicles, and public service company system property decrease from $4.62 million to $4,262,050.43. The impact on individual tax assessments will depend on the rate at which the property has appreciated or depreciated.

165. This revenue-neutral rate is calculated by first determining the rate that must be imposed upon the revalued tax base to produce revenues equal to those for the current fiscal year. The new tax base is $3.45 billion. The current year's levy is $21 million. Thus, a tax rate of $.61 per hundred would have to be imposed to produce revenues equaling those of the current year [($3,450,000,000 / 100) / $21,000,000) = $.61]. This rate is then increased by three percent, the average annual percentage increase in the tax base due to improvements since the last general reappraisal [$.61 * 1.03]. The resulting rate is .6283, rounded to $.63. The resulting tax levy is $21,630,000.

These calculations are set forth in Table 2.

Table 2. The Revenue-Neutral Tax Rate

Calculation of revenue-neutral tax rate	2006–7	2007–8
Tax base (dollars)	3,000,000,000	3,450,000,000
Overall growth in revaluation year (percent)		15
Increase in personal property value in revaluation year (percent)		3
Real property assessed value (dollars)	2,340,000,000	2,770,200,000
Personal property assessed value (dollars)	300,000,000	309,000,000
Registered motor vehicle assessed value (dollars)	300,000,000	309,000,000
Public service company system property (dollars)	60,000,000	61,800,000
Tax rate in 2006–7	0.70	
Tax levy in 2006–7 (dollars)	21,000,000	
Rate necessary to produce 2006–7 revenue in 2007–8		0.61
Average annual increase in tax base since last revaluation (percent)		3
Revenue neutral rate for 2007–8		**0.63**
Tax levy in revaluation year at revenue-neutral rate (dollars)		21,630,000
Change in personal property levy (percent)		-7.75
Change in real property tax levy (percent)		6.03
Percent of tax base		
Real property	78.00	80.30
Personal property	10.00	8.96
Registered motor vehicles	10.00	8.96
Public service company system property	2.00	1.79
Tax levy by property type (dollars)		
Real property	16,380,000.00	17,367,949.57
Personal property	2,100,000.00	1,937,295.65
Registered motor vehicles	2,100,000.00	1,937,295.65
Public service company system property	420,000.00	387,459.13
Total personal and public service company	**4,620,000.000**	**4,262,050.43**

Conclusion

Revaluations are conducted to ensure that property owners bear a share of the total tax burden that is proportionate to the value of taxable property they own. While revaluations may be politically unpopular, infrequent reassessments of real property have been linked to systematic bias against certain groups of property owners in the property tax structure[166] as well as general lack of assessment uniformity.[167] Numerous requirements set forth in the Machinery Act operate to make the revaluation process more transparent for taxpayers. Boards of county commissioners must conduct a public hearing before adopting the schedule of values. Assessors must notify taxpayers of any change in real property valuation before the board of E&R convenes. The hearings and deliberations of the board of E&R are public. By comparing the revenue-neutral tax rate published in the taxing unit's budget with the rate adopted by a taxing unit, citizens can ascertain whether a reduction in the tax rate in a revaluation year is a revenue-neutral reduction, or, instead, a rate reduction that represents an increase in the tax levy. Ironically, this level of visibility and transparency may fuel criticism by subjecting property taxes to "a level of scrutiny rarely faced by taxes less familiar to the average taxpayer."[168] Despite its detractors, the property tax is likely continue to serve a critical role in the financing of local government in North Carolina as it has since the early days of statehood.[169] Perhaps if citizens have an improved understanding of the revaluation process, the duties and qualifications of the tax assessor, the purpose for which reassessments are conducted, and the avenues of appeal and review, they will be less prone to sticker shock during revaluation.

166. Jerome F. Heavey, *Patterns of Property Tax Exploitation Produced by Infrequent Assessments*, 42 American Journal of Economics and Sociology, October, 1983, 441-49 (reporting findings from study of tax assessments in thirty-five Pennsylvania school districts indicating that assessment ratios were systematically biased against cities).

167. Tae Ho Eom, *A Comprehensive Model of Determinants of Property Tax Assessment Quality: Evidence in New York State*, Public Budgeting and Finance, Spring 2008, 58.

168. Joan Youngman, *Enlarging the Property Tax Debate—Regressivity and Fairness*, 26 State Tax Notes, October 3, 2002, 45.

169. Charles D. Liner, *The Evolution of North Carolina's State and Local Tax System*, in State and Local Government Relations in North Carolina: Their Evolution and Current Status, 51, 53 (Charles D. Liner ed., 1995).

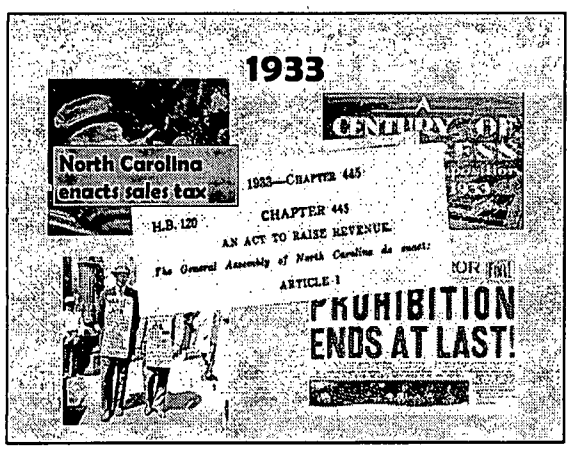
This bulletin is published and posted online by the School of Government to address issues of interest to government officials. This publication is for educational and informational use and may be used for those purposes without permission. Use of this publication for commercial purposes or without acknowledgment of its source is prohibited.

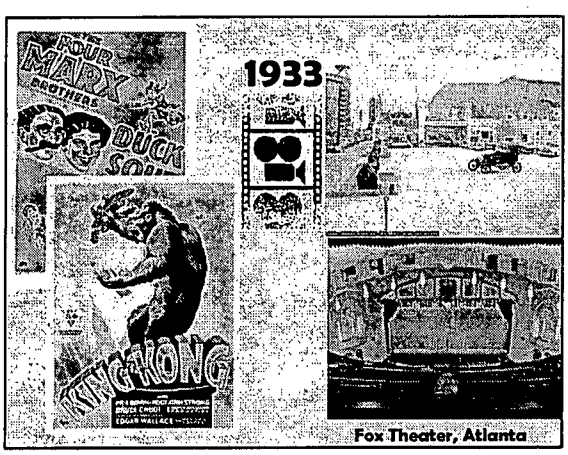
To browse a complete catalog of School of Government publications, please visit the School's website at www.sog.unc.edu or contact the Publications Division, School of Government, CB# 3330 Knapp-Sanders Building, UNC Chapel Hill, Chapel Hill, NC 27599-3330; e-mail sales@sog.unc.edu; telephone 919.966.4119; or fax 919.962.2707.

©2008
School of Government. The University of North Carolina at Chapel Hill

Taxation for the Digital Age

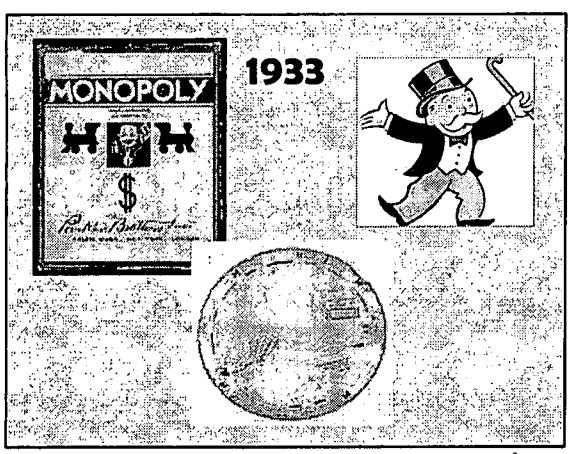
Trina Griffin
NCGA Research Division
December 15, 2008

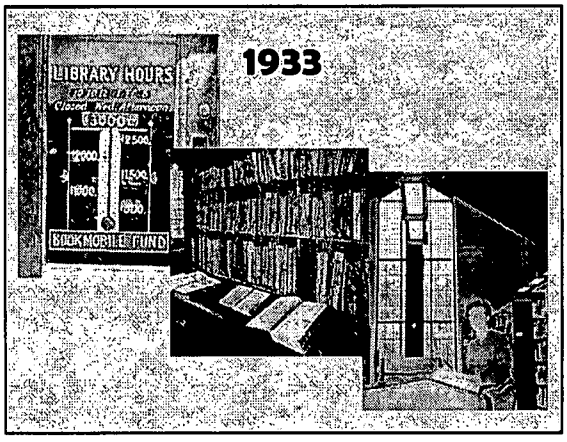


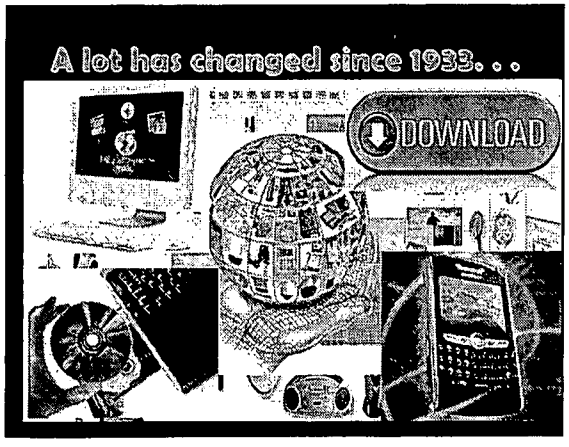



1933
ACTION COMICS
LOOKING FORWARD
FRANKLIN D. ROOSEVELT
Old Corner Bookstore
Boston MA

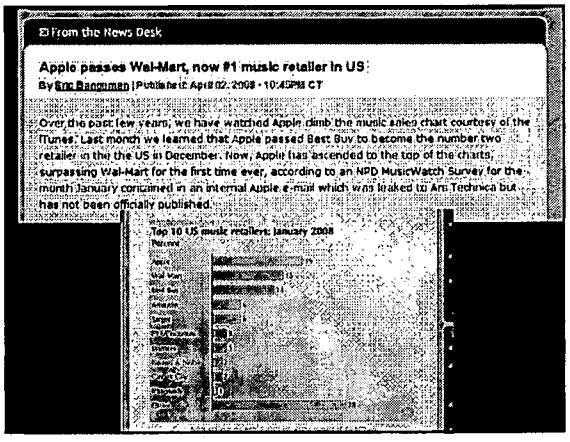

1933
STORMY WEATHER


MONOPOLY
1933


1933
LIBRARY HOURS
BOOKMOBILE FUND

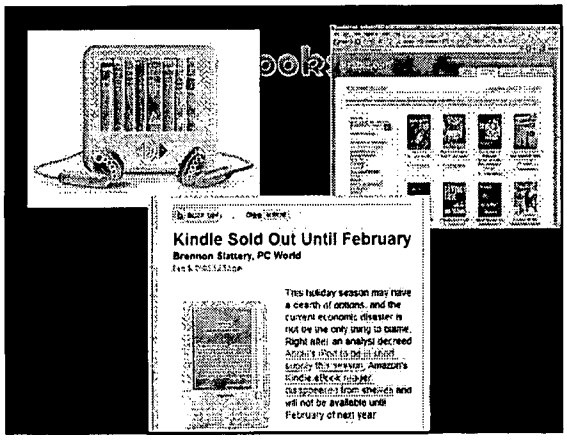

A lot has changed since 1933. . .
DOWNLOAD

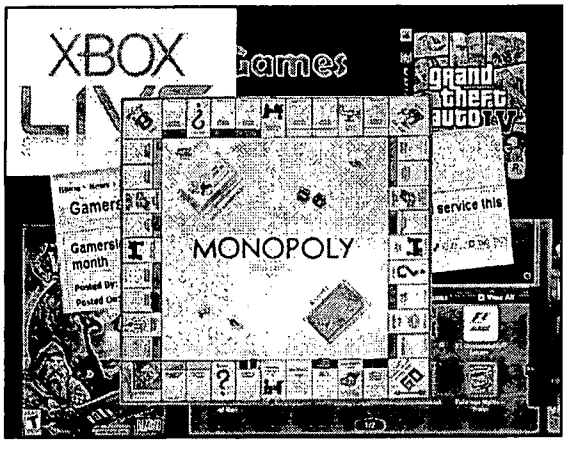

Ringtones
Deluxe
+100
Music

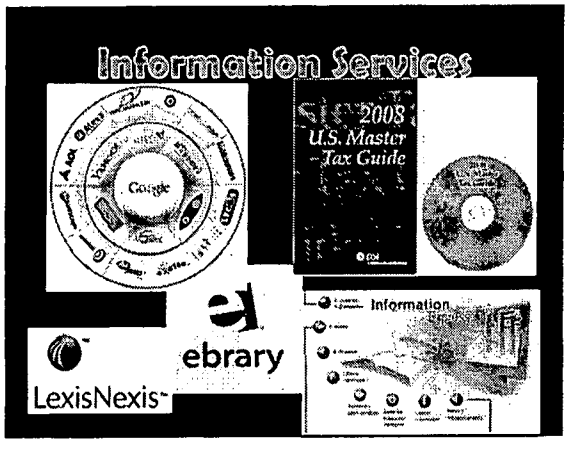


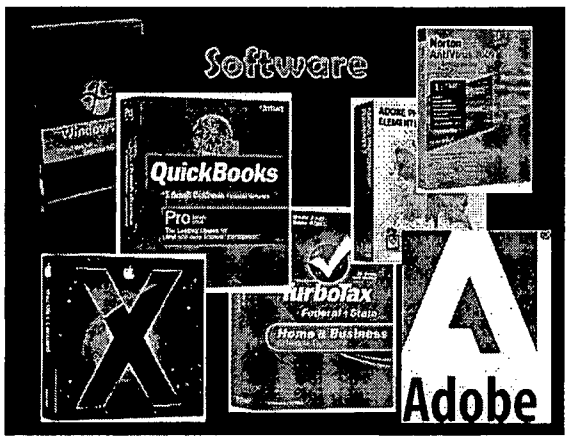
- Downloads = 30% of ALL music revenues in U.S.; expected to grow to 41% in 5 years.
- Sales of "physical" music media expected to plummet from current 64% share of sales to 40% by 2013.




Kindle Sold Out Until February
Brennon Slattery, PC World


XBOX
MONOPOLY


Information Services
2008
U.S. Master
Tax Guide
ebrary
LexisNexis



NC Sales Tax

- Generally, applies to sales of tangible personal property.
- "Personal property that may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses."
- Exemption for computer software delivered electronically or delivered by load and leave.

Movies

Taxed	Not Taxed
• In theater	• Downloaded movie
• In-store DVD purchase	• Streaming movie video
• Online DVD purchase	
• DVD rental in-store or by mail	
• Pay-per-view on cable or satellite	

Books

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail	• Downloaded online

Music

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail • Satellite radio service	• CD or songs downloaded online • Ringtone downloaded online or to phone

Games

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail	• Downloaded online • Online or subscription gaming

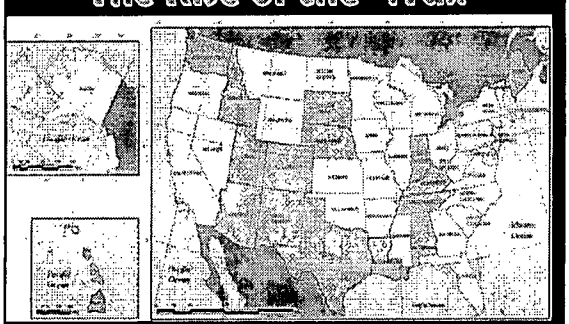
Information Services

Taxed	Not Taxed
• Print material • CD delivered by mail	• Subscription for online access

Software

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail	• Downloaded online • Load and leave

The Rise of the "iTax"



Streamlined Sales Tax Project

- "Specified Digital Products"
  - "Digital Audio Visual Works"
  - "Digital Audio Works"
  - "Digital Books"
- States may not interpret the definition of TPP to include any item within definition of specified digital products.
- States may tax all, some, or none.

"We live in a world where often times the value is not in the object itself, but in the digital information stored on a computer somewhere."



REVENUE LAWS STUDY COMMITTEE
Wednesday, January 07, 2009
Room 544, Legislative Office Building
9:30 a.m.

MINUTES

The Revenue Laws Study Committee met at 9:30 a.m. on Wednesday, January 07, 2009, in room 544 of the Legislative Office Building. Twelve members of the committee were present. Senator Clodfelter presided as chair.

Approval of Minutes from the December 15 Meeting

Representative Brubaker motioned for the approval of the December 15, 2008 minutes and the motion carried. A copy of the minutes is attached.

Review of Property Tax Recommendations

Martha Walston, a staff attorney with the Fiscal Research Division, was recognized. She outlined property tax reappraisal schedule current law, methods of revaluations, the advantages and disadvantages of advanced schedules, schedules of other states and possible recommendations. A copy of the proposed bill draft and the county information handout is attached.

IRC Update

Heather Fennell, a staff attorney with the Research Division, was recognized to outline federal changes to the Internal Revenue Code and the effects on North Carolina revenue laws. A copy of her power point and a summary is attached.

Barry Boardman, a fiscal analyst with the Fiscal Research Division, was recognized to provide estimated financial impacts of the federal changes on North Carolina revenue.

Taxation for the Digital Age

Trina Griffin, a staff attorney with the Research Division, was recognized to explain how antiquated tax laws are not keeping up with technology leading to a loss of taxable sales. Sandra Johnson, a fiscal analyst with the Fiscal Research Division, was recognized to answer questions. A copy of Ms. Griffin's power point is attached.

Resale of Tickets via the Internet & 2009 Sunset

Cindy Avrette, a staff attorney with the Research Division, was recognized for an update on internet ticket sales/resales and the June 2009 expiration of the law. A copy of her handout is attached.

Update on Streamlined Sales Tax Project

Andy Sabol, Sales and Use Tax Division Director – NC Department of Revenue, was recognized for an update on the Streamlined Sales and Use Tax Governing Board

activities. He defined the project, its history, its current situation on the federal level and requested that the state be a serious advocate at the federal level for the project. A copy of his remarks is attached.

Comments on Changing the Corporate Tax Structure

Andy Ellen, Retail Merchants Association general counsel, was recognized. He is pleased about the streamlined projects, since it may bring tax equity to all merchants, storefront and digital. He expressed concern about privilege license tax inconsistencies and the need for the laws to be fixed. A copy of his remarks is attached.

Mark Prak, Brooks Pierce McLendon Humphrey and Leonard, was recognized. He feels that privilege license taxes are confusing and unequally applied which leads to impediments for new business startups.

John McAlister, NC Chamber, was recognized. He feels that corporate tax laws are a complex series of issues with varying views on clarification.

Joseph Crosby, Council on State Taxation, was recognized to discuss combined reporting. He said that its proponents see tax planning benefits while its opponents think it is too complex. It should be thoroughly evaluated before being adopted. A copy of his handout is attached.

Elaine Mejia, NC Justice Center Project Director, was recognized. She supports combined reporting and said many North Carolina businesses are already participating in other states where they do business.

The meeting adjourned at 11:50 a.m.

Senator Daniel Clodfelter, Presiding Chair

DeAnne Mangum, Committee Clerk

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. Clodfelter

Sen. John Kerr Rep. Paul Luebke

Wednesday, January 7, 2009
Room 544, Legislative Office Building
9:30 a.m.

Rep. Brubaker

I. Approval of Minutes from December 15 Meeting

II. Review of Property Tax Recommendations
(1) – *Martha Walston, Fiscal Research Division* Chip Killen, recognized to speak positively

III. IRC Update
(2) – *Heather Fennell, Research Division* outlined each type of federal change
(3) – *Barry Boardman, Fiscal Research Division* provided an estimated financial impact of each federal change

IV. Taxation for the Digital Age
(4) – *Trina Griffin, Research Division* Sandra Johnson, Fiscal, recog to answer questions on revenue - ~~See~~ taxable sales.

V. Resale of Tickets via the Internet & 2009 Sunset
Andy Sabol - Department recognized to answer Qs.
(5) – *Cindy Avrette, Research Division*

VI. Update on Streamlined Sales Tax Project
(6) – *Andy Sabol, Department of Revenue* • defined project & its history • current issues/situation on federal • states need to be serious advocates on federal level

VII. Comments on Changing the Corporate Tax Structure
(7) – *Andy Ellen, Retail Merchants Association* General Counsel, pleased about streamlined project
(8) – *Mark Prak, Brooks, Pierce, McLendon, Humphrey & Leonard*
(9) – *John McAlister, NC Chamber*
(10) – *Joseph Crosby, COST* – handout Unitary combined report
(11) Glaino Mehta

VIII. Revenue Laws Technical and Administrative Changes – Part I
(12) – *Trina Griffin, Research Division*

IX. Adjournment
11:50 am

Next ~~Meeting Date:~~ Wednesday, January 21, 2009
in Room 544, LOB, at 9:30 a.m.

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Wednesday, January 7, 2009
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from December 15 Meeting

II. Review of Property Tax Recommendations
– Martha Walston, Fiscal Research Division

III. IRC Update
– Heather Fennell, Research Division
– Barry Boardman, Fiscal Research Division

IV. Taxation for the Digital Age
– Trina Griffin, Research Division

V. Resale of Tickets via the Internet & 2009 Sunset
– Cindy Avrette, Research Division

VI. Update on Streamlined Sales Tax Project
–Andy Sabol, Department of Revenue

VII. Comments on Changing the Corporate Tax Structure
– Andy Ellen, Retail Merchants Association
– Mark Prak, Brooks, Pierce, McLendon, Humphrey & Leonard
– John McAlister, NC Chamber
– Joseph Crosby, COST

VIII. Revenue Laws Technical and Administrative Changes – Part I
– Trina Griffin, Research Division

IX. Adjournment

Next Meeting Date: Wednesday, January 21, 2009
in Room 544, LOB, at 9:30 a.m.

House Pages

Name Of Committee: Rev. Law Study Date: Jan. 7-09

1. Name: _____

   County: _____

   Sponsor: _____

2. Name: _____

   County: _____

   Sponsor: _____

3. Name: _____

   County: _____

   Sponsor: _____

4. Name: _____

   County: _____

   Sponsor: _____

5. Name: _____

   County: _____

   Sponsor: _____

Sgt-At-Arms

1. Name: Judy Turner
2. Name: Martha Gadson
3. Name: Martha Parrish
4. Name: James Worth
5. Name: _____

VISITOR REGISTRATION SHEET

REVENUE LAWS — 01-07-09

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Brad Phillips	TWC
Lori Ann Harris	~~CATA~~
Edwin McLenaghan	OSBM
Ed Finlayson	BP
Herb Crenshaw	AT&T
Pam Meyer	NCACC
Wendy Kelly	SZD Wicker
Linda Millsaps	NCDOR
Henry M Lancaster →	LCA

VISITOR REGISTRATION SHEET

REVENUE LAWS — 01 07 09

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
R. Paul Wilms	
Mark Prak	BP MHL
Mitch Kokai	John Locke Foundation
Maran Tatum	BPMHL
Amy Schilder	MWC
Greg Radford	NC DOR
Lennie Collins	NC DOR
Doug P. Powell	NCDOR
Sam McEwen	NCDOR
Andy Sasol	NCDOR
Bill Spencer	NCDOR

VISITOR REGISTRATION SHEET

REVENUE LAWS — 01-07-09

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Robert Bowles	NC DOR
Janice W. Davidson	NC DOR
Kay Hobart	NC DOJ
JOHN SADOFF	NCDOR
Elizabeth Duncan	Womble Carlyle
Irene Coons	Verizon
Pat Goddard	Johnston County Tax Administration
David Baker	NC DOR
Bill Wilkes	NC DOR
Michael Houser	NC DOR

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — 1/7/09

Name of Committee — Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
Karl Knapp	NCLM
[signature]	NCICU
DAVID BARNES	Parker Sponsell
Thomas Moore	Edwards Wells
Bill Seagraves	KLG
Steve Brewer	EMBARQ
Debra Allen	AT+T
Dana Simpson	Smith Anderson
DANIEL BAUM	K+L GATES
Elaine Mejia	NC Justice Center
PATRICK BUFKIN	NMRS

VISITOR REGISTRATION SHEET

Name of Committee

Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
[signature]	JD, AL, PA
Paul Stock	NCBA
[signature]	Nelson Mullins
Cam Cover	BPMHL
Lew Ebert	NC Chamber
Joe Crosby	Council on State Taxation
Deatrice Williams	CUCA
L. Andrews	NCFB
Amy McConkey	Smith Anderson
Jay Stem	NCAA
Zeb Alley	NMRS

VISITOR REGISTRATION SHEET

Rev. Laws Study Comm. 1/7/09

Name of Committee Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO COMMITTEE CLERK

NAME	FIRM OR AGENCY AND ADDRESS
JOHN GOODMAN	NC CHAMBER
W. Daniel Ambuin	ElectriCities
Elizabeth Dalton	NCRMA
Andy Ellen	NCRMA
Ken Melton	Ken Melton & Assoc.
Dean Plunkett	NCBWWA
Chris Valauri	NCBWWA
Theresa Hobbs	CAA

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-LAz-5 [v.4] (1/6)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/7/2009 8:56:13 AM

Short Title: Real property sales information. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED.

Whereas, the Constitution of North Carolina requires that property must be taxed by uniform rule and that every classification must be made by general law uniformly applicable in every county, city and town, and other unit of local government; and

Whereas, the North Carolina General Statutes require that all property, real and personal, must so far as practicable be appraised or valued at its true value which is interpreted as meaning market value; and

Whereas, taxes levied by all counties and municipalities must be levied uniformly on assessments determined by the true value of most property; and

Whereas, to help ensure that tax values of real property reflect fair market value when the counties value their property for property tax purposes, the North Carolina Department of Revenue must conduct annual studies of the ratio of the appraised value of real property to its true value and establish for each county the median ratio as determined by the study for each calendar year; and

Whereas, one of the most accurate and cost efficient methods of producing a fair revaluation of property based on the true value of the property is to require that sales information reports be filed with the county whenever property changes hands; Now, therefore,

The General Assembly of North Carolina enacts:

SECTION 1. Article 19 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-317.2. Report on transfers of real property.**

To facilitate the accurate appraisal of real property for taxation, the information listed in this section must be reported to the county tax assessor on a form developed by the Department of Revenue. G.S. 161-32 prohibits recording a deed until the report is filed. The following information is required:

(1) The name of each grantor and grantee.
(2) A brief description of the property.
(3) The total sales price.
(4) Whether the transaction involves family members or affiliated companies.
(5) A listing of any personal property conveyed with the transaction.
(6) Whether the transaction is the result of a forced sale."

SECTION 2. Article 2 of Chapter 161 of the General Statutes is amended by adding a new section to read:

"**§ 161-32. Report on transfer of real property.**

The register of deeds may not accept for registration a deed transferring real property unless the county tax assessor certifies that a sales information report required by G.S. 105-317.2 has been filed. Failure to comply with this section does not affect the validity of a duly recorded deed."

SECTION 3. This act becomes effective January 1, 2010.

County	Does your County Send out Confirmation Letters?	Grantor, Grantee or Both	Does your County Require a Land Transfer Tax?	Is an Affidavit Required?
Alamance	NO		NO	
Alexander	YES	GRANTEE	NO	
Alleghany				
Anson				
Ashe	NO		NO	
Avery	YES	GRANTEE	NO*	
Beaufort	YES	GRANTEE	NO	
Bertie	YES	GRANTOR	NO	
Bladen	NO		NO	
Brunswick	YES	GRANTEE	NO	
Buncombe				
Burke	NO*		NO	
Cabarrus	YES	GRANTOR	NO	
Caldwell	YES		NO	
Camden	YES	BOTH	YES	YES
Carteret	YES	GRANTEE	NO	
Caswell	NO		NO	
Catawba				
Chatham	NO		NO	
Cherokee				
Chowan			YES	YES
Clay				
Cleveland	YES	GRANTEE	NO	
Columbus				
Craven	YES	GRANTEE	NO	
Cumberland	YES	GRANTEE	NO	
Currituck	NO		YES	YES*
Dare	NO		YES	YES*
Davidson	YES	GRANTEE	NO	
Davie	YES	GRANTEE	NO	
Duplin	NO		NO	
Durham	NO		NO	
Edgecombe	NO		NO	
Forsyth	YES*	BOTH		
Franklin	NO		NO	
Gaston	NO*		NO	
Gates	NO*		NO	
Graham	YES	GRANTEE	NO	
Granville	YES	BOTH	NO	
Greene	YES	GRANTEE	NO	
Guilford	YES*	GRANTOR	NO	
Halifax	NO		NO	
Harnett				
Haywood	YES	GRANTEE	NO	
Henderson	YES	GRANTEE	NO	
Hertford				
Hoke	YES	GRANTEE	NO	
Hyde				
Iredell	YES	BOTH	NO	
Jackson	YES	GRANTEE	NO	
Johnston	YES	GRANTEE	NO	
Jones	YES	BOTH	NO	
Lee	NO		NO	
Lenoir	YES	GRANTEE	NO	
Lincoln				
Macon	YES*	DID NOT SAY	NO	
Madison				
Martin	NO*			YES
McDowell	NO		NO	
Mecklenburg	YES	BOTH	NO	

County	Does your County Send out Confirmation Letters?	Grantor, Grantee or Both	Does your County Require a Land Transfer Tax?	Is an Affidavit Required?
Mitchell	NO		NO	
Montgomery	YES	GRANTEE	NO	
Moore	NO		NO	
Nash	YES	GRANTEE	NO	
New Hanover	YES	BOTH	NO	
Northampton	YES	BOTH	NO	
Onslow	YES	GRANTEE	NO	
Orange				
Pamlico	YES	GRANTEE	NO	
Pasquotank	NO		YES	YES
Pender	NO*		NO	
Perquimans				
Person	NO*		NO	
Pitt	YES	GRANTEE	NO	
Polk	NO		NO	
Randolph	YES	BOTH	NO	
Richmond	YES	GRANTEE	NO	
Robeson				
Rockingham	YES	GRANTEE	NO	
Rowan	YES	BOTH	NO	
Rutherford	YES	GRANTEE	NO	
Sampson				
Scotland	YES	GRANTEE	NO	
Stanly	NO		NO	
Stokes	NO		NO	
Surry	YES	BOTH	NO	
Swain	YES	GRANTEE	NO	
Transylvania	YES	BOTH	NO	
Tyrrell				
Union	YES	GRANTEE	NO	
Vance	NO		NO	
Wake	NO		NO	
Warren	YES	GRANTEE	NO	
Washington				
Watauga	YES*	GRANTEE	NO	
Wayne	NO		NO	
Wilkes	YES	GRANTEE	NO	
Wilson	NO		NO	
Yadkin	YES	GRANTEE	NO	
Yancey	NO		NO	

Avery	Considering imposing a transfer tax, it will be considered for the next general election.
Burke	We have a Conformation of Information Form that most attorneys complete and submit at the ROD.
Currituck	We require either an "Affidavit of Consideration or Value" or a copy of the sales contract. (We receive contracts about 20% of the time.)
Dare	We required an affidavit or a copy of the sales contract.
Forsyth	Forsyth County uses qualification letters to both the grantor and grantee ONLY AFTER other methods are exhausted.
Gaston	We plan to do this in 2009 & 2010 for our 2011 reappraisal. Grantee only.
Gates	We ask for a confirmation form to be filled out at the time of recording.
Guilford	We have sent sales confirmation letters in the past, but did not in 2008. We may send out letters for 2009.
Macon	Yes we send out verification letters for prior two years leading up to a revaluation
Martin	We don't send out letters, but we do confirm selling price with the lawyer or who ever come is to the ROD. An affidavit is required.
Pender	We will start this procedure this month with revaluation. Probably Grantor only.
Person	We request sales information and new billing address from closing attorney prior to recording a deed.
Watauga	Randomly select sales to send confirmation letters.

Stats

Total # Counties Responded	# of Counties that Send a Confirmation Letter	# of Counties w/ a Transfer Tax
81	50	5
	Percentage	Percentage
	62%	6%

you count Burke, Gaston, Gates, Pender & Person as sending out Confirmation Letters the percentage goes to 68%.

IRC Update 2009

Heather Fennell
Research Division
January 7, 2009

IRC Update

- Reference to the Internal Revenue Code is updated annually to incorporate changes to the Code.
- Constitutional prohibition against updating automatically.
- Generally, the update occurs in the year following the federal changes.
- Current reference date is ***May 1, 2008***.

Federal Changes since May 2008

Federal Legislation:

- Heartland, Habitat, Harvest, and Horticulture Act of 2008.
- Heroes Earnings and Relief Tax Act of 2008.
- Housing Assistance Tax Act of 2008.
- Emergency Economic Stabilization Act of 2008.
- Worker, Retiree, and Employer Recovery Act of 2008.

Treasury Changes:

- IRS Tax Notice 2008-83.

Heartland, Habitat, Harvest, and Horticulture Act of 2008

- Endangered Species Recovery Expense.

  Adds endangered species recovery expenses to category of expenses that qualify for deduction for qualifying soil and water conservation and land erosion expenditures.

- Charitable Contributions of Real Property for Conservation Purposes.

  Extends increased deduction for donations of conservation easements through December 31, 2009.

Heroes Earnings and Relief Tax Act of 2008

- State or Local Bonuses for Combat Veterans.

  Excludes from gross income bonus payments of a state or local government to a member of the armed services made for the member's service in a combat zone.

- Contributions of Military Death Benefits to Roth IRAs and Coverdell ESAs.

  Allows death benefits to be contributed to a Roth IRA or Coverdall ESA regardless of contribution limits.

Housing Assistance Tax Act of 2008

- Real Property Tax Deduction for Non-itemizers

  For tax years beginning in 2008, creates an additional deduction for local real property taxes for taxpayers who take the standard deduction. The deduction is caped at $500 for individuals and $1000 for joint filers.

Emergency Economic Stabilization Act of 2008 (EESA)

- Authorized the Treasury's Troubled Assets Relief Program (TARP).
- Appropriated $700 billion for bailout.
- Broad authority to the Treasury to purchase, manage, modify, sell and insure troubled assets and to invest capital in banks to shore up capital and stimulate new lending.
- Various tax provisions.

EESA – Compensation Limits

Executive Compensation Limits

Firms that sell directly to the Treasury must follow standards for compensation:

1. No compensation for unnecessary and excessive risks.
2. Recovery of bonus paid on inaccurate statements.
3. Prohibition on golden parachutes.

Firms with assets greater than $300 million that sell through public auction to the Treasury must limit executive compensation:

1. $500,000 limit on deductibility of executive compensation.
2. No deduction for excess golden parachutes, excise tax of 20% on golden parachutes.
3. No new golden parachutes.

EESA – Individual Tax Benefits

- Extension of Exclusion for Discharged Indebtedness on Principal Residence.

  Extends the exclusion from income of discharged indebtedness on a principal residence through calendar year 2012.

- Qualified Charitable Distribution from IRAs.

  Extends provisions allowing individuals 70 and older to distributed up to $100,000 per year directly to charitable institution for 2008 and 2009 tax years.

EESA
Extension of Deductions - Individuals

Extended through 2009:

- Real Property Tax Deduction for Non-itemizers.
- Deduction for Qualified Tuition and Related Expenses.
- Above-the-line deduction for Teachers.
- Election to Deduct State and Local General Sales Tax.

EESA
Extension of Deductions – Businesses

Extended through 2009:

- Enhanced Deduction for Charitable Contributions of Computers, Food Inventory, and Book Donations.
- Deduction for Environmental Remediation Costs (Brownfield Sites).

Extended through 2014:

- Deduction for Energy Efficient Buildings.

EESA – Other Business Provisions

Extended through 2009:

- Gain on Sales or Dispositions to Implement FERC or State Electric Restructuring Policy.
- Treatment of RIC Dividends Paid to Foreign Persons.
- 15-Year MACRS Recovery for:
  1) Leasehold Improvements.
  2) Restaurant Improvements and Buildings.
  3) Retail Improvement Property.

EESA – Other Business Provisions

Extended through 2009:

- Tax Treatment of Certain Payments to Controlling Exempt Organizations.
- Basis Adjustment to Stock of S Corporations Making Charitable Contributions of Property.
- Seven-Year Depreciation for Motorsports Facilities.

EESA – Other Business Provisions

Extended for 1 year:

- Extend and Modify Treatment of Certain Qualified Film and Television Productions.

New Provision:

- Farming Equipment Treated as Five-Year Property.

EESA – Disaster Relief

- Relief for Midwestern Disaster Areas.
- Casualty Losses Attributable to Federally Declared Disasters.
- Expensing of Qualified Disaster Costs.
- Net Operating Losses Attributable to Federally Declared Disasters.
- Special Depreciation Allowance for Qualified Disaster Assistance Property.
- Increased Expensing for Qualified Disaster Assistance Property.

Worker, Retiree, and Employer Recovery Act of 2008

- Required Minimum Distributions from Retirement Accounts.

  Eliminates the required minimum distribution for certain retirement accounts for calendar year 2009.

IRS Notice 2008-83

- Issued by Treasury on September 30, 2008.
- Provides guidance on Section 382 limits on deductions against taxable income allowed for losses when a corporation undergoes an ownership change.
- Current legislation in Congress to rescind.
- Currently being reviewed by the Treasury Inspector General.

IRS Notice 2008-83 – Sec. 382

- Section 382 limits the use of losses to offset taxable income of a corporation that has undergone a change in ownership.
- "Change in ownership." – The percentage of a corporation's stock owned by one or more 5 percent shareholders increases by more than 50 percentage points within a 3-year period.
- The limitation is equal to the stock value of the loss corporation immediately before the ownership change multiplied by the prescribed long-term tax-exempt rate (approx. 4.6%).

IRS Notice 2008-83

"For purposes of section 382(h), any deduction properly allowed after an ownership change (as defined in section 382(g)) to a bank with respect to losses on loans or bad debts (including any deduction for a reasonable addition to a reserve for bad debts) shall not be treated as a built-in loss or a deduction that is attributable to periods before the change date."

IRS Notice 2008-83

- Deductions for losses on loans or bad debts after an ownership change of a bank will not be subject to the loss limitation rules of Section 382.

IRC Update

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 7, 2009
Introduced by:		**Summary by:**	Heather Fennell
Version:			Committee Counsel

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

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

BILL ANALYSIS:

This bill would change the reference date to January 1, 2009, effective when the bill becomes law. Changing the reference date to January 1, 2009 would incorporate the changes made in the following acts: the Heartland, Habitat, Harvest, and Horticulture Act of 2008, signed into law May 22, 2008 (P.L. 110-234); the Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245); the Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289); the Emergency Economic Stabilization Act of 2008 signed into law October 3, 2008 (P.L. 110-343); and the Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458) signed into law December 23, 2008.

In addition to the preceding acts, an action by the Treasury Department may affect State revenue. On September 30, 2008 the IRS issued Notice 2008-84. This notice provides a potential tax break to purchasers of banks with outstanding bad debt.

Heartland, Habitat, Harvest, and Horticulture Act of 2008

Endangered species recovery expense. – The act creates a new deduction for endangered species recovery expenditures for expenses incurred after December 31, 2008. Farmers may currently claim a deduction for qualifying soil and water conservation expenditures and land erosion prevention expenditures. The deduction is limited to 25% of gross income derived from farming during the tax year but can be carried forward indefinitely. This act adds endangered species recovery expenditures to the

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

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

category of expenditures that qualify for the deduction. The expenditures must be paid or incurred by a farmer after December 31, 2008 for the purpose of site-specific management actions recommended in recovery plans approved pursuant to the Endangered Species Act of 1973. Depreciable structures, appliances, or facilities do not qualify for the deduction.

Charitable Contributions of Real Property for Conservation Purposes. – The act extends the increased deduction for charitable contributions of real property for conservation purposes for tax years beginning before January 1, 2009. The deduction for capital gain appreciated real property is generally limited to 30% of the donor's adjusted gross income if the donor uses the fair market value of the donated property. If the donor's basis is used as the value of the property, and the property is donated to a "maximum deduction" organization, the deduction is limited to 50% of the donor's adjusted gross income.[3] Deductions for donations to non-maximum donation organizations are limited to 20% of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years. The Pension Protection Act of 2006 increased the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50% of adjusted gross income, with a 15-year carryforward for any excess. A "qualified farmer or rancher" may deduct the value of the gift up to 100% of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming is greater than 50% of the taxpayer's gross income for the tax year. The land donated by a farmer or rancher also must "be available" for agricultural use, but it need not be used for that purpose. This act extends these provisions through December 31, 2009.

Heroes Earnings Assistance and Relief Tax Act of 2008

State or Local Bonuses for Combat Veterans. – The act excludes state or local bonuses for combat veterans from gross income for income tax purposes. Generally all income is included in gross income unless the income is explicitly excluded. "Qualified military benefits" are excluded from gross income. These benefits generally include allowances or in-kind benefits provided to family members and former members of the armed services, or their dependents by reason of the member's service, including housing, moving, and travel allowances. This act expands the definition of "qualified military benefits" to include bonus payments by a state or local government to a member or former member of the armed services, or to a dependent of a member. To qualify for the exclusion, the payment must have been made for the member's service in a combat zone.[4]

Contributions of Military Death Gratuities to Roth IRAs and Coverdell ESAs. – The act allows military death gratuities to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs. Upon notification of the death of military personnel on active duty or on inactive duty training, a death gratuity is paid to or for the person's survivor. The death gratuity is a qualified military benefit and excluded from income. Roth IRAs are subject to annual contribution limits equal to the lesser of the statutory dollar amount or 100% of taxable income. For 2008, the annual limit on contributions is $5,000 for individuals, with an additional catch up contribution of $1,000 allowed for individuals over age 50. Sums may be rolled-over from eligible

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

[4] A combat zone is defined as any area the president has by executive order designated an area in which the Armed Forces are or have engaged in combat.

retirement plans to Roth IRAs, subject to income-phase out limitations. For 2008, rollovers are allowed for individuals whose gross adjusted income does not exceed $100,000. A Coverdell Education Savings Account is a tax-exempt trust created for paying the education expenses of the trust's designated beneficiary. Annual contributions to Coverdell ESAs may not exceed $2,000. This act allows the gratuity to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs.

Housing Assistance Tax Act of 2008

Real Property Tax Deduction for Non-itemizers. – The act creates a deduction for real property taxes paid by non-itemizers for any tax year beginning in 2008. Taxpayers can take either the basic standard deduction, or itemize deductions, but not both. Taxpayers who itemize deductions may deduct state and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. This act allows taxpayers who take the standard deduction to claim an additional deduction for state and local real property taxes for any tax year beginning in 2008. The deduction is the lesser of (1) the amount allowable as a deduction for state and local taxes if the taxpayer claimed itemized deductions, or (2) $500 for individuals, $1000 for joint returns.

Emergency Economic Stabilization Act of 2008

Executive Compensation Limits for Financial Institutions Participating in Troubled Asset Relief Program (TARP). – The act restricts certain financial institutions that sell troubled assets to the Treasury Department by means of a public action from deducting more than $500,000 for executive compensation and prohibits the firms from contracting for new golden parachute payments. Firms that sell troubled assets directly to the government must exclude incentives for executive officers to take unnecessary risks; must recover bonuses to senior executives based on materially inaccurate information; and may not make any golden parachute[5] payments to senior executives while the government holds an equity or debt position in the firm.

Previously, there were three limits in the IRC for executive compensation:

(1) A publicly held corporation cannot deduct applicable employee remuneration that exceeds $1 million per tax year.

(2) A corporation cannot deduct excess golden parachute payments paid to a disqualified individual that were triggered by a change in ownership or control.

(3) Excess payments are subject to a 20% excise tax paid by the recipient.

This act imposes new restrictions on executive compensation for financial institutions that sell troubled assets as part of TARP.

Limits when financial institutions sell troubled assets through a public auction. – If a firm sells troubled assets through a TARP managed public auction to the Treasury, and has assets in excess of $300 million, the firm must adhere to the following limits on executive compensation.

(1) $500,000 limit on the deductibility of executive compensation, including incentive and commission pay.

(2) No deduction for excess golden parachute payments; excess payments are also subject to a 20% excise tax paid by the recipient.

[5] A parachute payment is any payment in the nature of compensation paid to a disqualified individual that either is contingent upon a change in ownership of the corporation and equals or exceeds 3 times the individual's base pay, or is made under an agreement that violates securities laws or regulation.

(3) Prohibition from entering into a new employment contract that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership.

Limits when sales made directly to the Treasury: If a firm sells troubled assets directly to the Treasury, the firm must adhere to the following standards for compensation and benefits paid to senior executive officers for the duration of time the government holds the assets:[6]

(1) Limits on compensation that exclude incentives for executives to take unnecessary and excessive risks that threaten the value of the firm.

(2) Recovery of any bonus or incentive compensation paid to an executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate.

(3) Prohibition on golden parachutes.

Extension of Income Exclusion for Discharged Indebtedness on Principal Residence. – The act extends the exclusion from income for discharged indebtedness on principal residences created by the Mortgage Forgiveness Act of 2007 for discharges occurring before January 1, 2013. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the unpaid mortgage debt, the canceled debt is considered income under the Code. There is no income limitation but no more than $2 million in mortgage debt is eligible for exclusion. The exclusion from income for this discharged indebtedness related to a principal residence for the three-year period beginning January 1, 2007 and ending December 31, 2009. This act extends the exclusions for discharged indebtedness related to a principal residence for the period beginning January 1, 2007 and ending on December 31, 2012.

Qualified Charitable Distribution from IRAs. – The act extends the favorable treatment of qualified charitable distributions from IRAs for two years, for distributions made in 2008 and 2009. Generally, to make a charitable donation from an IRA, a distribution must be taken and the applicable rules regarding taxable income apply. The distribution is included in taxable income to the extent the distributions are not attributable to a return of nondeductible contributions. The standard charitable deduction rules then apply to the donation. The Pension Protection Act of 2006 provided that individuals 70 ½ or older could distribute up to $100,000 per taxable year from their IRAs to charitable institutions without recognizing the income. The distribution must be made directly to the charitable organization from the trustee. This distribution counts towards the required minimum distribution. This is extended by the act for distributions in 2008 and 2009.

Transportation Fringe Benefit for Bicycle Commuters. – The act allows a new transportation fringe benefit for bicycle commuters. In general, commuting expenses to and from a place of business are not deductible. Transportation fringe benefits can defray some of an employee's commuting expenses with either pre-tax dollars that reduce otherwise taxable compensation, or with direct, employer-subsidized amounts that are considered tax free. This act adds qualified bike commuting reimbursements to the type of qualified transportation fringe benefits that an employer may provide to an employee who commutes to work using a bike.

[6] A senior executive officer is an individual who is one of the top five highly paid executives of a public company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1394.

Extension of certain deductions. –

Real Property Tax Deduction for Non-itemizers. – The act extends the deduction created in the Housing Assistance Tax Act of 2008, for tax years beginning in 2008 and 2009.

Election to Deduct State and Local General Sales Taxes. – The act extends the deduction for state and local sales taxes to tax years beginning before January 1, 2010. The deduction is either (1) the total of actual general sales taxes paid as substantiated by accumulated receipts, or (2) an amount form IRS generated tables plus the amount of general sales tax paid in the purchase of a motor vehicle or boat. North Carolina is currently decoupled from this deduction.

Deduction for Qualified Tuition and Related Expenses. – The act extends the deduction for qualified tuition and related expenses for tax years beginning before January 1, 2010. The expenses eligible for the deduction include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or dependent at an eligible institution of higher education. The maximum deduction is $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 for joint filers) and $2,000 for taxpayers whose AGI does not exceed $80,000 ($160,000 for joint filers).

Above-the-Line Deduction for Certain Expenses of School Teachers. – The act extends the above-the-line deduction for eligible educators for tax years beginning in 2008 and 2009. The $250 deduction is allowed for books, supplies, and computer equipment purchased by an eligible educator for use in the classroom.

Enhanced Deduction for Charitable Contributions of Computers. – The act extends the enhanced deduction for charitable contributions of computers for tax years beginning in 2008 and 2009. C corporations that make qualified contributions of computer technology and equipment may claim and enhanced deduction equal to the corporation's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. The enhanced deduction may not exceed twice the corporation's basis in the property.

Enhanced Deduction for Charitable Contributions of Food Inventory. – The act extends the enhanced deduction for charitable contributions of food inventory for tax years beginning in 2008 and 2009. Taxpayers may take a deduction for donated food inventory equal to the lesser of (1) the donated item's basis plus one-half of the amount of gain that would be realized if the donated food item was sold at fair market value, or (2) two times the donated item's basis. The deduction is limited to 10% of the taxpayer's net income, however, the 10% limitation is suspended for contributions made by farmers or ranchers between October 3, 2008 and January 1, 2009.

Enhanced Deduction for Charitable Contributions of Book Donations. – The act extends the enhanced deduction for charitable contributions of book donations for tax years beginning in 2008 or 2009. Any corporation, other than an S corporation, can take an enhanced deduction for contributions of book inventory equal to the lesser of (1) the donated inventory item's basis plus one-half of the item's appreciation, or (2) two times the donated inventory item's basis.

Deduction for Environmental Remediation Costs. – The act extends the election to deduct environmental remediation costs to cover expenditures paid or incurred in 2008 and 2009. A

taxpayer may elect to deduct certain environmental cleanup costs in the tax year paid or incurred, rather than capitalize them. The election only applies to costs that are incurred in connection with the abatement or control of hazardous substances at a "qualified containment site," also called a "brownfield site."

Deduction for Energy Efficient Commercial Buildings. – The act extends the deduction for energy-efficient commercial building property for five years and is available for qualified property placed into service after December 31, 2005 and before January 1, 2014. The deduction applies to "energy efficient commercial building property," which is defined as depreciable property that is installed as part of a building's (1) interior lighting systems, (2) heating, cooling, ventilation, and hot water systems, or (3) envelope, and is part of a certified plan to reduce the total annual energy and power costs of these systems by at least 50%. The deduction is limited to the product of $1.80 and the total square footage of the building, reduced by the aggregate amount deducted in any prior year.

Gain on Sales or Dispositions to Implement FERC or State Electric Restructuring Policy. – The act extends the special gain recognition rule for qualifying electric transmission transactions that implement FERC or state electric restructuring policy for two years for qualified electric utilities to sales or dispositions prior to January 1, 2010. A qualified electric utility can elect to recognize qualified gain from a qualifying electric transmission transaction over an eight-year period to the extent the amount realized from the sale is used to purchase exempt utility property within an applicable period.

Treatment of RIC Dividends Paid to Foreign Persons. – The act extends the exemption from the 30% tax on regulated investment company (RIC)[7] dividends that are designated as interest-related or short-term capital gains for two years to tax years beginning before January 1, 2010. Generally, US income paid to a nonresident alien or foreign corporation that is not connected with a US trade or business is subject to a flat 30% tax which is collected through withholding. Dividends that are designated as interest-related or short-term capital gains are exempt from the 30% tax.

15-Year MACRS Recovery period for Qualified Leasehold Improvements, Qualified Restaurant Improvements and Buildings, and Qualified Retail Improvement Property. – The act extends the 15-year Modified Adjusted Cost Recovery System (MACRS) recovery period for qualified leasehold improvements and restaurant improvements and buildings for two years and applies to property placed in service before January 1, 2009. The act also creates 15-year a MACRS recovery period for qualified retail improvement property and applies to property placed in service after December 31, 2007 and before January 1, 2009. Before these provisions, the improvements would generally be considered a structural component of the building and would be depreciated over a 39 year period.

Tax Treatment of Certain Payments to Controlling Exempt Organizations. – The act extends the special rules that permit the exclusion of qualifying payments by a controlled entity to a tax-exempt organization from that tax exempt organization's unrelated business income (UBTI) for two years through December 31, 2009. Tax-exempt organizations are taxed on UBTI, including amounts paid by a controlled entity. Only the excess amount of certain qualifying payments of rent, royalties, annuities, or interest income is included. Qualifying payments must be made in connection with a contract that is in

[7] A RIC is commonly known as a mutual fund.

effect August 17, 2006. Payments that exceed the amount that would be paid in an arms-length transaction are included in the UBTI.

Basis adjustment to stock of S corporations making charitable contributions of property. – The act extends the provision providing that the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation equals the shareholder's pro rata share of the adjusted basis of the contributed property for two years and applies to tax years beginning before January 1, 2009. This change preserves the intended benefit without causing the shareholder to recognize a gain or reduced loss that is attributable to the appreciation upon the subsequent sale of stock.

Seven-Year Depreciation Period for Motorsports Facilities. – The act extends the 7 year MACRS recovery period for motorsports entertainment complexes to property placed in service in 2008 and 2009. Historically, race tracks and facilities were treated by the IRS the same as theme and amusement parks. The American Jobs Creation Act of 2004 codified this treatment. A "motorsports entertainment complex" is a racing track facility that is permanently situated on land, hosts at least one racing event for cars of any type, trucks, or motorcycles during the 36-month period following the first day of the month in which it is put in service, and is open to the public for an admission fee.

Extend and Modify Treatment of Certain Qualified Film and Television Productions. – The act extends the expensing election related to film and television productions for one year for productions that begin before January 1, 2010, and allows the election to be made, in part, for productions with aggregate costs over the dollar production limit. A taxpayer may deduct the production costs of a qualifying film or television production. To qualify for the election, the aggregate production cost may not exceed $15 million. This act modifies the provision so that the first $15 million of otherwise qualifying film or television productions may be treated as an expense even if the aggregate cost of production exceeds $15 million.

Certain Farming Equipment Business Machinery or Equipment Treated as Five-Year Property. –The act provides that certain machinery or equipment used in a farming business is treated as five-year property for purposes of claiming MACRS depreciation. The equipment does not include grain bins, cotton ginning assets, fences or land improvements. Property that is used in a farming business can be depreciated under the General Depreciation System (GDS) using the 150-percent declining-balance method. Farm machinery and equipment generally has a recovery period of 10 years and has a straight-line recovery method.

Disaster Relief. -

Relief for Midwestern Disaster Areas. – The act modifies and extends many of the tax benefits extended to the victims of Katrina, Wilma, and Rita hurricanes to the victims of storms that hit the Midwest in the summer of 2008. These include the extension of special expensing for qualified property, an enhanced low-income housing credit, and flexible tax-exempt bond financing rules.

Casualty Losses Attributable to Federally Declared Disasters. – The act increases the deduction for casualty losses attributable to federally declared disasters for tax years beginning after December 31, 2007. Personal casualty losses are deductible to the extent the losses exceed $100

per casualty and the sum of the casualty losses exceed 10% of the taxpayer's AGI. For tax years beginning after December 31, 2007, the standard deduction is increased by the amount of any disaster loss amount for casualty losses attributable to a federally declared disaster occurring in 2008 and 2009. The losses are deductible without regard to whether the losses exceed 10% of a taxpayer's adjusted gross income. The deduction for any casualty attributable to a federally declared disaster occurring in 2009 is limited to the amount of the loss that exceeds $500.

Expensing of Qualified Disaster Costs. – The act allows a taxpayer to elect to expense qualified disaster expenses after 2007, rather than capitalizing them. Qualified disaster expenses include any expenditure that is all of the following:

(1) Paid or incurred in connection with a trade, business, or business-related property.
(2) Otherwise chargeable to a capital account.
(3) Made for any of the following:
    (a) The abatement or control of hazardous substances that were released on account of a federally declared disaster.
    (b) The removal of debris from, or the demolition of structures on, business-related property that is damaged as the result of a federally declared disaster.
    (c) The repair of business-related property damaged as a result of a federally declared disaster.

Net Operating Losses Attributable to Federally Declared Disasters. – The act creates a special five-year carryback period for net operating losses (NOLs) has been created for a qualified disaster loss. In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year.

Special Depreciation Allowance for Qualified Disaster Assistance Property. – The act allows an additional 50% depreciation allowance can be claimed for real and personal business property that is purchased to rehabilitate or replace similar property that is destroyed or condemned as a result of a residentially declared disaster for property placed in service after December 31, 2007, with respect to disasters declared after that date and occurring before January 1, 2010.

Increased Expensing for Qualified Disaster Assistance Property. – The act increases the maximum section 179 expense allowance and investment limitation amount for qualified section 179 disaster property placed in service after 2007. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Internal Revenue Code. To be eligible, the property must be tangible personal property which is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take expensing first and claim section 168(k) depreciation on any remaining basis. First year expensing is increased for disaster property:

(1) The section 179 expense deduction ($250,000 for 2008) is increased by the lesser of $100,000 or the cost of the qualified section 170 disaster assistance property placed in service during the tax year.

(2) The amount of the investment limitation ($250,000 for 2008) is increased by the lesser of $600,000 or the cost of qualified section 179 disaster assistance property placed in service during the tax year.

Worker, Retiree, and Employer Recovery Act of 2008

Required Minimum Distribution. – The act eliminates the required minimum distribution for calendar year 2009 for individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans. Employer-provided qualified retirement plans and individual retirement accounts are subject to minimum distribution rules. Generally, required minimum distributions must begin by April 1 of the year following the calendar year in which the individual reaches 70 ½. The required minimum distribution for each year is determined by a formula that includes the account balance and the individual and individual's designated beneficiary's expected lifetime. Failure to make a required minimum distribution results in a 50% excise tax.

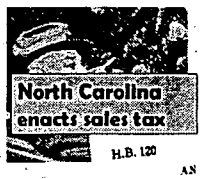
IRS Notice 2008-83

The IRS issued Notice 2008-83 on September 30, 2008. The notice suspends a rule that limits the use of built-in losses of banks following a change in ownership of the bank. Section 382 limits a corporation's ability to deduct its net operating losses against taxable income when the corporation undergoes an ownership change. An ownership change is defined as an increase in the percentage of a corporation's stock owned by one or more 5 percent shareholders by more than 50 percentage points within a 3-year period. After an ownership change, the deduction for the amount of losses attributable to the period before the ownership change is limited. The limit is generally equal to the value of the loss corporation at the time of the change multiplied by the applicable federal long-term tax-exempt interest rate. This notice provides that losses on loans or bad debts will not be limited by section 382 for banks that undergo an ownership change.

Taxation for the Digital Age

Trina Griffin
NCGA Research Division
January 7, 2009

1933



1933—CHAPTER 445

CHAPTER 445

H.B. 120

AN ACT TO RAISE REVENUE.

The General Assembly of North Carolina do enact:

ARTICLE 1

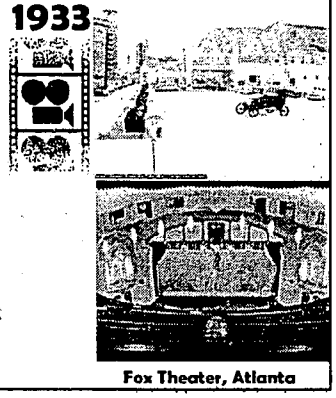


PROHIBITION ENDS AT LAST!

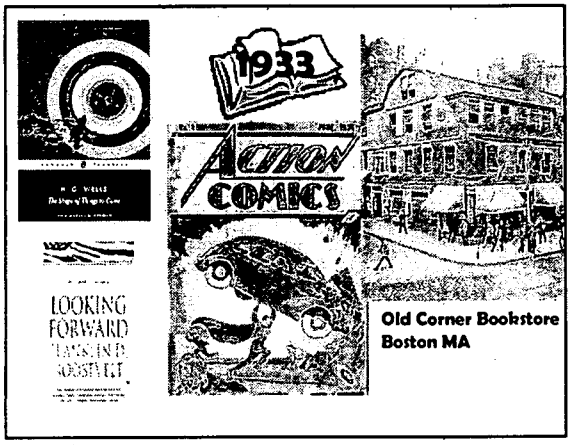
1933

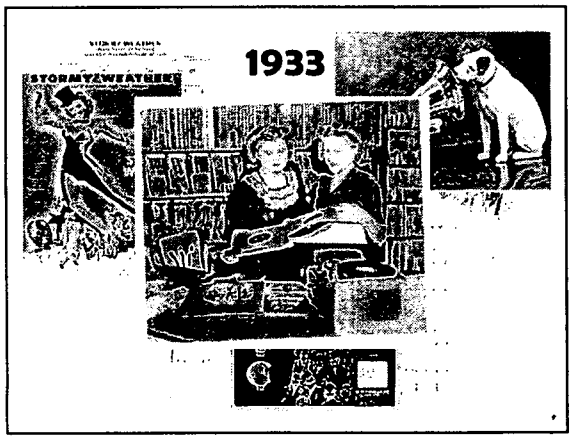


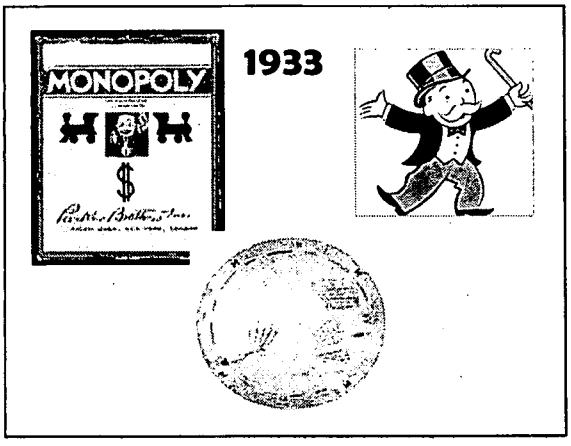


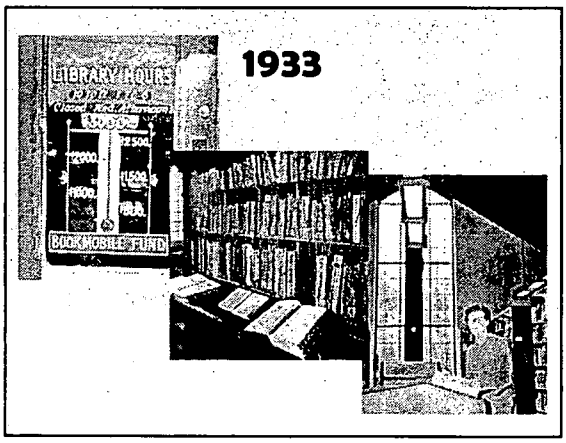


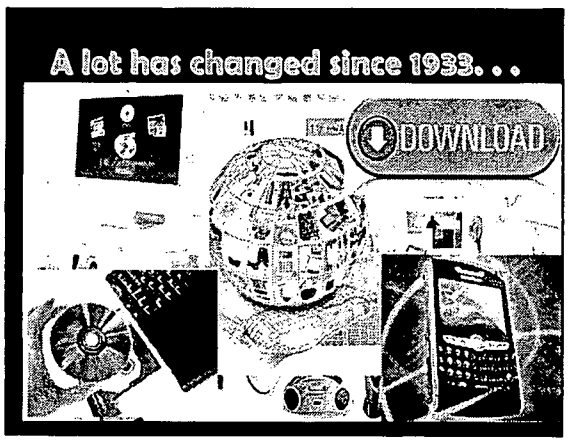
Fox Theater, Atlanta


1933
ACTION COMICS
LOOKING FORWARD
Old Corner Bookstore
Boston MA

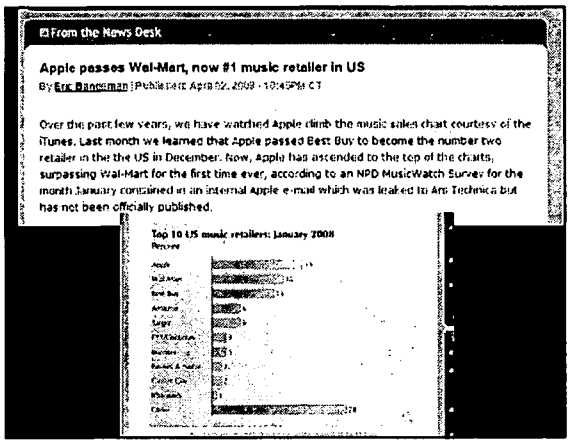

1933


MONOPOLY
1933

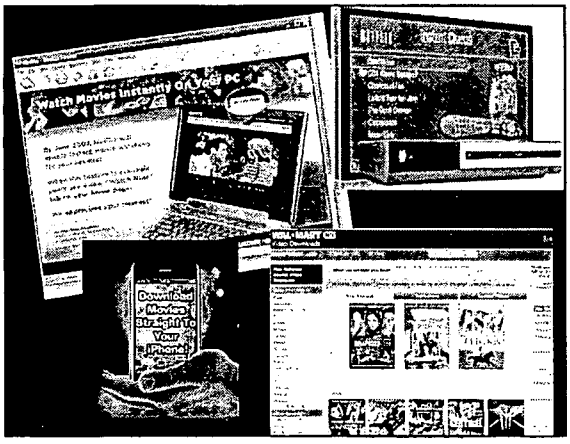

1933
LIBRARY HOURS
BOOKMOBILE FUND

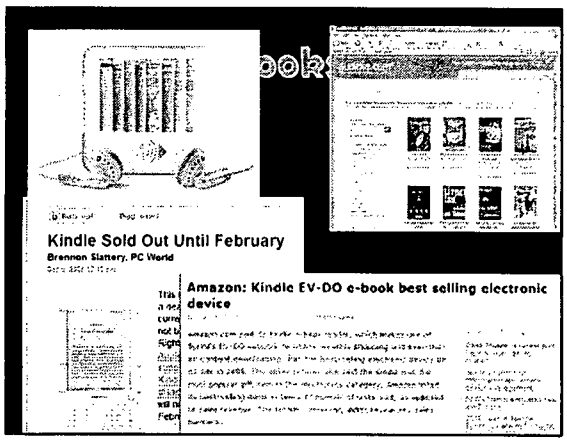

A lot has changed since 1933. . .
DOWNLOAD

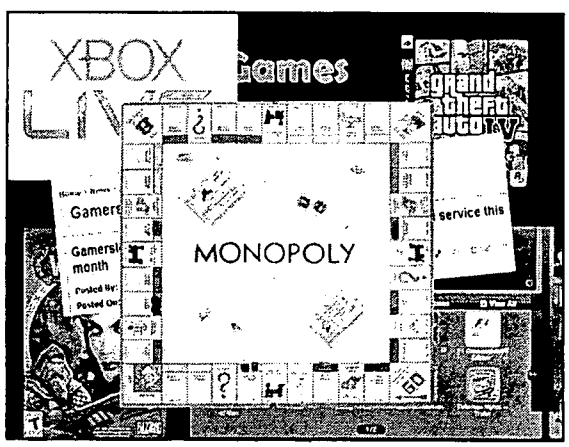

Ringtones
+100
Music

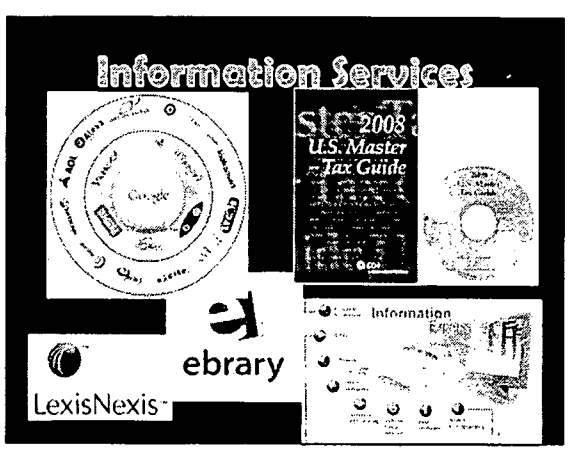


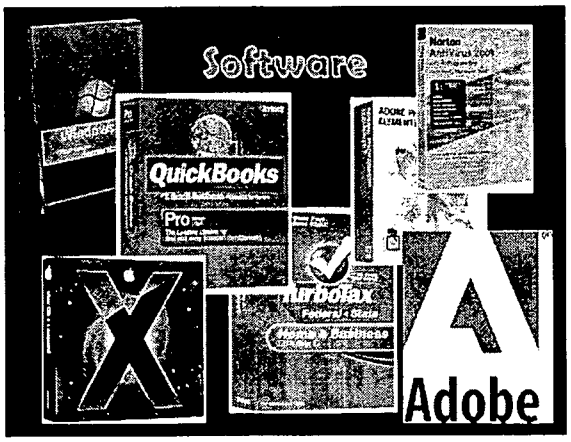
- Downloads = 30% of ALL music revenues in U.S.; expected to grow to 41% in 5 years.
- Sales of "physical" music media expected to plummet from current 64% share of sales to 40% by 2013.




Kindle Sold Out Until February
Brennon Slattery, PC World
Amazon: Kindle EV-DO e-book best selling electronic device


XBOX
MONOPOLY


Information Services
2008
U.S. Master Tax Guide
ebrary
LexisNexis



NC Sales Tax

- Generally, applies to sales of tangible personal property.
- "Personal property that may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses."
- Exemption for computer software delivered electronically or delivered by load and leave.

Movies

Taxed	Not Taxed
• In theater	• Downloaded movie
• In-store DVD purchase	• Streaming movie video
• Online DVD purchase	
• DVD rental in-store or by mail	
• Pay-per-view on cable or satellite	

Books

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail	• Downloaded online

Music

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail • Satellite radio service	• CD or songs downloaded online • Ringtone downloaded online or to phone

Games

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail	• Downloaded online • Online or subscription gaming

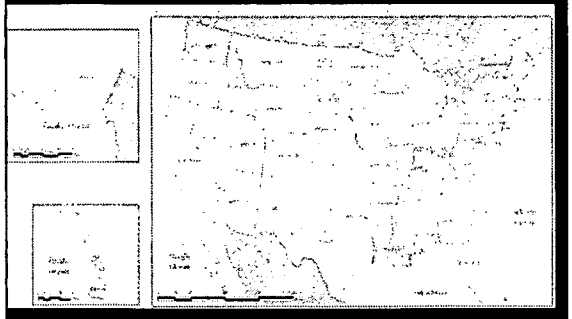
Information Services

Taxed	Not Taxed
• Print material • CD delivered by mail	• Subscription for online access

Software

Taxed	Not Taxed
• In-store purchase • Online purchase delivered by mail	• Downloaded online • Load and leave

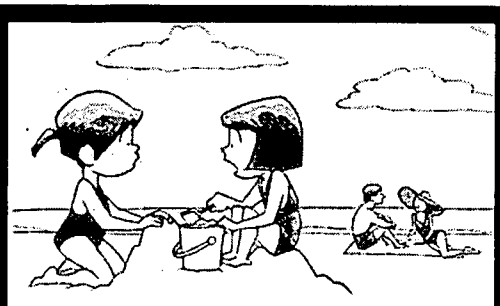
The Rise of the "iTax"



Streamlined Sales Tax Project

- "Specified Digital Products"
  - "Digital Audio Visual Works"
  - "Digital Audio Works"
  - "Digital Books"
- States may not interpret the definition of TPP to include any item within definition of specified digital products.
- States may tax all, some, or none.

"We live in a world where often times the value is not in the object itself, but in the digital information stored on a computer somewhere."



"I'm never having kids. I hear they take nine months to download."

1 ▣ **S.L. 2008-158:**
Resale of Tickets via Internet

Cindy Avrette, Research Division
Revenue Laws Study Committee
January 7, 2008

2 ▣ **Summary of Legislation**

- Allows admission tickets to be resold on the Internet at a price greater than the price printed on the ticket
  - Otherwise, Class 2 misdemeanor
  - Provided consumer and venue protections
    - Ticket Guarantee
    - Full refund if event cancelled or purchaser denied admission through no fault of purchaser
    - Prohibition on ticket purchasing software

3 ▣ **June 30, 2009 Sunset**

- Effective August 1, 2008, and expires June 30, 2009
- History of SB 1407
  - Senate version of the bill imposed 3% gross receipts privilege tax on the ticket resale
    - Tax applicable to the difference between the price of the ticket sold and the face price of the ticket
  - House removed the tax provision
  - Enacted bill contained monthly reporting requirement and sunset date

4 ▣ **Reporting Data-to-Date**

- Four reports filed
- Different filers
- Less than 100 tickets resold
- Less than $5,000 of net proceeds

5 ▣ **What's next?**

- Do Nothing
  - Act sunsets
  - Criminal liability for selling tickets at more than face value reinstated
  - No prohibition on ticket purchasing software
- Extend Sunset
- Resolve Tax Issue

January 7, 2009

MEMORANDUM

To: Representative Paul Luebke, Co-Chair
Senator John H. Kerr, III, Co-Chair
Revenue Laws Study Committee
North Carolina General Assembly

From: Andy Sabol, Director
Sales and Use Tax Division
North Carolina Department of Revenue

Subject: Streamlined Sales and Use Tax Governing Board Activities Update

The Streamlined Sales and Use Tax Project is entering its ninth year of efforts to provide simplification and uniformity to the administration of sales and use tax in addition to furthering the development of technological solutions for the collection and remittance of sales and use tax. The adoption of the Streamlined Sales and Use Tax Agreement ("Agreement") in November 2002 provided the framework of the principles that states would have to adopt to achieve the uniformity and simplification measures initially established by the coalition of states, local governments, and the business community that are part of the effort. In October 2005, the Streamlined Sales Tax Governing Board ("Governing Board") was formed as an entity to administer the Agreement after the requisite number of states was found to be in compliance with the provisions of the Agreement. The membership of the Governing Board consists of representatives from the twenty-two member states with representatives of local government and the business community participating through their service on various committees and councils.

A goal of the states with adoption of the changes necessary to come into compliance with the Agreement was to encourage sellers, especially remote sellers to voluntarily agree to collect sales and use tax in those states that had taken action to simplify and to adopt uniform measures. The Governing Board established a central registration system in October 2005 that allows sellers to register for sales and use tax purposes in all member states. Over 1000 sellers have registered since the system's inception. For North Carolina, this has resulted in collections of approximately $36 million in new

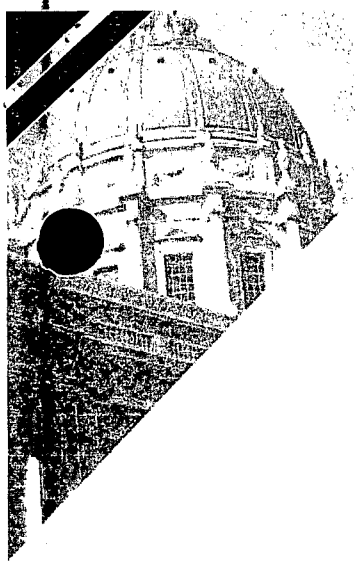
revenues since October 2005. Collections continue to increase each year as over $15 million was received in fiscal year 2007-2008 and $7.9 million has been received for the 2008-2009 fiscal year.

The states realize that the amounts being collected voluntarily are far less than the amounts estimated that states are not collecting from sales by remote sellers that do not have a physical presence in states and, based on United States Supreme Court decisions, cannot be required by states to collect. The Governing Board has recently commissioned a study by an authority in the field to provide an update on estimates of tax legally due but uncollected as a result of sales made by remote sellers. The Supreme Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote sellers. Legislation has been introduced in the last several sessions of Congress that would authorize states to require collection of sales and use tax by remote sellers. The legislation, as introduced, would provide such authorization to those states that had adopted the simplification and uniformity measures established in the "Agreement," in addition, to a few items not addressed in the Agreement. There have been subcommittee and committee meetings held on the legislation in past Congressional sessions; however, there has not been any significant action taken. It is anticipated that legislation will again be introduced soon after the new Congress convenes.

The leadership of the Governing Board believes that the upcoming session of Congress represents the best opportunity for action on Streamlined-related legislation. The Governing Board is in the process of selecting an agent to advocate to members of Congress on behalf of the Governing Board for enactment of legislation. The Governing Board is holding a quarterly meeting in May 2009 in the Washington D.C. area and state delegates will schedule meetings with their respective members of Congress to encourage passage of Streamlined-related legislation. Similar meetings were held in 2008.

With each bill that has been introduced in Congress, there have been two major items that were not firmly established and that are not included in the provisions of the "Agreement," a small seller threshold and vendor compensation. The small seller threshold would exclude remote sellers that sell under a certain dollar amount per year from having to collect tax in states in which they do not have nexus. The vendor compensation provision would require states to allow a vendor's discount to all sellers, not just remote sellers. The legislation that has been introduced simply provides that a state must allow "reasonable" compensation but does not attempt to set out what is considered to be "reasonable." There have been discussions that the legislation introduced in the upcoming session of Congress will delegate the determination of the appropriate small seller threshold level and reasonable compensation to the Governing Board. To that end, the Governing Board has commissioned a task force, headed by Harley Duncan, the former executive director of the Federation of Tax Administrators, to review these issues and present recommendations. An interim report has been issued and work will continue on these topics.

The Governing Board is requesting that state and local governments concerned about the remote sales issue to seriously consider becoming involved with advocating passage of Streamlined-related legislation with members of Congress. Especially important is securing support from members to the referring committees, which in the past have been the House Judiciary and Senate Finance Committees. Another important item is securing co-sponsorship for introduced legislation. North Carolina has been an active participant in the Streamlined efforts since the beginnings in March 2000 and the General Assembly has continued to show its support through passage of legislation over the years of measures necessary to stay in compliance with the "Agreement." My staff and I will be glad to provide any assistance that we can to the General Assembly for any action to promote passage of federal legislation.



COST
COUNCIL ON STATE TAXATION

COMBINED REPORTING
UNDERSTANDING THE REVENUE AND COMPETITIVE EFFECTS OF COMBINED REPORTING

MAY 2008

By Robert Cline, Ernst & Young LLP

CONTENTS

Executive summary 1

I. Introduction 3

II. Revenue impacts from adopting combined reporting 9
- A. Factors affecting revenue impacts 9
- B. Case studies of combined reporting revenue impacts 12

III. Impacts of combined reporting on a state's economic competitiveness 14
- A. How does combined reporting affect a state's competitiveness? 14
- B. Tax simulations of impacts of corporate income tax changes 15
- C. Expanded interstate growth comparisons 16
- D. Recent state-by-state data on investment trends 17
- E. Summary of economic impacts 18

IV. Compliance and administrative impacts 19

V. Conclusions 20

Appendix: State estimates of combined reporting revenue impacts 21

EXECUTIVE SUMMARY

One of the most controversial business tax policy issues currently debated by state legislators, tax administrators, and corporate taxpayers is how a state should determine the corporate income tax base for multistate corporations with multiple businesses and entities. The debate is framed as a choice between two distinctly different corporate income tax systems used by states to answer this question: separate filing and combined reporting.

The first approach to determining the income of a multistate enterprise, separate filing, treats each corporation as a separate taxpayer. Under separate filing, each corporation includes only its income on the corporate tax return it files. The second approach, combined reporting, treats affiliated taxpayers (parents and subsidiaries) engaged in a unitary business as a single group for purposes of determining taxable income.[1] In the process of determining tax liabilities of the members of the combined group, the separate incomes of the members are added together or "combined." In effect, combined reporting treats the members of the unitary business as though they were a single company in determining their income. Under both systems, the income of the taxpayer or group is then distributed (apportioned) by a formula to a specific state. States vary widely both on the composition of the combined group and the apportionment formula.

Prior to Vermont's adoption of combined reporting beginning in 2006, no state had adopted combined reporting for two decades. West Virginia and Michigan followed Vermont in adopting combined reporting for their business income taxes, and New York recently expanded its combined filing requirements. Additional states are considering the switch from separate filing to combined reporting. Proponents

Robert Cline is the National Director of State and Local Tax Policy Economics at Ernst & Young LLP. He is the former tax research director for the states of Michigan and Minnesota. He has a Ph.D. in economics from the University of Michigan. He is part of E&Y's Quantitative Economics and Statistics practice that provides quantitative, regulatory and policy services to private and public sector clients.

maintain that the switch will increase state corporate tax collections and reduce tax base shifting attributable to tax planning by multistate firms. Opponents assert that combined reporting decreases a state's economic competitiveness and may result in a state taxing more or less income than is justified based on the taxpayer's actual in-state activities. This study provides additional information that should help legislators and policymakers better understand the complex issues involved in this debate.

Key study findings

- Combined reporting may increase, decrease or leave unchanged the taxable income reported on the combined return compared to the sum of the taxable incomes for the separate taxpayers, assuming that corporations in the combined group are already taxpayers in a state. The result depends upon the difference in profitability per dollar of U.S. payroll, property and/or sales ("factors") for the different corporations in the group.
- Combined reporting has uncertain effects on a state's revenues, making it very difficult to predict the revenue effect of adopting combined reporting. This is due to the fact that combined reporting assumes that all members of the group have the same profitability per dollar of factors. This assumption contradicts both economic theory and business experience. The assumption is invalid for almost all taxpayers, not just corporations using tax planning strategies.
- Combined reporting replaces one set of distortions with another set of distortions. Combined reporting may reduce distortions in reported taxable income among related companies due to tax planning. However, combined reporting will simultaneously create new distortions related to the averaging effect for a large number of taxpayers with different profitability across businesses, with no tax planning. This fact should not be ignored in the evaluation of the benefits and costs of adopting combined reporting.
- Combined reporting cannot differentiate between real economic differences among taxpayers and the tax planning situations many intend for it to address. For this reason, a switch to combined reporting may have significant and unintended impacts on taxpayers and tax liabilities unrelated to tax planning.
- The type of filing system a state uses does not provide an explanation for the presence of zero or minimum tax filers. Proponents of combined reporting have frequently argued that combined reporting is justified by the significant percentage of corporate income taxpayers that pay no tax or pay only a state's minimum tax unrelated to corporate profits. The study finds that a high percentage of companies in both separate and combined filing states paid no corporate income taxes in excess of the minimum tax for the years reported.
- Reliably estimating the state revenue impact of adopting combined reporting is a very challenging task. Considerable uncertainty surrounds combined reporting estimates due to: the lack of needed information on separate filing returns, inability to identify members of the unitary group, absence of information on carryover net operating losses and unused credits into the new system, insufficient data to estimate changes in apportionment formulas, and the interaction of combined reporting with addback statutes and other measures previously enacted to address income shifting in many separate filing states.
- A review of past state revenue estimates of combined reporting reveals a wide range of expected impacts reflecting the high degree of uncertainty in the estimation process. States that looked at current tax return information as a starting point in the estimating process found lower impacts. The short-run impact of adopting combined reporting may be a relatively small increase or even no change in corporate income tax revenue. The one state that actually reviewed the initial estimates after implementation, Minnesota, concluded that combined reporting did not increase revenues at all in the short- or intermediate-run.
- States that have already enacted addback provisions can expect significantly reduced additional revenue from combined reporting. Addback provisions achieve much of the same revenue effect as combined reporting.
- Economic theory, empirical studies and economic simulation modeling all suggest that switching from separate filing to combined reporting will have a negative impact on a state's economy. If combined reporting increases tax revenues, it will also increase effective corporate income tax rates, on average, for the states' taxpayers. In response, firms will reduce the level of investment and jobs in states adopting combined reporting.
- Simple comparisons of aggregate state job growth rates, when adjusted to reflect population changes, show that separate filing states are doing no worse or slightly better than combined reporting states. Data on recent large investment projects across the states reinforce this conclusion. Comparisons of separate filing and combined reporting states show that the ratio of project-related jobs to gross state product is substantially higher for separate filing states.
- The additional compliance, administrative and litigation costs associated with combined reporting should be in-

cluded in a balanced evaluation of the benefits and costs of adopting combined reporting.

The analysis in this paper suggests that combined reporting is not a panacea for addressing the problem of how to determine accurately multistate business income that is attributable to economic activity in a state. From a business taxpayer perspective there is a significant risk that combined reporting will arbitrarily attribute more income to a state than is justified by the level of a corporation's real economic activity in the state. This will occur simultaneously with any gains from reducing tax planning opportunities.

State legislators should carefully evaluate the revenue, economic development, and tax policy impacts before adopting combined reporting. The revenue and economic impacts are complex and, in some cases, uncertain. Given this uncertainty, legislators should consider the range of options available for achieving their corporate tax policy objectives at a lower cost, while minimizing the unintended and negative consequences from combined reporting.

I. INTRODUCTION

Overview

One of the most controversial business tax policy issues currently debated by state legislators, tax administrators, and corporate taxpayers is how a state should determine the multistate corporate income tax base. This complex and controversial tax policy question has two separate, but closely related, issues that are central to this debate. The first is determining the total income attributable to the taxpayer and the second is determining the state's share of that total income.

Answering the first question is relatively straightforward in the case of a single, unaffiliated company doing business in a single state or in multiple states. The total income of the company is the tax base distributed across the states where the taxpayer is operating. It becomes more complex, however, when a parent company operates with a number of affiliates with economic activity in multiple states. In this case, states have historically taken two distinct approaches to determining income: separate filing and combined reporting.

In separate filing states, the parent company and affiliates are treated as separate companies in determining income. Each of the companies that a state is permitted to tax (companies with "nexus") files a tax return that includes only the income and factors of that company. In determining income, there is no merging of income or factors of the related companies.

In contrast, combined reporting states disregard separate legal business entities in determining income for corporate tax purposes.[2] The parent corporation and its affiliates that are engaged in a unitary business are treated as a single group in determining income.[3] In the process, the nationwide income and factors of the members of the unitary group are combined, as though they were operating as a single company.

The second key question, how should the total tax base be divided among these states, is answered using an apportionment formula that includes measurable, state-specific "factors" (payroll, property and sales) assumed to reflect where the firm's economic activity generating the income is located. For a single company, a weighted average of a state's shares of the taxpayer's factors (for example, instate payroll divided by U.S.-wide payroll) is applied to the taxpayer's business income to determine each state's share of the tax base. The apportionment formula approach is used for taxpayers with multistate business income in both separate and combined filing states.

Even with a single company as the taxpayer, there is some controversy and disagreement among the states over the measurement and weighting of the factors. For example, 18 states have adopted (or are phasing in) an apportionment formula that uses only the sales factor. In effect, these states take the view that only sales generate income. At the other extreme, 11 states have "traditional" apportionment formulas that apply a weight of one-third to the sales factor and two-thirds to the payroll and property factors combined. These states view payroll and property together as the most important determinants of where income is generated.

In the states with combined reporting, the apportionment formula is applied to the combined income of the unitary group to determine the distribution of nationwide income to a state. Compared to the separate filing method, the combined reporting apportionment formula includes the nationwide factors of the combined group in determining the state's share of factors. For example, with two affiliated corporations in a combined group, each company's share of payroll is calculated by dividing the company's instate payroll by the sum of the nationwide payroll for both members of the unitary group, rather than only the nationwide factors for one firm as calculated under separate filing. Each firm's weighted average of the apportionment factors is then multiplied by the group's combined income to determine each company's taxable income in a state. The sum of the taxable income amounts for the two firms equals the group's total income.

Issues related to combined reporting

The proponents of combined reporting focus on the combination of income dimension of mandatory combined reporting.[4] They argue that combined reporting is needed to offset erosion in the corporate income tax base attributed to tax planning strategies available to multistate corporations. Proponents argue that these strategies, such as the use of passive investment companies to manage intangible assets or the distortions in prices charged by one firm to other firms in the group (transfer prices), allow multistate corporations to

lower their tax liabilities by shifting income to affiliates in low-tax or no corporate income tax states. By combining income of affiliated companies in a unitary group, the adoption of combined reporting is viewed as one method of negating these shifts and making the group's tax liability independent of business structure.

The proponents of combined reporting also argue that it provides increased uniformity in the effective tax rates paid by companies that operate as multiple divisions rather than multiple corporations. Proponents expect single-company corporations to have fewer tax planning opportunities that reduce tax liabilities. It is also argued that combined reporting will reduce the administrative and compliance costs associated with monitoring transfer prices under separate filing systems.

While the proponents focus on expanding the taxable income of an affiliated group of taxpayers, there is less discussion or even awareness of the impacts of combining factors in moving from separate filing to combined reporting. Issues related to factor combination (the second question of how to distribute income among the states) introduce additional controversy into the debate that goes beyond the issue of how to define the taxpayer group and how to combine income. As discussed in this paper, these two issues are integrally interrelated.

The interaction of the two issues creates significant challenges and uncertainty in estimating the revenue impacts of adopting combined reporting and magnifies the potential negative impact on a state's economy from adopting combined reporting. More fundamentally, the interaction creates an actual or perceived disconnect in the link between the location of measurable, state-specific factors and the attribution of income to a state. This distortion adds even more controversy to the debate; while combined reporting is advocated as a method of more reliably measuring the income of a unitary business, it may not attribute this income to the state in which the economic activities that actually generated the income occur.

While the proponents focus on expanding the taxable income of an affiliated group of taxpayers, there is less discussion or even awareness of the impacts of combining factors in moving from separate filing to combined reporting.

Examples of the possible effects of combined reporting on state tax liabilities

The example provided in Table 1 may help to clarify this point by illustrating how combined reporting works. Company 1 and Company 2 are commonly-owned multistate corporations engaged in a unitary business operating in State A, which apportions multistate income based on an equally weighted, three-factor formula using payroll, property and sales.[5] Also assume that for non-tax reasons the two companies are operated as separate legal entities. Both companies have $10 million of annual sales and $1 million of net income.

Under *separate filing*, both firms file separate tax returns in State A as follows:

- Company 1 has 5 percent of each factor (payroll, property, and sales) in state A. With an equally weighted apportionment formula, the apportionment factor is also 5 percent. After apportionment, Company 1 has 5% of its $1 million of U.S. income or $50,000 taxable in the state.

Table 1
Example of Combined Reporting Reducing State Taxes
(dollars in thousands)

A. Separate filers **Company 1**	**US-wide**	**In-state**	**In-state share**
Sales	$10,000	$500	5.0%
Payroll	5,000	250	5.0
Property	5,000	250	5.0
Apportionment factor			5.0%
Taxable income	$1,000	$50	
Company 2			
Sales	$10,000	$5,000	50.0%
Payroll	1,000	500	50.0
Property	1,000	500	50.0
Apportionment factor			50.0%
Taxable income	$1,000	$500	
Total taxable income: separate		**$550**	
B. Combined report			
Sales	$20,000	$5,500	27.5%
Payroll	6,000	750	12.5
Property	6,000	750	12.5
Apportionment factor			17.5%
Taxable income: combined	**$2,000**	**$350**	
Change in taxable income			
Company 1		$22	
Company 2		-$222	
Total change		**-$200**	

- Company 2 has 50% of each factor in State A; after apportionment, $500,000 (50 percent) of its U.S. income is taxable in State A.
- The sum of the incomes taxable in State A is $550,000 under separate filing.

Assume that State A adopts combined reporting and Company 1 and Company 2 are members of a unitary group. (To simplify the example, assume that they do not have intercompany sales.) The combined nationwide income of the unitary group is $2 million, the sum of the separate company incomes. To determine each company's taxable income in State A, the in-state payroll, property and sales for each firm is divided by the total of the U.S.-wide factors summed over both firms, $20 million of sales and $6 million each for payroll and property. After weighting each factor by one-third, the combined apportionment factor is 17.5%. Multiplying the combined income of $2 million by 17.5% results in total income subject to tax in State A of $350,000, a reduction of $200,000.

The 36% reduction in taxable income from $550,000 to $350,000 can be explained in terms of the mechanics of combined reporting. When the two companies are combined two things happen: 1) they must include the combined income for both firms on their tax returns ($2,000 in this example), and 2) their apportionment factor is lowered significantly as the U.S.-wide factors of both firms are included in the denominator of the apportionment factors.[6] In both cases the income they report increases by 100 percent because each has the same amount of U.S. income. If the apportionment factor for both companies were reduced by exactly 50 percent, there would be no change in income apportioned to State A.

However, in this example Company 1 is bigger than Company 2 as measured by U.S. factors. As a result, when the two firms are combined, the apportionment factor for Company 2 falls by 72 percent. Because it falls by more than 50 percent, it more than offsets the doubling of income to be apportioned and Company 2's taxable income in State A falls by 44 percent to $278,000. In contrast, Company 1, because it has larger U.S.-wide factors, only experiences a 28 percent decrease in the apportionment factor following combination. This is too small a decrease to offset the doubling of U.S.-wide income, so taxable income for Company 1 rises by 44 percent to $72,000.[7] In effect, combination significantly "dilutes" the apportionment percentage for both companies by increasing the denominators of the factors, but the Company 2 reduction is 2.6 times larger. Because Company 2 has 50 percent of its factors in State A, compared to only 5 percent for Company 1, the 44 percent decrease in taxable income for Company 2 results in a greater dollar reduction in taxable income than the increase for Company 1 and total taxable income goes down under combined reporting.

Another way to understand why combined taxable income fell is to note that Company 2 is approximately 66 percent more profitable, per dollar of total U.S. factors, than Company 1. Because of the averaging of income per dollar of factors under combined reporting, the combination of the two firms lowers the income per dollar of in-state factors for Company 2 by 25 percent, while increasing the income per dollar of in-state factors for Company 1 by 25 percent. Because Company 2 accounts for 86 percent of the in-state factors, combined reporting lowers total taxable income attributed to State A.

There are a number of reasons why profits per dollar of factors vary across firms and states. The most important source of variation is the difference in ratios of value added to sales across companies and states. Value added is the additional value that a company adds to the products and services that it purchases from other companies. It measures the contribution of the companies' labor and capital to production.[8] Firms with high value added, such as manufacturers using significant amounts of real, personal and intangible capital, tend to have high ratios of income to factors. In contrast, retailers will have low value added (and income) relative to sales and other factors. This is why retailers are often referred to as low-margin businesses. There are also competitive and economic factors that influence the ratio of income to factors in different regions of the country.

Table 2 provides an example where combined reporting would have no impact on state taxes compared to a separate filing system. In this situation, the ratios of income to U.S. factors included in the apportionment formula are the same for both companies. Under combined reporting, the income apportioned to the state on the combined return is the same as the combined income of the separate filers even though their in-state apportionment factors are different because there is no change in income per dollar of in-state factors. In this example, the combined income to be apportioned is doubled and the apportionment factor for both companies is reduced by 50 percent. As a result, there is no change in State A taxable income. Combined reporting will not change taxable income (and taxes) attributable to these two firms overall. It will increase the tax on Company 1 and reduce the tax on company 2.

Table 2
Example of Combined Reporting with no Change in State Taxes
(dollars in thousands)

A. Separate filers

Company 1	**U.S.-wide**	**In-state**	**In-state share**
Sales	$10,000	$500	5.0%
Payroll	5,000	250	5.0
Property	5,000	250	5.0
Apportionment factor			5.0%
Taxable Income	$1,000	$50	
Company 2			
Sales	10,000	5,000	50.0%
Payroll	5,000	2,500	50.0
Property	5,000	2,500	50.0
Apportionment factor			50.0%
Taxable income	$1,000	$500	
Total taxable income: separate		**$550**	

B. Combined Report

Sales	$20,000	$5,500	27.5%
Payroll	10,000	2,750	27.5
Property	10,000	2,750	27.5
Apportionment factor			27.5%
Taxable Income: combined	$2,000	**$550**	
Change in taxable income			
Company 1		$0	
Company 2		$0	
Total change		**$0**	

Table 3 provides an example of the situation where combined reporting would increase taxable income apportioned to State A. In this case, Company 1 has significantly higher profits per dollar of U.S. factors than Company 2. In moving to combined reporting, the income each company is apportioning doubles. Because Company 1 is smaller (in terms of U.S. payroll and property), combination reduces its apportionment factor by 72 percent more than offsetting the higher income and reducing State A taxable income. In contrast, Company 2's apportionment factor only falls by 28 percent, resulting in a significant increase in Company 2's taxable income apportioned to the state. Because Company 2 has significantly larger in-state factors, the taxable income on the combined report increases. In this example, combination increases corporate income attributable to State A by $200,000 or 36 percent.

The example in Table 3 is generally the one that proponents of combined reporting have in mind when they present the case for switching from separate filing to combined reporting. Proponents often describe the more extreme case where Company 1 has no physical presence (as compared to a relatively small presence shown in Table 3) in State A, and therefore, is not a taxpayer in the state. This firm is often described as a Delaware intangible holding company receiving royalties from Company 2 for the use of intangible property. Combined reporting then results in Company 1's income being included on the return for Company 2, and the sum of the U.S. factors for both companies being included in the denominators of Company 2's apportionment factors. In this situation, combined reporting doubles the income reported on Company 2's return but only reduces Company 2's apportionment factor by 28 percent.[9] The net result is a 44 percent increase in Company 2's income apportioned to State A.

The proponents of combined reporting might argue that even in the situation shown in Table 3 (both companies are taxpayers) the profits per dollar of factors for Company 2 might be artificially reduced due to improper transfer pricing adjustments or other tax planning techniques. Conversely, they might argue that the income per dollar of factors is artificially inflated for Company 2. By combining income, any income shift between affiliates due to tax planning might be negated.

Table 3
Example of Combined Reporting Increasing State Taxes
(dollars in thousands)

A. Separate filers

Company 1	**US-wide**	**In-state**	**In-state share**
Sales	$10,000	$500	5.0%
Payroll	1,000	50	5.0%
Property	1,000	50	5.0%
Apportionment factor			5.0%
Taxable income	$1,000	$50	
Company 2			
Sales	$10,000	$5,000	50.0%
Payroll	5,000	2,500	50.0%
Property	5,000	2,500	50.0%
Apportionment factor			50.0%
Taxable income	$1,000	$500	
Total taxable income: separate		**$550**	

B. Combined report

Sales	$20,000	$5,500	27.5%
Payroll	6,000	2,550	42.5%
Property	6,000	2,550	42.5%
Apportionment factor			37.5%
Taxable Income: combined	**$2,000**	**$750**	
Change in taxable income			
Company 1		-$22	
Company 2		$222	
Total change		**$200**	

However, it is also possible that the income-factor differences actually reflect differences in relative profitability based on the economics of the two businesses with no tax planning involved. In the case where the differences are "real" (not created by tax planning opportunities), combined reporting will distort the distribution of taxable income and taxpayers could assert that by adopting combined reporting State A is arbitrarily attributing a portion of the income earned by factors and economic activity in other states to State A. This fundamental difference in perspective on the relationship between real economic activity, reported income and the mechanism for attributing multistate income to different states is one of the reasons why many taxpayers with diverse businesses strongly oppose the concept of combined reporting.

This fundamental difference in perspective on the relationship between real economic activity, reported income and the mechanism for attributing multistate income to different states is one of the reasons why many taxpayers with diverse businesses strongly oppose the concept of combined reporting.

It is also apparent that some state tax administrators and legislators do understand the different impacts on state corporate tax collections under combined reporting illustrated in the three examples. This understanding is evident in a bill introduced this legislative session in Alabama.[10] The bill would give the Commissioner of Revenue the authority to require a corporation to file a combined return if the ratio of the taxpayers profits (under separate filing) to profits of the combined unitary group is less than 50 percent of the taxpayers factors (payroll, property and sales) relative to the factors of the group. This arbitrary rule would have the effect of ensuring that the average income (profits) per dollar of in-state factor is increased with combination.

The exercise of this authority will increase Alabama tax collections, regardless of the presence of intercompany transactions, income shifting or economic differences in profitability among members of the unitary group. Because the bill does not allow taxpayers to elect combined reporting, it avoids any revenue losses from the example illustrated in Table 1 where the firm added to the group decreases both income per dollar of in-state factors and taxable income apportioned to the state. The bill is designed to raise revenue, not to create a fairer attribution of multistate taxable income to Alabama.

Insights provided by the three simple examples include:

- Independent of any intercompany transactions that could distort taxable income between the two companies, the examples show that under different circumstances mandatory combined reporting could result in reduced, unchanged, or increased income taxable in a state. The outcome is dependent on the level of each company's income, total U.S. apportionment factors, and state apportionment percentages under separate filing. Changes in the relative levels of these factors can result in seemingly arbitrary assignment of income to a particular state.
- The example that shows combined reporting reducing a state's taxable income (and taxes) may not be intuitively obvious, but it is a result of the fundamental assumption underlying combined reporting. The assumption is that both of the companies in the combined group are equally profitable for each dollar of their factors. In other words, each dollar of capital equipment (property), labor costs (payroll) or sales is assumed to generate the same level of profits in both companies.

  The proponents of combined reporting argue that this is a reasonable assumption because it is not possible to determine where corporate net income is generated for a group of unitary companies. However, economists would assert that income, a payment for the use of capital, varies depending upon the amount of equity capital used in each company. The combined reporting assumption that the profitability of the two firms is the same, when economic theory and fact conclude otherwise, illustrates the disconnect between economic reality and the operation of the state corporate income tax system.[11]

  In effect, combined reporting based on this averaging assumption creates distortions in the distribution of taxable income among firms and across states that are unrelated to business economics. This is a result similar to the situation where distortions in transfer prices may result in the distribution of income across states unrelated to real economics. While combined reporting may reduce distortions related to tax planning, it will have the effect of creating new distortions related to the averaging effect. This fact should not be ignored in the evaluation of the benefits and costs of adopting combined reporting.

  The key point is that combined reporting cannot differentiate between the examples reflecting real economic differences and the tax planning situations it intends to address. For this reason, a shift to combined reporting

The combined reporting assumption that the profitability of the two firms is the same, when economic theory and fact conclude otherwise, illustrates the disconnect between economic reality and the operation of the state corporate income tax system.

may have significant and unintended impacts on taxpayers and tax liabilities unrelated to tax planning. Legislators need to be aware of this problem and consider alternatives for dealing with the shifting of income through tax planning opportunities that do not have these unintended consequences caused by combined reporting.

- To estimate reliably the revenue impact of adopting combined reporting, estimators would have to know which companies would be combined and all details related to their apportionment factors and incomes. For example, in Tables 1-3, if Company 2 was not a taxpayer in State A under separate filing, the needed information would not be available from State A tax return information. This helps explain why estimating the revenue impact of combined reporting is so difficult. (This is discussed in detail in a later section.)

... a shift to combined reporting may have significant and unintended impacts on taxpayers and tax liabilities unrelated to tax planning.

No-tax or minimum-tax returns

Proponents of combined reporting have frequently argued that combined reporting is justified by the significant percentage of corporate income taxpayers that pay no tax or pay only a state's minimum fee or tax. To many legislators, these appear to be surprisingly large numbers of taxpayers. It is often suggested by proponents of combined filing that this results from tax planning opportunities in separate filing states. What has been overlooked is how many taxpayers in combined reporting states also pay no tax based on income or only minimum taxes unrelated to a taxpayer's income.

Table 4 provides a broader perspective on the issue of taxpayers that have no positive income tax liabilities beyond minimum taxes. Collection information on the components of corporate tax liabilities that address this issue is available from a number of state tax agencies. Table 4 presents information on the number of returns that have zero or only minimum tax liabilities in both separate filing and unitary combined filing states. Minimum taxes may be, for example, fixed dollar amounts, sliding scale taxes based on the level of factors (payroll, property and sales), or other non-income measures. The table also shows the tax year for the reported data.

In order to make interstate comparisons, the last column reports the percentage of total corporate income tax returns that report zero or only minimum tax liabilities. The interesting insight from the percentages shown in the last column of Table 4 is the similarity in the range of percentages for combined and separate return states. The combined reporting states have zero or only minimum tax percentages that range between 44.5 and 71.2 percent; the range for separate return states is 50.1 to 71.9 percent. The percentages in Table 4 show that at least 45 percent of the taxpayers in both separate and combined filing states paid no corporate income taxes in excess of the minimum fee for the years reported, including the years of significant corporate tax growth following the 2001 recession. Note that Utah, a unitary state, and Pennsylvania, a separate filing state, both have no-or-minimum tax percentages exceeding 71 percent.[12]

Table 4
State Corporate Income Tax Returns with State No Liability or Only Minimum Taxes

		Returns with minimum tax or no income tax	
State	**Year**	Number	% of total
I. Combined returns			
California	2005	163,712	49.0%
Kansas	2005	17,645	56.7
Minnesota	2001	23,321	44.5
Nebraska	2005	11,342	56.3
Utah	2005	14,981	71.2
II. Separate returns			
Massachusetts	2004	32,645	53.5%
North Carolina	2004	52,788	65.5
Ohio	2006	45,353	50.1
Pennsylvania	2002	100,448	71.9
Virginia	2005	46,998	63.3
Wisconsin	2004	33,883	65.1

While the simple average percentage of taxpayers paying no more than the minimum fee is slightly higher in the separate filing states, it still exceeds 55 percent in combined reporting states. Clearly, this commonly high level of taxpayers with only zero or minimum payments cannot be explained by tax

planning opportunities in either type of reporting system.[13] Instead, they are explained by economic and other tax system features including the presence of significant carryforward losses, a large number of inactive corporations in all the states, regulatory registration requirements, and the share of businesses with income less than state exclusions and deductions and with before-credit tax liabilities less than credits. The exclusions, deductions and credits that reduce or eliminate regular tax liabilities have been adopted by legislators to achieve non-revenue objectives, including stimulating capital investment and new job creation in a state.

Clearly, this commonly high level of taxpayers with only zero or minimum payments cannot be explained by tax planning opportunities in either type of reporting system.

The important point for emphasis in the corporate income tax policy debate is that a majority of corporations in the states included in Table 4 (excluding Minnesota and California) do not have income tax liabilities in excess of minimum taxes. State tax agencies could do a better job of explaining to legislators the reason for these apparently high percentages that are independent of the type of state filing system.

State tax agencies could do a better job of explaining to legislators the reason for these apparently high percentages ...

II. REVENUE EFFECTS FROM ADOPTING COMBINED REPORTING

This section looks at the experience of state revenue estimators in tackling the very challenging task of estimating the revenue effects of switching from separate to combined reporting. The central problem is that corporate tax returns in separate filing states do not contain sufficient information to estimate reliably the revenue impacts of adopting mandatory combined reporting. In separate filing states, only the U.S.-wide net income and apportionment factors of the separate multistate taxpayers are available from state tax return information. In many cases even the data that is reported on corporate tax returns is not captured during the processing of corporate returns because of resource limitations in state tax agencies.

Given this lack of information from state tax returns, revenue estimators must supplement actual state-specific tax return information with data from other sources that may have limited applicability to the state considering combined reporting or may provide only partial state-specific information that is difficult to extrapolate to the population of state taxpayers. The alternative sources of information that have been used in different states include:

- Federal tax return information for consolidated federal returns that include state taxpayers in the consolidated group.
- Tax return information from unitary states that may partially match actual taxpayers filing separately in the state preparing the combined reporting revenue estimate.
- The experience of a state's auditors in challenging transactions or structures under the state's current separate income tax filing system.
- Revenue estimates prepared by other states that are applied to the estimating state using ratios of tax return information combined with comparisons of state economic variables.

The following discussion highlights the difficulties in producing reliable estimates under the various approaches. The discussion of the key issues challenging all revenue estimators is followed by a summary of specific state estimates of the expected impact of adopting combined reporting. The evaluation is not a critique of revenue estimators, but rather a reflection of the lack of information for reliably estimating the revenue impacts of adopting a different corporate income tax system.

A. Factors affecting revenue impacts

This section identifies several of the most important data limitations that increase uncertainty in the revenue estimates of the impact of combined reporting.

Identifying members of a unitary group

Mandatory combined reporting requires affiliated companies in a unitary group to file a combined return. Unfortunately, combined reporting laws do not provide specific details on what constitutes a unitary relationship among related companies. Consequently, it is left to revenue agency regulations and court decisions, only available after the adoption of combined reporting, to offer guidance on how to define a unitary business. Revenue estimates of the switch to combined reporting have to be made without this guidance. This is an important source of the uncertainty in the revenue estimating process.

Under the combined reporting concept, there are two independent tests that must be met before an entity can be included in a combined report. First, only firms that meet minimum ownership requirement thresholds are to be included in the group filing a combined return. Typically, the group includes firms with at least fifty percent common ownership. However, there is little, if any, information on state separate tax returns or attached state-required versions of federal corporate tax returns to identify firms that may be included in a unitary group if they meet the ownership test. Because federal consolidated returns use an 80 percent ownership test, members of the federal consolidated group do not, in many cases, match the potential members of a state combined group.

The second test for being included on a combined report is that the included firms must have a unitary relationship, which is a constitutional requirement. In other words, definite economic and managerial interactions must provide a link between the members of the group. States are constitutionally limited to including only the companies that have a unitary business connection among the firms in the state combined group. Even if members of the federal combined group are identical to a state's common ownership group, some members of the federal group may not meet the state's unitary requirement. As discussed in the section on compliance costs, there is significant uncertainty over the factors that determine a unitary relationship among members of a group meeting the ownership requirements. Determining the unitary group of taxpayers is a difficult first step in the estimation process.

Net operating losses

A key factor in determining the change in revenue from adopting combined reporting is the treatment of net operating losses (NOLs). Consistent with the underlying theory that is used to justify the combination of a unitary group's income, combined reporting should also allow any NOLs earned by separate members to be aggregated and used to offset the group's combined income going forward. However, this consistent treatment of NOLs can result in a significant reduction in the unitary group's taxable income in the transition from separate to combined reporting. This occurs because combination can convert unused NOLs (for separate filers) into current "used" deductions against the combined net income of the unitary group. In other words, a greater amount of NOLs can be used earlier to offset current positive taxable income. While this is a transition issue for carryovers from the separate filing system, it can have a significant impact on the estimated revenue impacts of adopting combined reporting.

For example, under separate filing each affiliated company is restricted to deducting only carryforward NOLs or current-

... combined reporting should also allow any NOLs earned by separate members to be aggregated and used to offset the group's combined income going forward.

year losses that they generate. In other words, the NOLs from a subsidiary cannot be used to offset the taxable income of the parent company under separate filing. Under combined reporting, the NOLs and current losses may be used to offset the combined income of the affiliated group. In effect, combined reporting is likely to increase the amount of NOLs that effectively offset net income and reduce corporate income tax collections. As discussed in the state case studies in the Appendix, one of the most significant challenges in estimating the net revenue impact of combined reporting is determining the negative impact of future and previously accumulated NOLs on the combined unitary income base. The revenue impacts of adopting combined reporting are heavily influenced by the treatment of NOLs under combined reporting. This is particularly important when the economy is experiencing a sharp economic slowdown or a recession.

State corporate income taxpayers have accumulated large net operating losses over the last decade. For example, as reported in annual reports of the California Franchise Tax Board, annual losses reported on state corporate returns grew significantly faster than reported profits from 1997 to 2001; as a result, the ratio of losses to profits increased from 35 to 81 percent over the four-year period. Since the end of the recession in 2001, losses have continued to average over 50 percent of profits. To the extent that corporations taxable in states currently considering adopting combined reporting have experienced a similar surge in annual losses, the cumulative stock of NOLs may substantially reduce expected revenue or even result in an initial revenue loss from adopting combined reporting.

Assuming that taxpayers in a separate filing state are allowed to carry forward unused NOLs to future years, switching to combined reporting should provide the same carryforward treatment. However, because combined reporting treats the affiliated companies as a single corporation, any carryforward NOLs from separate returns should be allowed to offset the income of the combined group, not just the income of the entity generating the NOLs under separate filing. Any limit on the use of the carryforwards would be inconsistent with the rationale for requiring combined reporting.

The following example illustrates the possible negative impact of NOLs on state corporate income tax collections. Two subsidiaries and a parent company operate as part of a verti-

cally integrated company. State A that is adopting combined reporting has a 100% sales factor apportionment formula. It is also assumed that the manufacturing and sales distribution companies have nexus in State A; the parent's headquarter company does not.

- The manufacturing subsidiary has net income of $50 and sells 50% of its output to a sales distribution subsidiary located in State A.
- The sales distribution subsidiary has net income of $50 and sells 50% of the company's final product in State A and 50% to final customers in other states.
- The parent company has operating losses of $60 based on economic activity unrelated to the subsidiaries and sales to final customers outside of State A.

Under separate filing, the two subsidiaries are taxpayers in State A. With 50 percent of their sales in the state, they both have 50 percent apportionment percentages in State A, and the sum of their taxable incomes attributable to State A is $50.

Any limit on the use of the carryforwards would be inconsistent with the rationale for requiring combined reporting.

If State A adopts combined reporting, the sales factor for the combined group excludes intercompany sales and is equal to sales to unrelated parties for the three companies ($700 in State A and $1,500 in the U.S.) by the sales and distribution subsidiary in State A.[14] However, the income of all three companies is combined for a total of $40 of income. The income loss of the parent company, which does not have nexus in State A, is included in the combined group U.S. income amount, resulting in $60 less of U.S. net income subject to apportionment to State A.[15] Despite the fact that the apportionment factor remains the same under separate and combined reporting, the inclusion of losses held in the parent company reduces income taxable in State A by 60%.[16]

Tax revenue estimators have limited information on the carryover stock of NOLs for existing taxpayers. Even if reported on tax returns, this information may not be captured when returns are processed. More importantly, the unitary group will normally include corporations that are not current taxpayers, since it includes non-nexus companies. Revenue estimators will have no information on the carryovers for these firms.

Table 5
How Net Operating Losses May Reduce Taxable Income Under Combined Reporting

	Sales factor		Apport.	Taxable income	
Filing system	US	State A	factor	US	State A
Separate filing					
Manufacturing subsidiary	$1,000	$500	50%	$50	$25
Sales/distribution subsidiary	1,400	700	50	50	25
Headquarters	100	-	-	-60	-
Separate filing income					**$50**
Combined filing					
Manufacturing subsidiary	$1,000	$500		$50	
Sales/distribution subsidiary	1,400	700		50	
Headquarters	100	-		-60	
Eliminate intercomp. sales	-1,100	-500			
Total for combined group	$1,400	$700	50%	$40	**$20**
Change in taxable income					**-$30**

Apportionment factors

Even if the net income of a unitary group is measured accurately, it is difficult for estimators to measure the apportionment factors of members of the unitary group that are not currently state taxpayers. Mandatory combined reporting requires that the group's net income be apportioned to the combined filing state based on the state's share of the group's factors that include a weighted average of the state's share of payroll, property and sales or a single sales factor. Separate filing states are generally limited to knowing only the in-state share of factors for each separate filer without having information on intercompany sales between members of the combined group. In addition, if a unitary group includes companies that are not current state taxpayers, revenue estimators may have no information about the factors of the non-nexus members of the combined group. As shown in the examples included in this study, small errors in the estimates of the apportionment factor can have large impacts on revenue estimates.

Addback statutes

As illustrated in several of the case studies, there can be substantial differences in the expected additional revenues from combined reporting depending upon whether or not a separate-filing state has already adopted expense addback provisions for royalties and expenses related to payments to affiliates for the use of intangible property and, in some states, for interest payments to affiliates as well. States with addback provisions already collect a portion of the revenue normally

States with addback provisions already collect a portion of the revenue normally expected from adopting combined reporting.

expected from adopting combined reporting. The revenue estimates should not double count this revenue. There are now 22 states with various forms of addback statutes.

B. Case studies of combined reporting revenue impacts

This section summarizes the revenue estimating experience of states that either have adopted combined reporting or have recently considered the adoption. The Appendix provides more detailed information about the revenue estimates and lessons learned from the estimating process.

Table 6 presents the results of this state-by-state review. The table identifies both the estimated annual revenue impacts and the percentage change in corporate income taxes from adopting combined reporting. Where available, the estimates represent the first full-year impacts of the change in tax collections in switching from separate filing to combined reporting. The comments in the last column of the table identify issues that are specific to a state and that may, therefore, limit the application of the results to other states.

Table 6
State Revenue Estimates of the Impact of Combined Reporting

State revenue estimates	Annual impact (millions)*	Percent of corporate income taxes	Year estimate was prepared	Comments
Iowa	$75	16.7%	2007	Permits consolidated filing
Maryland	25	3.0	2007	Addback of expenses
Massachusetts	188	8.9	2007	Addback of expenses; methodology not described
Minnesota – initial est.	23	5.5	1981	Low end of estimated range
Minnesota – revised est.	–	–	1984	Short-run, post-implementation
New York	315	6.0	2007	Addback of expenses
New Mexico	90	20.0	2008	Permits comb./ consol. election; methodology not described
Pennsylvania	150	7.9	2004	With uncapped NOLs
West Virginia	24	10.0	2007	Methodology not described
Wisconsin	30	3.5	2007	Est. for non-bank taxpayers

*For the first full-year of tax impacts, where available.

The individual state studies provide important insights and lessons related to estimating the revenue impacts of adopting combined reporting. The following highlights summarize the detailed, state-by-state descriptions of revenue impact analyses presented in the Appendix.

High Degree of Uncertainty of Revenue Impacts

There is a very large range of estimates of the revenue impacts across the states as shown in the table. For analyses prepared at the time of the adoption of combined reporting, the percentage increases range from 3 percent of corporate tax revenue in Maryland to 20% percent in New Mexico. While states do differ in the structure of their corporate income taxes and the composition of their economies, this unusually wide range illustrates the inherent uncertainty in estimating these impacts.

It should be noted that bill analyses for three of the high-end estimates of the percentage increase in corporate taxes from adopting combined reporting (Massachusetts, New Mexico and West Virginia) do not provide a description of the methodology used to estimate the impacts. The estimates based on detailed analyses of corporate tax return data or information from state tax auditors (New York, Pennsylvania and Wisconsin, for example) report significantly lower impact estimates. Several of the bill analyses (Maryland and Minnesota) actually note that the impacts cannot be reliably estimated.

In addition, this wide range in the net impacts masks substantially larger potential errors in the tax increase and tax decrease components of the estimated net change. Small errors in estimating both increases and decreases can have large impacts on the net change revenue estimates. As explained in the discussion of Pennsylvania's estimates in the Appendix, if tax increases were overestimated by 10 percent and decreases underestimated by 10 percent, the Pennsylvania estimate of the combined reporting impact would drop by 60 percent. In this case, the additional revenue from combined reporting would drop from 7.9 percent as reported in Table 6 to a little over 3 percent.

... this wide range in the net impacts masks substantially larger potential errors ...

The important point is that the size of the potential errors should be made clearer in the estimation process, especially if legislators are relying on the adoption of combined reporting to close state tax revenue gaps due to the current economic slowdown. As an example, the Minnesota bill analysis pointed out to lawmakers that the estimated switch to combined

reporting was expected to raise between $23 and $103 million, an unusually large range for a bill analysis. As explained below, the actual results in Minnesota were closer to a zero increase.

Shorter-run revenue increases could be very small

Only one state, Minnesota, conducted an analysis of the revenue impacts of adopting combined reporting after implementation of the law change. Using actual tax return data, Minnesota researchers compared initial taxes paid under combined reporting with estimates of the sum of taxes that would have been paid by members of the combined group if separate filing had continued. The comparison found that, for the first tax year under combined reporting, tax collections actually decreased. Instead of collecting 15% more in taxes as predicted in the bill analysis, state taxes fell 9% with the adoption of combined reporting.

After analyzing additional tax return data, the researchers concluded that the short-to-intermediate impact was no change in corporate tax revenue. A major reason for this unexpected result was the fact that combined reporting "unlocked" net operating losses (NOLs) that previously could not be claimed on separate returns. In the transition, the NOLs actually reduced the income tax base.

Instead of collecting 15% more in taxes as predicted in the bill analysis, state taxes fell 9% with the adoption of combined reporting.

As illustrated by Pennsylvania's experience, the revenue estimates are very sensitive to the treatment of NOLs under combined reporting. In the Pennsylvania estimates, full allowance of NOLs (both carried in from the separate filing system and earned under the combined reporting system) reduced the expected additional revenue from combined reporting by 64 percent; for manufacturing, the reduction was 80 percent. In addition, revenue estimators often are asked to estimate the impact of combined reporting proposals that do not clearly specify the NOL treatment. Combined with the lack of information about the accumulated stock of NOLs, this creates significant uncertainty in the estimation process.

As the U.S. economy continues to slow in early 2008, corporate profits are declining and net losses in selected industries may increase significantly. As a result, NOLs will becoming increasingly more important in determining the shorter-run revenue impacts of switching to combined reporting. This will add further to forecasting risk.

Even if the longer-run estimates of revenue impacts from adopting combined reporting are reliable, states lack sufficient information to determine the time profile of the revenue response as taxpayers adjust to combined reporting. As shown in the Minnesota case, little additional revenue may be collected in the short-run, an adjustment period that may cover several years. This creates an additional fiscal risk for legislators who view combined reporting as a short-run, budget-balancing component.

This creates an additional fiscal risk for legislators who view combined reporting as a short-run, budget-balancing component.

Addback provisions substantially reduce revenue impacts

Approximately 20 states have adopted various add-back provisions that deny income tax deductions for selected expenses paid to affiliates for the use of intangible assets. Of this group, 16 are separate filing states. The addbacks have the effect of increasing the taxable income of separate filers in the state by the amount of the disallowed deductions without requiring combined reporting. These provisions, therefore, reduce the additional revenues expected from adopting combined reporting.

For separate filing states with add-back provisions, the percentage increase in corporate taxes shown in Table 6 averages 5.9 percent; for New York and Maryland, the average is 4.5 percent. The revenue impact estimates in Maryland, for example, suggest that the adoption of expense add-back provisions reduced the additional revenue from combined reporting by approximately by roughly 55 percent.

Based on this experience, it is reasonable to conclude that the large number of separate filing states with add-back provisions can expect additional intermediate- or long-run corporate income tax collection increases of no more than 5 percent in shifting from separate to combined filing.

Each state's experience is unique

In considering the use of revenue impact ratio estimates for combined reporting from other states, tax researchers must carefully consider the unique tax system features and tax compliance issues in each of the other states. For example, Wisconsin estimated that combined reporting would increase corporate tax collections by 10.5 percent. However, an estimated 75 percent of the total was from banks. Because many states tax banks under separate tax systems from gen-

eral corporate taxpayers, the Wisconsin ratio is not applicable in these other states. Adjusted to remove banks, the Wisconsin ratio was 3.5 percent, the figure shown in Table 6.

A related point is that the members of a combined unitary group may vary across states and will differ from the corporations included on federal consolidated returns. States may use different ownership tests for affiliation, as well as different concepts for determining a unitary relationship among affiliated corporations. These differences greatly limit the applicability of federal or other state tax return information in the estimation process.

Revenue estimates do not consider negative impacts on the economy

All of the revenue estimates reviewed in this study are static revenue estimates. In other words, the estimates assume that there will be no change in the level of economic activity or corporate tax bases in response to the adoption of combined reporting. However, as discussed further in the next section, combined reporting will increase the taxes paid for many corporations operating in a state. In response to higher taxes, these corporations can be expected to reduce their level of investment in the state. This results in a negative feedback effect in the form of reduced state and local taxes from all sources, not just corporate income taxes. If this dynamic tax effect is included in the revenue estimates, the net impact of combined reporting on state tax collections may be substantially reduced from the static revenue impacts reported in Table 6.

In response to higher taxes, these corporations can be expected to reduce their level of investment in the state.

III. IMPACTS OF COMBINED REPORTING ON A STATE'S ECONOMIC COMPETITIVENESS

Some proponents of combined reporting suggest that the shift from separate to combined reporting would not have any negative impact on a state's economy. For example, after citing manufacturing job growth performance in selected combined states and anecdotes about corporation investment decisions, one proponent suggests "that the burden of proof ought to lie with combined reporting opponents to demonstrate that the policy has a negative impact on state economic growth."[17] In legislative testimony focusing on combined reporting in 2005, the Secretary of the Pennsylvania Department of Revenue stated: "There is no evidence that adoption of combined reporting has a negative effect on a state's ability to attract employers. In fact, by some measures combined reporting states have actually done better economically than separate company states."[18]

Measuring the impact of a single tax policy change, such as adopting combined reporting, on a state's economy is, in fact, difficult to do. The basic problem lies in the inability to account for "all other factors" that are changing simultaneously and affect a state's economy. These factors include changes in the U.S. economy, changes in the composition of economic activity within a state, and changes in tax policies in other states. This is why simple comparisons of groups of states on a single economic measure, such as manufacturing job growth, cannot "prove" that the policy change has had either a positive or a negative impact on an economy.

This section discusses several different approaches to identifying the economic impacts of combined reporting. These different approaches suggest that combined reporting may have a negative impact on a state's economy. The approaches include predictions derived from economic theory, the simulation of corporate tax changes using state economic models (which attempt to hold other factors constant), empirical studies of the response of economic activity to changes in business tax rates, and an expanded comparison of state job growth rates.

... simple comparisons of groups of states on a single economic measure, such as manufacturing job growth, cannot "prove" that the policy change has had either a positive or a negative impact on an economy.

A. How does combined reporting affect a state's competitiveness?

Proponents of combined reporting focus on the increase in the corporate income tax base that they anticipate from eliminating income-shifting opportunities under separate filing tax systems. The expectation is that combining income of affiliated corporations will negate any tax-related shifts in income among states due to transactions or restructuring that are unrelated to the on-going business operations in a state. However, this perspective assumes that combined reporting can achieve revenue-raising objectives without having a significant negative impact on the level of payroll, property and sales in a state. In other words, this perception assumes that any income-shifting activity has no real economic substance

and negating these shifts will have no impact on a state's real economy. This is not correct. In fact, a shift to combined reporting can have substantial negative impacts on the real economy.

... a shift to combined reporting can have substantial negative impacts on the real economy.

As shown in the taxpayer example in Table 3, adopting combined reporting may actually increase effective corporate income tax rates even in cases where there is no tax planning that distorts income. This occurs when the income per dollar of factors used in the apportionment formula is higher for the additional firms added to the combined group compared to the ratio for the original separate filing company. In this case, combination increases income to be apportioned by a greater percentage than the decrease in the apportionment factor and state tax payments increase. Compared to the income earned by the separate filing company, this increases the effective tax rate on additional investment in the state adopting combined reporting. It is also possible that the move to combined reporting could decrease effective tax rates, but if state revenue estimators score the legislation as a tax increase, then effective tax rates on average must also be assumed to increase.

Enactment of combined reporting will increase effective tax rates on some new investment and may trigger redistributions of investments and jobs among states, independent of any reduction in tax planning opportunities. As pointed out in the discussion of the revenue estimates, even if combined reporting results in a relatively small increase in net corporate taxes, there will be significant firm-level increases and decreases in tax liabilities. Depending upon the industry distribution of winners and losers and the overall size of the net tax increase, adopting combined reporting may have a negative impact on a state's overall economy.[19]

If the increased tax liabilities are imposed on multistate firms sensitive to interstate effective tax rate differences, combined reporting may result in a reduction in the level of investment and jobs in a state. The companies most affected would be those that sell products or services in national or international markets and use significant amounts of mobile capital. These are firms that will have a limited ability to pass higher taxes on to customers in higher prices but do have the option of shifting capital and jobs to locations with lower state tax rates.

To the extent that combined reporting increases a state's taxes (relative to other states) and reduces the after-tax rate of return on mobile investments, it can negatively impact a state's real economy. The higher corporate taxes directly lower the after-tax rate of return on the firm's operations in the state. In response, the firm is likely to shift payroll, property, and even sales to other states to reduce the percentage of total combined income subject to the higher tax rate. This shift will continue until output prices increase or the number of workers or the amounts paid to workers and capital in the state fall enough to increase the firm's before-tax net income from operations in the tax-increase state.

The shifting process ends when the after-tax rate of return is restored to a competitive level. Note that the adjustment process results in reduced employment, investment, and overall economic activity in the state. These are changes in real economic activities, not just changes in a state's share of a fixed level of the taxpayer's U.S.-wide corporate income. Economic theory suggests that the combination of relatively fixed in-state labor and increasingly mobile capital (including intangibles, machinery and equipment, and structures) across state and national borders will result in corporate tax increases being borne by labor in the state through fewer jobs (or lower wages over time) or by in-state consumers through higher prices for goods and services.[20] In other words, the burden of the higher corporate taxes will fall primarily on the residents of a state, not on capital investors.

... the burden of the higher corporate taxes will fall primarily on the residents of a state, not on capital investors.

B. Tax simulations of impacts of corporate income tax changes

State tax policy simulation model analysis also suggests that a shift from separate to combined reporting for corporate income taxes can reduce the level of jobs and investment in a state. In a recent study, E&Y estimated the potential economic and fiscal impacts of adopting combined reporting in Maryland.[21] Policy options that E&Y was asked to analyze included a corporate income tax increase and a shift to combined reporting.

The first step in modeling the expected economic impacts is to estimate the increase in tax liabilities from combined reporting (the "static" revenue impact). E&Y used the $25 million impact estimate reported in the fiscal note prepared by the

... a shift from separate to combined reporting for corporate income taxes can reduce the level of jobs and investment in a state.

Maryland Department of Legislative Services described earlier. Starting with the $25 million net change, E&Y distributed the change by industry. The estimated revenue impact for each industry was then used as inputs into an economic model of Maryland's economy.[22] The model incorporates empirical estimates from the economic literature on the response of investment and employment to changes in the cost of investing (cost of capital) in the state. The economic model was used to translate the change in each industry's cost of capital (equal to the change in tax liabilities) into changes in economic output, income, and jobs recognizing the complex interactions of all the sectors in Maryland's economy.

The results of the simulation show that the negative impact of adopting combined reporting on the Maryland economy, in terms of lost jobs per dollar of increased tax revenue, is actually slightly larger than the negative job impact from increasing the corporate income tax rate. This difference is primarily due to differences in the distribution of net tax changes by industry between rate changes and adopting combined reporting.

These results are consistent with recent empirical studies of the impact of business tax changes on state economies. As summarized by a nationally-recognized public finance economist, "... the majority view among economists is that the long-run effect of a 10 percent cut in state and local business taxes, holding other effects on business location constant, is to raise business activity in a state by about 2 percent."[23] Conversely, if combined reporting raises net business taxes by 10 percent, economic activity would fall by 2 percent, based on this "elasticity" of response. The negative impact on jobs will vary with the composition of a state's economy and the size and industry distribution of winners and losers.[24]

C. Expanded interstate growth comparisons

As already noted, some proponents of combined reporting have suggested that adopting combined reporting may not have a negative impact on a state's economy. This conclusion is sometimes based on simple comparisons of economic growth between states with unitary combined reporting and separate filing. Such comparisons are an oversimplification that does not hold constant key economic and demographic factors that determine differences in state growth rates. For example, prior trends, tax policy, or demographic factors could not have predicted the growth of Silicon Valley in California in the 1990s.

Job growth comparisons

Table 7 illustrates the limitations of this simple comparison approach in trying to identify the impact of combined reporting on a state's economy. The table provides a high-level comparison of private-sector job growth rates for separate filing and combined filing tax states. Unlike the comparisons of changes in manufacturing jobs only that have been used to evaluate the economic performance of combined and separate filing states, the employment data in the table cover all private-sector employees including the fast-growing financial and service sectors of the economy. The 24-year period covers the years between the adoption of combined reporting in Minnesota and Illinois and the first effective year of Vermont's adoption of combined reporting.

The first column in Table 7 shows the private-sector employment growth rate between 1982 and 2006. The second column shows population growth over the same period. The third column shows the difference between the employment and population growth rates. For example, in California, the employment growth rate (67 percent) exceeded the population growth rate (47 percent) by 20 percentage points. The weighted average growth rate differences are reported at the top of the combined reporting and separate filing state groups.

Even a cursory state-by-state comparison of the job and population growth rates indicates that the difference in the job growth rates between combined reporting and separate filing states is due primarily to the region in which a state is located, not its corporate income tax structure. The second column in Table illustrates this point. The combined states have aggregate population growth ratios that are almost 63 percent higher than the rate for separate filing states.

The subtraction of population growth in the third column is a simple way to "control" for other state-specific growth factors that are not directly related to corporate taxation. A comparison of the aggregate growth rate differences suggests that job growth (relative to population growth rates) has been about 6 percent higher in the separate filing states. The use of population growth as a single measure of all the complex factors explaining changes in a state's private-sector employment is a vast oversimplification. However, it does show that adjusting job growth measures for population changes provides additional insight into the source of differences in interstate job growth.

Table 7
Job Growth by State, Combined and Separate Filing States (1982-2006)

State	Employment growth	Population growth	Employment/ population growth
Combined Total:	**72%**	**39%**	**33%**
Alaska	76	49	27
Arizona	174	113	61
California	67	47	20
Colorado	90	55	35
Hawaii	69	43	26
Idaho	129	51	79
Illinois	42	12	30
Kansas	50	15	35
Maine	63	16	46
Minnesota	73	25	48
Montana	79	17	61
Nebraska	60	12	49
New Hampshire	79	39	40
North Dakota	50	-5	55
Oregon	93	39	54
Utah	146	64	82
Separate Filing Total:	**59%**	**24%**	**35%**
Alabama	68	17	50
Arkansas	71	23	48
Connecticut	29	12	18
District of Columbia	39	-8	48
Delaware	82	42	40
Florida	124	73	51
Georgia	108	66	43
Indiana	56	15	41
Iowa	50	3	47
Kentucky	62	14	48
Louisiana	26	-1	27
Maryland	79	31	48
Massachusetts	37	12	26
Michigan	52	11	41
Mississippi	54	14	40
Missouri	52	19	33
New Jersey	44	17	27
New Mexico	91	53	38
New York	29	10	19
North Carolina	86	47	39
Ohio	43	7	36
Oklahoma	31	29	1
Pennsylvania	37	5	32
Rhode Island	35	12	23
South Carolina	76	35	41
South Dakota	88	13	74
Tennessee	81	30	51
Texas	71	12	60
Virginia	91	39	52
Vermont	68	20	48
West Virginia	28	-7	34
Wisconsin	61	18	44

Note: Controlling for population growth, job growth is nearly the same from 1982 to 2006 for combined reporting and separate filing states.

... job growth ... has been about 6 percent higher in the separate filing states.

Regression analysis

The job and population growth information from Table 7 was further analyzed using linear regression analysis. The regression analysis related the state-by-state job growth numbers to differences in population growth rates, average levels of private-sector wages and a variable that identifies combined reporting states.[25] After accounting for the other factors, the coefficient on the combined reporting variable is not significantly different from zero. In other words, this equation using highly-aggregated data does not find an independent impact of combined reporting on state job growth for all states combined.[26]

D. Recent state-by-state data on investment trends

A final source of information for comparing the economic performance of states with combined and separate reporting is E&Y's annual 50-state study of new capital investment and new and retained jobs for major business investment projects.[27] The information on project investments was compiled by E&Y from both public and private data sources and information from state economic development agencies. The E&Y study provides a snapshot of where recent major investments are being made in the U.S. by both domestic and foreign companies.

Table 8 provides the state-by-state information on new and retained jobs that are associated with the announced investments included in each of the past three years of projects (2004 through 2006). To scale for differences in the size of state economies, the three-year sum of project jobs is divided by the 2006 measure of private-sector gross state product (GSP), the most comprehensive measure of the level of annual economic activity in a state.

The figures in the Jobs column in Table 8 present the ratios of new and retained jobs per $1 billion of GSP. For example, over the three-year period, announced projects in California accounted for 22.4 jobs per $1 billion of 2006 GSP, a relatively small number compared to most other states. The states are divided into combined and separate filing states; the combined states include those that had combined reporting in effect prior to the 2006 implementation of combined reporting in Vermont.

The average figures (sum of jobs divided by the sum of GSP in each group) for the two groups of states are presented in the last rows of Table 8. There is a significant difference in

the number of new or retained project jobs relative to $1 billion of GSP: the ratio is 134 for separate filing states and 50 for combined reporting states. A number of separate filing states in the Southeast and the Midwest show the highest job gain relative to GSP from major investments over the last three years.

Table 8
New and Retained Jobs from Mobile Investments, per $1 billion of Gross State Product (2004-2006)

Combined filing		Separate filing	
State	**Jobs***	**State**	**Jobs***
Alaska	n.a.	Alabama	334.6
Arizona	17.2	Arkansas	47.3
California	22.4	Connecticut	61.3
Colorado	14.8	Delaware	56.7
Hawaii	n.a.	District of Columbia	11.4
Idaho	72.6	Florida	109.3
Illinois	93.9	Georgia	218.1
Kansas	193.0	Idaho	72.6
Maine	53.5	Indiana	258.2
Minnesota	103.3	Iowa	230.2
Montana	24.8	Kentucky	321.3
Nebraska	122.9	Louisiana	129.2
New Hampshire	15.0	Maryland	106.7
North Dakota	74.4	Massachusetts	11.1
Oregon	17.2	Michigan	199.7
Utah	145.3	Mississippi	171.8
Average	**50.0**	Missouri	126.7
		New Jersey	28.6
		New Mexico	112.8
		New York	65.0
		North Carolina	208.2
		Ohio	145.5
		Oklahoma	241.5
		Pennsylvania	86.2
		Rhode Island	92.7
		South Carolina	200.9
		South Dakota	34.6
		Tennessee	183.0
		Texas	136.0
		Vermont	6.0
		Virginia	270.3
		West Virginia	133.3
		Wisconsin	80.5
		Average	**134.2**

*Figures are 3-year sums of new jobs per $1 billion of gross state product.

While this comparison also does not control for other factors that explain the differences in the ratios, it does show that separate filing states have recently been more successful in attracting new investments that add or retain jobs. This new investment is the source of future growth in state investment, employment, productivity and real household income.

... separate filing states in the Southeast and the Midwest show the highest job gain relative to GSP from major investments over the last three years.

E. Summary of economic impacts

This study does not provide a comprehensive analysis of all the factors that explain differences in the growth of jobs across the states. It does look at additional sources of information that can be used to begin addressing the question of what the economic impact will be if a state adopts combined reporting given the mix of combined and separate filing states. Given the fact that combined reporting will result in increases in corporate income taxes on a significant number of multistate companies, even if the net change in tax revenue is small, economic theory predicts that combined reporting will have a negative impact on the state's economic growth if it also raises tax revenue. Economic modeling of the impacts using a comprehensive model of Maryland's economy supports this conclusion.

In addition, there is recent evidence that separate filing states are attracting substantially more new investment and employment than are combined reporting states, although this difference cannot be directly attributable to variation in the structure of state corporate income taxes. Finally, after controlling for population growth, a variable that is not "explained" by differences in corporate income tax systems, comparisons of job growth rates find that separate filing states have slightly higher job growth rates. While this additional analysis does not "prove" that a shift to combined reporting by a single state will harm the state's economy, it does suggest that legislators should be more concerned about the possible negative effects on investment and jobs when debating the merits of adopting combined reporting.

... legislators should be more concerned about the possible negative effects on investment and jobs when debating the merits of adopting combined reporting.

IV. COMPLIANCE AND ADMINISTRATIVE IMPACTS

Combined reporting creates complexities in corporate income tax systems that can add to taxpayer compliance costs and state administrative costs. The following sections outline the complex steps that are involved in implementing combined reporting for state corporate income taxes. The steps include determining 1) the affiliated companies to include in a unitary group, 2) the taxable income of the unitary group, and 3) a state's share of the taxable income.

Determining the unitary group

In determining if affiliated corporations are engaged in a unitary business, taxpayers and tax administrators must first address the challenging question of how to define the trade or business that is unitary. This involves examining the economic relationships between divisions within a single company or interactions and interdependencies among affiliated corporations linked by common ownership. Members of a unitary group must be linked by more than a passive investment relationship; there must be an exchange or flow of economic value among affiliates that exceeds the flows between independent, unrelated business entities. Therefore, a finding of a unitary relationship must be based on a determination of the economic relationship among commonly owned corporations.

Taxpayers are often left to determine which corporations to include in the unitary group without detailed guidance from state statutes or, in many cases, without detailed regulations. The economic relationships must be traced by identifying the activities undertaken by each division or subsidiary and the resulting flows of goods and services, often by product or service line, between related corporations. In the case of corporations with a number of business activities that are not in the same line of business or are not related processes in one line of business, the unitary determinations involve not only quantitative measures, but also qualitative dimensions. These qualitative dimensions introduce both controversy and uncertainty into the corporate tax system. As a result, taxpayers and tax administrators often disagree on the affiliated corporations that meet the unitary test. More complex audits and appeals and increased litigation can be expected as a result of the unitary determination in states adopting combined reporting.

The complexity in determining the affiliated corporations to be included in a unitary group can be seen in a recent New York State Department of Taxation and Finance explanation of the rules for complying with the 2007 expanded requirements for mandatory filing of a combined report.[28] Under the new law, combined reporting is required when there are "substantial intercompany transfers" among related corporations. The rules list ten specific steps (several of which involve repeated rounds of calculations) to follow in determining if a combined return is required and, if so, which firms to include. The initial step requires each taxpayer to determine all related corporations that meet specific ownership requirements. In following steps, taxpayers continually expand the number of corporations to be included in the unitary return by identifying every corporation with substantial intercompany transfers with any other corporation included in a prior step. In determining whether substantial intercompany transactions exist, taxpayers must examine the "facts and circumstances" for all activities and transactions between all related companies and the taxpayer in each step.[29]

More complex audits and appeals and increased litigation can be expected as a result of the unitary determination in states adopting combined reporting.

Combined reporting also involves substantial administrative costs. To evaluate the taxpayer's determination of a unitary relationship, state auditors must look beyond accounting and tax return information. They must rely on publicly available information or ask taxpayers for detailed information on ownership shares, organizational charts, directories of officers and directors for each affiliate, inter-corporate reporting requirements and communications, annual changes in corporate structure and operations each year and descriptions of inter-corporate transactions, including financial flows related to loans and the production and use of intangible property, in evaluating ownership and economic factors that determine a unitary relationship. Service flows include research, insurance, training, purchasing, advertising accounting, human relations, administration and computing.

In effect, auditors must determine how a taxpayer and its affiliates operate at a fairly detailed level to determine which affiliates are unitary. Auditors must interact with a corporation's operational and tax staffs to gather this operational information. Determining the scope of the unitary group is a complicated, subjective, and costly process that is not required in separate filing states.[30]

Combined reporting also involves substantial administrative costs.

The determination of the unitary relationship must be done annually in light of on-going changes in business operations and structure such as mergers, acquisitions and divestitures. In other words, the unitary concept is a dynamic one that must be continually evaluated. In addition, it involves examining the economic relationships between all affiliated companies, not just those that have nexus in the taxing state.

Calculating combined income

Once the unitary group is defined, the net income to be included on a combined report must be determined. This step is considerably more complicated than simply basing the calculations on consolidated federal taxable income. In most combined reporting states, the group of corporations included in a federal consolidated return differs from the members of a combined group. This occurs because most states use a different ownership test for inclusion, and more importantly, state combined groups may include only firms that are unitary in operation, a concept that has no federal counterpart. Included groups and their taxable income may also differ across states because of different state-specific requirements for determining which corporations are unitary.

This step also involves identifying the split between apportionable business income and allocable non-business income. This is a determination that, in theory, requires examining the relationship between income sources and the business operations of each corporation included in a unitary business. Again, the determination applies to all firms in the unitary group, not just those corporations with nexus in the taxing state that were already separate filers in a state before the adoption of combined reporting. It also involves accurately attributing related expenses to both business and non-business income.

It should also be noted that transfer pricing issues still arise under combined reporting. Only the inter-corporate transactions among the companies included in the unitary group are eliminated in determining combined income. Transfer pricing issues will still remain for any transactions between the unitary group and affiliated companies not included in the unitary group.

Apportioning income

The final determination is calculating the apportionment percentage to be applied to the combined income of the unitary group in determining the state's share of the income. The factors included in the apportionment formula should be related geographically to the production of the unitary group's income. Factors that are related to non-business income and non-unitary businesses should not be included in the apportionment formula. These factors have to be determined separately for each corporation in the combined group and for each combined reporting state.

An additional complication under combined reporting is the need to eliminate sales among members of the combined group to avoid including the sales multiple times in the apportionment formula. In making these adjustments taxpayers have to eliminate sales among the unitary members but not sales between affiliated corporations that are not in the unitary group. This increases the number of additional calculations in determining apportioned net income in combined reporting states. In addition, factors normally have to be calculated (and inter-corporate sales eliminated) for all members of the unitary group, not just members with nexus.

In addition to variations in apportionment formulas among the states that apply to all corporate taxpayers, further compliance costs related to combined reporting result from variations across states in the methods used to calculate the apportionment factors. For example, the numerators of apportionment factors may include or exclude the dollar amounts of factors for members of the unitary group that do not have nexus in a state. As another example, states vary in the treatment of factors from foreign subsidiaries that are associated with foreign income, such as dividends from foreign subsidiaries, included in the combined income of a unitary group. All of these variations add to compliance and administrative costs.

V. CONCLUSIONS

This study has provided a detailed analysis of the mechanics of combined reporting. It shows that switching from separate filing to combined reporting can decrease, increase or leave state tax collections unchanged depending upon the complex economic relationships among corporations included in a combined group. Because of this complexity, the overall revenue impact of adopting combined reporting is very difficult to predict reliably. As a result, significant uncertainty is associated with bill analyses prepared by state revenue estimators. A comparison of these estimates suggests that the additional revenues generated by combined reporting may be fairly modest, particularly in separate-filing states that have already adopted expense disallowances for affiliated corporations.

While the proponents of combined reporting have focused on the benefits in terms of reducing tax planning opportunities, the paper points out additional costs related to combined reporting that state legislators need to consider. These include the potential negative economic impacts of increasing effective corporate tax rates on corporations operating in a state. The higher effective tax rates are expected to reduce investment and jobs in a state. This negative impact on a state's business tax competitiveness affects all taxpayers facing higher effective rates, not just those using tax planning techniques. The additional compliance, administrative and

litigation costs associated with combined reporting should also be included in a balanced evaluation of combined reporting.

The analysis in this paper suggests that combined reporting is not a panacea for addressing the problem of how to determine accurately multistate business income that is attributable to economic activity in a state. While proponents argue that it helps to overcome distortions in the reporting of income among related companies in separate filing systems, the mechanics used under combined reporting create new distortions in assigning income to different states. The combined reporting assumption that all corporations in an affiliated unitary group have the same profitability per dollar of factors (payroll, property and/or sales) is not consistent with either economic theory or business experience. Consequently, combined reporting may reduce the link between income tax liabilities and where income is actually earned even in the absence of distorted transfer prices or income shifting strategies. In this situation, many corporate taxpayers may conclude that there is a significant risk that combined reporting will arbitrarily attribute more income to a state than is justified by the level of a corporation's real economic activity in the state.

... combined reporting is not a panacea for addressing the problem of how to determine accurately multistate business income that is attributable to economic activity in a state.

State legislators should carefully evaluate the revenue, economic development, and tax administration and compliance impacts before adopting combined reporting. The impacts are complex and, in some cases, uncertain. Given this uncertainty, legislators should consider all the options available for achieving their tax policy and/or revenue objectives at a lower cost in terms of the unintended consequences associated with combined reporting.

State legislators should carefully evaluate the revenue, economic development, and tax administration and compliance impacts before adopting combined reporting.

APPENDIX: STATE ESTIMATES OF COMBINED REPORTING REVENUE IMPACTS

This Appendix provides a more detailed discussion of state-by-state estimates of the static revenue impacts of proposals to adopt combined reporting. It includes a detailed discussion of the methodology and data used to prepare the estimates. The sources of the information include bill analyses prepared during legislative sessions, tax agency studies, state tax studies and testimony before tax committees and tax commissions.

Minnesota

The Minnesota legislature adopted mandatory combined reporting in 1982.[31] Combined reporting was adopted with limited debate about the tax policy issues related to the bill, but considerable discussion over the revenue estimates. Because Minnesota corporate taxpayers filed tax returns on a separate entity basis prior to the law change, there was no state tax return data that could be used directly to determine combined filing groups and their tax liabilities under combined reporting. Based on a survey of other states with combined reporting, Minnesota assumed a 15 percent increase in tax collections from adopting combined reporting. At the time, a 15 percent increase in corporate income taxes generated $63 million (over 18 months). Recognizing the high degree of uncertainty in estimating the revenue impacts of the law change, lawmakers were warned that the impact could range from $23 and $103 million, an unusually wide range for a bill analysis. In almost all tax bill analyses in Minnesota, a single number (point estimate) is provided for revenue impacts.

Because the law adopting combined reporting also required a report to the legislature on some elements of the revenue impacts of the law change, Minnesota provides a unique, post-law-change evaluation of the impact of combined reporting. Comparing actual liabilities for firms filing combined returns in 1982-83 with recomputed liabilities as if they had filed separate returns, the Department of Revenue found that combined reporting actually reduced tax liabilities by roughly nine percent on initial combined returns. The decline was partially due to the conversion of unused separate entity losses into current loss offsets for 100 percent Minnesota unitary groups and bank holding companies filing combined reports.[32]

Based on the calculations from actual combined reports, the estimates of the additional revenue raised from combined reporting were lowered to zero for each fiscal year through 1985, four years after mandatory combined reporting went

... the Department of Revenue found that combined reporting actually reduced tax liabilities by roughly nine percent on initial combined returns.

into effect. Even if the adoption of combined reporting leads to higher corporate income tax collections over the longer run, the Minnesota ex-post evaluation does suggest that the initial impact of adopting combined unitary reporting may be a smaller revenue increase than forecasted or actually a decrease in revenues. An actual short-run reduction in revenue may occur if the stock of NOLs carried into the new system is significant. The Minnesota experience clearly illustrates the difficulty in reliably forecasting corporate income tax changes when a state moves from separate returns to combined reporting.

Wisconsin

The Wisconsin Department of Revenue prepared revenue estimates of a proposal to adopt mandatory combined reporting in 2003.[33] Similar to the Minnesota experience, Wisconsin was also constrained by the lack of data on corporate tax returns filed on a separate entity basis. The method chosen to estimate the revenue impact of combined reporting was to integrate 1994-1995 Wisconsin tax return information with Minnesota Department of Revenue data for taxpayers filing combined reports in Minnesota, a mandatory combined reporting state.

Wisconsin research staff identified large state corporate income taxpayers and asked Minnesota to match each Wisconsin taxpayer to a Minnesota group based on federal taxpayer identification numbers. Minnesota identified the combined groups and Minnesota nexus taxpayers that were linked to the identified Wisconsin separate filers. This taxpayer list was then used by Wisconsin to pull separate filing information for the taxpayers provided by Minnesota. The Wisconsin staff then merged the Minnesota and Wisconsin taxpayer information. This database was used to estimate the impact of combined reporting.

A noteworthy limitation on the Minnesota taxpayer data was the fact that it did not include information on banks. The Wisconsin researchers developed independent estimates for the banks. While the estimates discussed during the presentation were only preliminary, combined reporting was expected to generate $75 million based on tax year 1996 collections. However, only $25 million was estimated to come from non-bank taxpayers. The $75 million figure was 11.7 percent of the corresponding total Wisconsin corporate income tax collections. For non-bank taxpayers, the $25 million tax increase was 4.2 percent of non-bank corporate tax collections, a figure that is more applicable in states that tax banks and other financial institutions under separate tax systems.

In July 2007, the Wisconsin Legislative Fiscal Bureau estimated the full-year impact of adopting mandatory combined reporting at $90 million for FY 2009. This estimate is 10.5 percent of the projected total corporate income tax collections under current law. No separate estimate was available for the non-bank impact from combined reporting in the July 2007 estimates. However, a better gauge of the revenue impact of combined reporting may be estimated by the non-bank impact. Because Wisconsin has more recently aggressively challenged the use of Nevada-based, intangible asset holding companies owned by banks, the state may already have collected a substantial portion of the estimated $90 million through targeted compliance activities under their separate filing system. If the $90 million estimate is adjusted to remove the same portion of the total attributed to banks in the 2003 estimates, the additional revenue from combined reporting would drop to $30 million or 3.5 percent of projected revenues. This is the percentage show in the summary table.

Pennsylvania

Pennsylvania's experience in estimating the corporate tax impacts of adopting combined reporting provides a clear example of how NOL provisions may significantly affect the estimates. In 2004, the Pennsylvania Department of Revenue (DOR) presented their preliminary estimates of the revenue impact of adopting combined reporting at a meeting of the Pennsylvania Business Tax Reform Commission.[34] Similar to the methodology used by Wisconsin, the DOR also relied on Minnesota corporate income tax data (for tax year 2000), using combined income and apportionment data for Minnesota filers with Pennsylvania and IRS corporate tax data, to derive Pennsylvania-specific estimates. In addition to identifying the affiliates that may be required to file as a unitary group, Pennsylvania also used the combined dataset to estimate the impact of carryforward NOLs.

According to the treatment of NOLs, the estimated increases in corporate taxes expected from combined reporting ranged from $150 million to $411 million.[35] The larger tax increase assumed that the separate company NOLs carried into the new system were capped at $2 million per year per entity (with a 20-year carryover) and that no cap was imposed on NOLs earned by the group. The much lower tax increase estimate assumed that NOLs (carried in from separate filing) were uncapped for an individual company and could be used by all members of a unitary group without any annual cap. In other words, full utilization of NOLs reduced the pro-

jected net gain in corporate tax revenue by 64 percent; for manufacturing the reduction in additional taxes was nearly 80 percent.

Another way to understand this difference in impact estimates is to note that the relatively large estimate of net revenue from combined reporting in Pennsylvania results from the state's unique cap on NOLs and denying the full use of precombination NOLs. For this reason, the higher Pennsylvania revenue estimates cannot be used as a basis for estimating the revenue impacts of adopting combined reporting in other states that allow full NOL offsets.

The Pennsylvania debate over combined reporting provides a clear example of the importance of NOLs in determining the short- to intermediate-run revenue impacts of adopting combined reporting. It also illustrates the difficulties involved in determining how to integrate precombination losses into a new combined reporting system. The Pennsylvania Tax Commission report's discussion of combined reporting considered a number of options, ranging from disallowing any carryovers to allowing full, uncapped carryovers that can be used by the full unitary group.[36] The recommendation to continue the cap on NOLs generated prior to combined reporting was designed to maximize the revenue impact of adopting combined reporting.

To summarize the revenue impacts, the $411 million estimate for increased corporate income tax revenue from combined reporting represented 21.7 percent of estimated Pennsylvania tax collections in 2000. However, allowing full use of NOLs would have generated $150 million, a much smaller 7.9 percent increase.

The Pennsylvania estimates also show that a shift to combined reporting creates significant winners and losers. The $150 million estimate results from the offsetting of large tax increases and decreases. For the combined groups that were identified from the Minnesota data (excluding regional firms), the losers paid $187 million more in taxes and the winners paid $133 million less, for a net change of only $54 million.[37] There were an estimated 2,546 groups with tax increases and 2,097 groups with tax decreases. Small errors in estimating both increases and decreases from the Minnesota sample can have large impacts on the net change estimated. For example, if tax increases are overestimated by 10 percent and decreases are underestimated by 10 percent, the estimated net change from combined reporting would drop by 60 percent to only $22 million.

The Pennsylvania estimates also show that a shift to combined reporting creates significant winners and losers.

There are additional issues with the estimating methodology that suggest that even the smaller estimate still overstates the probable impact of adopting combined reporting in Pennsylvania. These include:

- The relatively small number of Minnesota taxpayer groups actually used in the estimating process (152 out of over 4,600 groups supplied by Minnesota) presents a challenge in extrapolating the Minnesota data to all Pennsylvania taxpayers.
- There were a number of large regional firms that have nexus in Pennsylvania but were not included in a Minnesota combined group. The impact on these firms had to be estimated with less detailed information on combined group entities and apportionment factors.
- The apportionment factors and NOL information for the Minnesota sample firms was determined by Minnesota, not Pennsylvania, tax provisions.
- The estimates do not allow for the carry-in NOLs to be used by the entire unitary group, a treatment inconsistent with the theory of combining the income (and losses) of a unitary group.
- There was a lack of detailed information on the cumulative unitary group NOLs or unused credits that could potentially be used to offset tax increases from combined reporting.

Maryland

In 2004, the Maryland Department of Legislative Services estimated the fiscal impact of a bill requiring water's edge mandatory combined reporting (SB 727). The bill included corporations located in "tax havens" in the unitary group. The fiscal note estimated that combined reporting would raise $55 million each year through FY 2009.[38] However, the estimate was not based on any Maryland-specific tax return information. The estimate was, in fact, prepared by the Multistate Tax Commission in a 2004 study.

The Department of Legislative Services reestimated the revenue impact of combined reporting in the 2007 fiscal note for SB393. In this analysis, the estimated, on-going impact of combined reporting was reduced by 55 percent to $25 million annually.[39] The primary reason for the 55 percent reduction in the estimate of the revenue impact appears to be the fact that a large portion of the revenue expected earlier from combined reporting was picked up by expense addback legislation adopted by the legislature in 2004.[40] The $25 million increase is 3.0 percent of corporate income tax collections in fiscal year 2006.

The fiscal note points out that the impact "cannot be reliably estimated." Again, the estimate was based on national data and, in addition, estimates prepared by other states.[41] The Department also acknowledged that they did not have Maryland taxpayer information to use in the estimating process, primarily because the Department did not have access to confidential taxpayer information.

The 2007 Maryland budget bill did not impose mandatory combined reporting. However, it did require for all tax years beginning after 31 December 2007, that corporate taxpayers report information to the Comptroller for each entity in an affiliated group, including firms that are not currently Maryland taxpayers. Taxpayers must calculate and report the tax liability of a water's edge unitary group as if Maryland had already adopted combined reporting. This information will be used by the Comptroller's Office to estimate the impact of adopting combined reporting in Maryland.

Iowa

Iowa currently offers taxpayers the choice between filing separate or consolidated returns with affiliated companies doing business in Iowa. The governor's budget recommendations for fiscal year 2009 included a proposal for mandatory combined reporting estimated to raise $75 million in 2009. This would be an increase of 16.7 percent in forecasted 2008 corporate income tax revenues. The proposal appears to require mandatory filing of a combined return following federal consolidated return provisions for determining an affiliated group.

A 2007 Department of Revenue study estimating the revenue impact of requiring combined reporting for all corporate taxpayers provides some background information on the estimating methodology.[42] The study used federal consolidated corporate income tax data for federal filers that matched Iowa taxpayer identification numbers (including both separate and consolidated state filers). Federal and Iowa tax data were combined to estimate the revenue changes for mandatory combined filing. The Iowa results show the challenges of trying to use federal consolidated return information to estimate state combined filing proposals:

- Only 51 percent of Iowa separate filers (not matched to federal separate filers) could be linked to a federal consolidated return.
- For those Iowa taxpayers linked to a federal consolidated return, the Department had to calculate the major Iowa line-item subtractions and additions that convert federal income into the state income concept.
- For Iowa taxpayers filing separate returns, the study estimated that the increase due to combined filing (based on 2001 data) was $31 million. The increase for Iowa taxpayers currently electing to file state consolidated returns would increase by a similar $30 million in 2003. Apparently, a move to mandatory combined reporting is expected to substantially increase the income apportioned to Iowa for consolidated nexus groups because of the addition of factors and income for non-nexus affiliated companies.
- As the study pointed out, the estimates do not include any allowance for the unlocking of state NOL carryovers on combined returns. In addition, only NOLs reported on Iowa returns were used in the calculations; no information was available for firms in the federal consolidated group that were not Iowa taxpayers. As noted earlier, the estimated net impacts of adopting combined reporting are sensitive to the size of NOLs and the provisions affecting the use of NOLs by members of the combined group.
- Another important limitation of the study was the assumption that the members of the state combined group would mirror the firms reported on federal consolidated returns. In other words, it is assumed that all members of the federal consolidated group are unitary in operation, despite the fact that there is no unitary requirement (or concept) for federal consolidation. State revenue estimates that are based on combined income including non-unitary members of the federal consolidated group will overstate the revenue from combined reporting. In addition, companies taxed under alternative state tax systems, such as insurance companies and banks, were not eliminated from the state calculations.

In conclusion, if the $75 million net revenue estimate included in the governor's 2009 budget recommendations is based on the study's methodology, the estimate may be significantly overstated.

... if the $75 million net revenue estimate included in the governor's 2009 budget recommendations is based on the study's methodology, the estimate may be significantly overstated.

Massachusetts

In 2007, the governor recommended mandatory combined reporting. The estimated revenue increase for fiscal year 2009 was $188 million, 8.9 percent of projected corporate income tax collections.

Massachusetts adopted addback provisions in 2003. Addback is required for otherwise deductible royalty expenses and related interest expenses paid to related entities with exemptions. Compared to the estimates produced by several other states with addback statutes, Massachusetts appears to have estimated a significantly higher percentage increase in corporate taxes from combined reporting.

Compared to the estimates produced by several other states with addback statutes, Massachusetts appears to have estimated a significantly higher percentage increase in corporate taxes from combined reporting.

New York

For tax years beginning 1 January 2007, New York requires mandatory combined reporting for related corporations with substantial inter-corporate transactions. Prior to the change, taxpayers could file separate returns in the presence of substantial intercompany transactions if they could demonstrate that these transactions were conducted at arm's-length prices. While New York asserts that they are not a combined reporting state, the new filing requirements are much closer in effect to combined reporting.

The estimated impact of the law change was an increase of $315 million, 6.0 percent of corporation franchise (income) taxes.[43] New York estimators derived the revenue estimate from auditor-feedback and New York corporate taxpayer information. It is not clear whether the estimate reflects New York's requirement for corporate taxpayers to add back selected royalty expenses, including interest payments related to intangible assets, paid to related companies in determining taxable income. The addback provision should reduce the additional revenue expected from expanding the mandatory combined filing requirements in New York.

West Virginia

West Virginia adopted mandatory combined reporting for the corporate net income tax in 2007 for tax years beginning in 2009. The full-year revenue impact, as reported in the Fiscal Note Summary for SB 749, was estimated at $24.3 million or an increase of 10 percent of estimated fiscal year 2009 corporate income taxes; the increase is 6.5 percent for combined corporate income and business franchise tax collections. The fiscal note states that the estimate was "based on the experience of other states that have adopted combined reporting." As noted in the discussion of the estimating experience in other states, differences in taxpayer characteristics and state corporate tax features make it difficult to extrapolate revenue impacts from estimates made in different states.

... differences in taxpayer characteristics and state corporate tax features make it difficult to extrapolate revenue impacts from estimates made in different states.

New Mexico

HB 51 introduced in the 2008 legislative session makes combined reporting mandatory beginning for tax year 2008. New Mexico currently permits taxpayers to elect to file a consolidated or a combined return. The fiscal impact report for the bill estimates that the change will generate $90 million in additional revenue, an increase of 20 percent in corporate tax collections when fully phased in by fiscal year 2009. The fiscal report does not describe the methodology used to estimate the revenue impact.

The fiscal impact report does note that in fiscal year 2005 taxpayers electing to file combined returns accounted for 14 percent of all tax payments and taxpayers electing to file a consolidated return accounted for 32 percent of all payments. As discussed in the Pennsylvania example, any revenue increase from shifting to a combined reporting system is the net effect of large increases and losses for different taxpayers. The New Mexico fiscal note implies that the election of either combined or consolidated filing has already partially reduced corporate income tax collections compared to a separately filing system. Therefore, the impact of adopting mandatory combined filing will primarily be to increase taxes for the companies that elected to file separately under current law.

Given the fact that New Mexico currently allows taxpayers with an election to file combined or consolidated returns (including domestic corporations that meet federal rules for common ownership), the relative size of the New Mexico revenue impact estimate of adopting mandatory combined reporting is not applicable to other states that are considering moving from separate to mandatory combined filing systems.

ENDNOTES

1. The concept of a "unitary business" is a constitutional requirement that limits the states' authority to determine the income of a multistate enterprise taxable in a state. The criteria used to determine whether a group of business entities or divisions are unitary are derived from state statutes and regulations and state and federal case law. These criteria are often based on a "flow of value" among the entities and divisions and include the following: unity of ownership, unity of operation and unity of use. Due to varying state definitions and case law decisions, the entities included in a unitary group are likely to vary significantly from state to state.
2. There are 20 corporate income tax states that can be described as combined reporting states, including New York and Michigan. In addition, Texas is using the combined reporting approach to determine the tax base under their modified gross receipts taxes that replaced corporate income taxes.
3. A group of related corporations may consist of multiple unitary groups. Although ownership is one test to determine whether separate legal entities are engaged in a unitary business, it is not the sole test. The number of unitary groups, and the composition of those unitary groups, will vary significantly for each corporate group and each state.
4. For a detailed discussion of the proponents view see Michael J. McIntyre, Paull Mines and Richard D. Pomp, *"Designing a Combined Reporting Regime for a State Corporate Income Tax,"* Louisiana Law Review, pp. 699-761 (Summer 2001). A more recent summary is provided in Michael Mazarov, "State Corporate Tax Shelters and the Need for Combined Reporting," *State Tax Notes* (November 26, 2007).
5. It is also assumed that the income being combined for the two companies is U.S.-wide income, not world-wide income. This is consistent with the companies making a water's-edge election for state corporate income tax purposes.
6. The calculations in the examples are consistent with the approach to combined reporting that respects the separate entities of the taxpayer members of a combined group. In this approach each corporation reports the unitary group's combined income on its own tax return and uses its own in-state factors (divided by the group's U.S.-wide factors) to apportion the combined income to a state. (This is often described as the *Joyce* approach to apportioning combined income based on a California corporate tax court case.) This approach is also consistent with Multistate Tax Commission Model Statute for Combined Reporting, as described in "Report of the Hearing Officer Regarding the Proposed Model Statute for Combined Reporting," Multistate Tax Commission (April 25, 2005).
7. Under combined reporting the in-state numerators of the two companies do not change. However, the sum of each factor for the two firms becomes the new denominator in the calculation of the overall apportionment ratio. The new apportionment ratios under combined reporting equal 3.6% for Company A and 13.9% for Company B.
8. While payroll and property are the sources of value added, state apportionment formulas also include destination sales in the formula to reflect a market state's interest in a portion of the income. The inclusion of sales in the apportionment formula weakens the link between income and the location of payroll and property, the factors that create value added. For states using sales only apportionment formulas, there is no direct link between the location of payroll and property that creates income and the apportionment formula that assigns the income to a state. Adding combined reporting to single sales factor apportionment compounds the disconnect between where income is produced and where income is apportioned. The exclusion of intangible capital, a growing source of income, from the property factor further adds to this disconnect. These features add to the perception among many business taxpayers that the current corporate income tax system is overstating the taxable income generated by economic activity in many states.
9. For simplicity, this calculation ignores the elimination of sales between the two companies. It also assumes that sales of Company 1 are not included in the numerators of the combined apportionment factors. (This is often described as the *Joyce* approach to apportioning combined income based on a California corporate tax court case.)
10. H.B. 768 was passed by the House Education Appropriations Committee on April 16, 2008.
11. Proponents of combined reporting would argue that state taxable income may not be reported correctly, due to improper transfer pricing and/or shifting of assets or liabilities between affiliated companies. Distinguishing improper actions from business-driven actions is difficult.
12. Pennsylvania's percentage is from tax year 2002 returns that were heavily influenced by the sharp reduction in corporate profits and the increase in actual losses due to the 2001 recession. Minnesota's percentage may also have been affected by the recession to a lesser extent.
13. This result is not unique to state income tax systems. At the federal level, approximately one-half of Subchapter C corporations have no taxable income in a given year, and approximately two-thirds of C corporations have no tax liability in a given year after subtracting special deductions, net operating loss carryforwards and tax credits. The percentage of C corporation returns without taxable income ranged from 45-52% between 1999 and 2005. The percentage of returns without tax liability ranged from 61-69% during the same period. (Source: IRS Statistics of Income data from the *Complete Corporate Report*, years 1999-2005.)
14. The example assumes that the sales into State A for the headquarters company are not included in the numerator (State A sales) of the apportionment formula under combined reporting.
15. In theory, the elimination of intercompany transactions would also result in a redistribution in the profits attributable to the manufacturing and distribution subsidiaries with no change in total combined profits. This redistribution is not shown in the table.
16. This same "unlocking" effect may occur with unused credits if a state allows credits to be used by any member of a combined group. Unlike NOLs that most states allow to be carried over to future years with some limits, tax credits may be lost if not used in the year in which they are earned by the taxpayer. Tax credits that went unused under separate filing because of insufficient taxable income and tax liabilities may be converted to used credits if the income of the unitary group increases under combined reporting.
17. Michael Mazarov, "Growing Number of States Considering a Key Corporate Tax Reform," Center on Budget and Policy Priorities," 12 September 2007, p. 9.
18. Gregory C. Fajt, Secretary, Pennsylvania Department of Revenue, Testimony before the House Finance Committee, 14 April 2005, p. 4. Secretary Fajt described the assertion that combined reporting will be bad for the state's economy as a "myth."
19. Several theoretical studies of the impact of combined reporting and apportionment on the allocation of economic activity among the states suggest that combined reporting, compared to separate filing, may increase the responsiveness of economic activity to state corporate income tax changes. After analyzing different simulations of the impact of tax rate changes for hypothetical groups of combined and separate filing states, a study concluded that shifts in sales, payroll and property factors are "far more sensitive" to changes in state corporate income tax rates under combined filing vs. separate filing tax systems. (Michael G. Williams, Charles W. Swenson, and Terry L. Lease, "Effects of Unitary vs. Nonunitary State Income Taxes on Interstate Resource Allocation: Some Analytical and Simulation Results," *The Journal of the American Taxation Association,* Spring 2001, p. 54). Also see Roger Gordon and John D. Wilson, "An Examination of Multijurisdictional Corporate Income Taxation Under Formula Apportionment," *Econometrica*, November 1986.
20. See Minnesota Department of Revenue, *2007 Minnesota Tax Incidence Study* (March 2007) for a discussion of how state and local business tax burdens are distributed among workers, investors, and households.

21. See Ernst & Young LLP, *Economic and Fiscal Impact Analysis of Maryland Tax Policy Options* (September 2007). The study was prepared for the Maryland Chamber of Commerce and associated local chambers and other organizations.

22. The dynamic impact simulations were done using a Regional Economic Models, Inc. (REMI) model of the Maryland economy. This model is used widely by state agencies as well as private-sector analysts.

23. Timothy J. Bartik, et al., *Michigan's Economic Competitiveness and Public Policy*, the W.E. Upjohn Institute for Employment Research (August 2006).

24. There is some evidence that investment decisions of multinational corporations are even more sensitive to state tax changes. In a study of foreign direct investment in individual states, the author found that a roughly 10 percent increase in state corporate tax rates would result in a 6 percent reduction in investment in the state. (See James R. Hines, Jr., "Altered States: Taxes and Location of Foreign Direct Investment in America," *The American Economic Review* (December 1996).

25. Regression equation: Job Growth = 0.62 + 0.036 CRdummy + 1.15 Population Growth - 0.01 Average Salary

T Statistic: (3.89)(0.81) (12.60) (-3.30)

R-squared = 0.81

Job Growth is the 1982-2006 growth in private-sector employment, CRdummy is a dummy variable with a value of 1.0 for combined reporting states, Population Growth is the 1982-2006 growth in population, and average salary is an average of the beginning and ending level of private-sector salaries.

26. The average salary measure serves as one measure of private-sector costs in a state. As expected, job growth is lower in states with higher wages.

27. See Ernst & Young LLP, *"The 2007 U.S. Investment Monitor* (2007) for further details on the data and methodology. The projects included in the studies are announced projects with a minimum of $20 million in capital investment and 20 new or retained jobs.

28. New York State Department of Taxation and Finance, Combined Reporting for General Business Corporations, TSB-M-07(6)C, 25 June 2007. For a more comprehensive discussion of the complexities involved in complying with the expanded New York State combined reporting requirements, see Kenneth T. Zemsky, "Understanding the New Developments Regarding Combined Filing in New York," *Journal of Multistate Taxation* (March/April 2008).

29. The rules list six specific types of transactions that have to be examined including intercorporate receipts, expenses and asset transfers.

30. On the other hand, separate filing states involve tax compliance and administrative costs related to the determination and auditing of transfer prices applied to transactions between affiliated companies.

31. The precursor to the combined reporting bill was a bill passed by the legislature in special session that required world-wide combined reporting for major oil companies. The bill was supported by a state organization affiliated with the national Citizens/Labor Energy Coalition. The bill was vetoed by the governor. (See Arthur C. Roemer, "Minnesota Taxation of Unitary Corporations," *Minnesota Tax Journal*, December 1982.) This article discusses the initial revenue estimates for the combined reporting bill adopted in 1982.

32. A draft report, "Unitary Primer," prepared by the Department of Revenue in January 1984 explained that these losses were not taken into account in preparing the initial revenue estimates. It is also possible that the weakness in the U.S. economy in the early 1980s produced a larger stock of unused NOLs than anticipated in the revenue estimates.

33. As reported by Eng Braun, Wisconsin Division of Research and Policy, Wisconsin Department of Revenue, *Corporate Tax Modeling for Combined Reporting*, presentation to the Federation of Tax Administrators Conference on Revenue Estimating and Tax Research, September 2003.

34. "Fiscal Impact of Combined Reporting on the Pennsylvania Corporate Net Income Tax" (27 May 2004) and "Revenue Estimate Update" (20 October 2004), presentations to the Pennsylvania Business Tax Reform Commission by Brenda S. Warburton, Research Director, Pennsylvania Department of Revenue.

35. The $150 million figure is estimated based on information in the 27 May 2004 Department of Revenue presentation on the ratio of additional revenue under the capped and uncapped (by individual firm) NOL options. The $150 million does not, however, allow for the carry-in NOLs to be used by the entire unitary group.

36. Pennsylvania Business Tax Reform Commission Report, November 2004 (Chapter 14, "Modifications of Existing Pennsylvania Net Operating Losses")

37. The distributions of winners and losers are from the estimates presented by the Department of Taxation on 27 May 2004. The ratio of winners to losers from these earlier estimates was applied to the October revised estimates to derive the tax change amounts for winners and losers reported here. These figures do not include the large regional groups estimated separately.

38. The estimate reported in the Maryland fiscal note did not include any separate estimate of possibly higher revenue from the tax haven component of the bill.

39. This was the low-end of an estimated range of $25 to $50 million. As pointed out in the fiscal note, the $25 million figure is more likely in the "near term."

40. The addback provisions increase state corporate income taxes by disallowing deductions for certain expenses paid to out-of-state affiliates. Combined reporting would also increase taxes in this situation in the absence of addback provisions. In effect, Maryland already added this revenue during the prior year by adopting addbacks, reducing the expected additional revenue from combined reporting. According to a recent *Estimated Maryland Revenues Report* from the Maryland Board of Revenue Estimates (13 December 2006), the new addback provisions resulted in at least $44.1 million in additional tax revenue in 2004.

41. It is interesting to note that the Maryland 2007 analysis refers to the Pennsylvania Department of Revenue estimates of combined reporting discussed above. As noted earlier, the Pennsylvania estimates relied heavily on Minnesota corporate tax return information. It is not clear how the Pennsylvania results were actually used in the Maryland estimating process.

42. "Combined Reporting: An Option for Apportioning Iowa Corporate Income Tax," Tax Research and Program Analysis Section, Iowa Department of Revenue (March 2007).

43. The percentage increase was based on the increase divided by the actual fiscal year 2007 corporate franchise tax, corporation and utility tax, and the income component of insurance taxes.

The Council On State Taxation (COST) is a nonprofit trade association consisting of nearly 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Council On State Taxation
122 C Street, NW, Suite 330
Washington, DC 20001
Phone: (202) 484-5222
Fax: (202) 484-5229
www.statetax.org

COST
Council On State Taxation

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2009

U D

BILL DRAFT 2009-SVz-4 [v.8] (12/31)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/7/2009 7:51:32 AM

Short Title: Rev Laws Technical & Admin Changes. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-41(a) reads as rewritten:

"(a) Every individual in this State who practices a profession or engages in a business and is included in the list below must obtain from the Secretary a statewide license for the privilege of practicing the profession or engaging in the business. A license required by this section is not transferable to another person. The tax for each license is fifty dollars ($50.00).

...

(12) A home inspector or an associate home inspector licensed under Article 9F of Chapter 143 of the General Statutes."

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

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

SECTION 3. G.S. 105-130.18 reads as rewritten:

"**§ 105-130.18. Failure to file returns; supplementary returns.**

If the Secretary determines that a corporation has failed to file a return or to include in a return filed, either intentionally or through error, items of taxable income, the Secretary may require from the corporation a return or supplementary return, under affirmation, of all the items of income that the corporation received during the year for which the return is made, whether or not taxable under this Part. If from a supplementary return or otherwise the Secretary finds that any items of income, taxable under this Part, have been omitted from the original return, that any items returned as

taxable are not taxable, or that any item of taxable income is overstated or understated, the Secretary may require that the item be disclosed under affirmation of the corporation, and be added to or deducted from the original return. The filing of a supplementary return and the correction of the original return does not relieve the corporation from any of the penalties under G.S. 105-236. The Secretary may proceed under the provisions of G.S. ~~105-241.1,~~ 105-241.9, whether or not the Secretary requires a return or a supplementary return under this section."

SECTION 4. Section 4(b) of S.L. 2008-134 reads as rewritten:

"**SECTION 4.(b)** This section is effective for taxable years beginning on or after January 1, ~~2009.~~2008."

SECTION 5.(a) G.S. 105-228.5B reads as rewritten:

"**§ 105-228.5B. (Effective until June 30, 2010) Proceeds credited to High Risk Pool.**

~~Within 75 days after the end of each fiscal year,~~ By November 1 of each year, the State Treasurer must transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund established in G.S. 58-50-225 an amount equal to the growth in net revenue from the tax applied to gross premiums under G.S. 105-228.5(d)(2). The growth in revenue from this tax is the difference between the amount of revenue collected during the preceding fiscal year on premiums taxed under that subdivision less $475,545,413, which is the amount of revenue collected during fiscal year 2006-2007 on premiums taxed under that subdivision. The Treasurer must draw the amount required under this section from revenue collected on premiums taxed under that subdivision."

SECTION 5.(b) G.S. 105-228.5B, as amended by S.L. 2008-118, reads as rewritten:

"**§ 105-228.5B. (Effective June 30, 2010) Distribution of part of tax proceeds to High Risk Pool.**

~~Within 75 days after the end of each fiscal year,~~ By November 1 of each year, the State Treasurer must transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund established in G.S. 58-50-225 an amount equal to thirty percent (30%) of the growth in revenue from the tax applied to gross premiums under G.S. 105-228.5(d)(2). The growth in revenue from this tax is the difference between the amount of revenue collected during the preceding fiscal year on premiums taxed under that subdivision less $475,545,413, which is the amount of revenue collected during fiscal year 2006-2007 on premiums taxed under that subdivision. The Treasurer must draw the amount required under this section from revenue collected on premiums taxed under that subdivision."

SECTION 5.(c) Subsections (a) and (c) of this section are effective when they become law. Subsection (b) of this section becomes effective June 30, 2010.

SALES TAX CHANGES

SECTION 6.(a) G.S. 105-164.14(j)(2)n. reads as rewritten:

"n. Solar electricity generating materials manufacturing. Solar ~~energy~~ electricity generating materials manufacturing means the development and production of one or more of the following:

1. Photovoltaic materials or modules used in producing electricity.
2. Polymers or polymer films primarily intended for incorporation into photovoltaic materials or modules used in producing electricity."

SECTION 6.(b) This section is effective July 1, 2008, and applies to purchases made on or after that date.

SECTION 7. G.S. 105-187.51C(c) reads as rewritten:

"(c) Forfeiture. – If the required level of investment to qualify as an eligible datacenter is not timely made, then the rate provided under this section is forfeited. If the required level of investment is timely made but any eligible machinery and equipment is not located and used at an eligible datacenter, then the rate provided for that machinery and equipment under this subdivision is forfeited. A taxpayer that forfeits a rate under this subdivision is liable for all past sales and use taxes avoided as a result of the forfeiture, computed at the combined general rate from the date the taxes would otherwise have been due, plus interest at the rate established under G.S. ~~105-241.1(i).~~ 105-241.21. If the forfeiture is triggered due to the lack of a timely investment required by this section, then interest is computed from the date the sales or use tax would otherwise have been due. For all other forfeitures, interest is computed at the combined general rate from the time as of which the machinery or equipment was put to a disqualifying use. A credit is allowed against the sales or use tax owed as a result of the forfeiture provisions of this subsection for privilege taxes paid pursuant to this section. For purposes of applying this credit, the fact that payment of the privilege tax occurred in a period outside the statute of limitations provided under G.S. ~~105-266~~ 105-241.6 shall not be considered. Interest shall not be computed against the amount of taxes offset by this credit. The past taxes and interest are due 30 days after the date of forfeiture. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the provisions of G.S. 105-236."

PROPERTY TAX CHANGES

SECTION 8.(a) G.S. 105-273(6) reads as rewritten:

"(6) Corporation. – An organization having capital stock represented by shares or an incorporated, nonprofit organization."

SECTION 8.(b) G.S. 105-277.1B(i) reads as rewritten:

"(i) Disqualifying Events. – Each of the following constitutes a disqualifying event:

(1) The owner transfers the residence. Transfer of the residence is not a disqualifying event if (i) the owner transfers the residence to a co-owner of the residence or, as part of a divorce proceeding, to his or her spouse and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(2) The owner dies. Death of the owner is not a disqualifying event if (i) the owner's share passes to a co-owner of the residence or to his or her

spouse ~~residence~~ and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(3) The owner ceases to use the property as a permanent residence."

SECTION 9.(a) G.S. 105-282.1(a)(1) reads as rewritten:

"(1) No application required. – Owners of the following exempt or excluded property do not need to file an application for the exemption or exclusion to be entitled to receive it:

a. Property exempt from taxation under G.S. 105-278.1 or G.S. 105-278.2.

b. Special classes of property excluded from taxation under G.S. 105-275(15), (16), (26), (31), (32a), (33), (34), (37), (40), ~~or (42).~~(42), or (44).

c. Property classified for taxation at a reduced valuation under G.S. 105-277(g) or G.S. 105-277.9."

SECTION 9.(b) This section is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

OCCUPANCY TAX CHANGES

SECTION 10. Section 1 of S.L. 2008-33 reads as rewritten:

"**SECTION 1.** Chapter 1055 of the 1983 Session ~~Laws~~ Laws, as amended by Section 21(e) of S.L. 2007-527, reads as rewritten:

'Section 1. ~~Levy of Tax.~~ Occupancy Tax. –

(a) Authorization and scope. – The Cherokee County Board of Commissioners may ~~by resolution, after not less than 10 days' public notice and after a public hearing held pursuant thereto,~~ levy a room occupancy and tourism development ~~tax.~~

~~(b) Collection of the tax, and liability therefor, shall begin and continue only on and after the first day of a calendar month set by the Cherokee County Board of Commissioners in the resolution levying the tax, which in no case may be earlier than the first day of the second succeeding calendar month after the date of adoption of the resolution.~~

~~'Sec. 2. Occupancy Tax.~~

~~(a) The county room occupancy and tourism development tax that may be levied under this act shall be a percentage~~ tax of three percent (3%) of the gross receipts derived from the rental of any room, lodging, or similar accommodation furnished by any hotel, motel, inn, tourist camp, or other similar place within the county ~~now~~ that is subject to ~~the three percent (3%)~~ sales tax imposed by the State under G.S. ~~105-164.4(3).~~ 105-164.4(a)(3). ~~During the first year in which a tax levied under this act is in effect, the tax shall be three percent (3%) of the gross receipts derived from the rental of taxable accommodations in the county. Thereafter, the rate of tax shall continue to be three percent (3%) unless the Cherokee County Board of Commissioners, by resolution, adopts a rate of less than three percent (3%). A change in the occupancy tax rate adopted by the board of commissioners becomes effective the first day of the second succeeding calendar month following the date of adoption of the resolution. The~~

~~Cherokee County Board of Commissioners may not change the occupancy tax rate more than once a year.~~

~~(b)~~ The occupancy tax is in addition to any State or local sales tax. This tax does not apply to accommodations furnished by nonprofit charitable, educational, ~~benevolent,~~ or religious organizations.

(b) Authorization of additional tax. – In addition to the tax authorized by subsection (a) of this section, the Cherokee County Board of Commissioners may levy an additional room occupancy tax of up to three percent (3%) of the gross receipts derived from the rental of accommodations taxable under subsection (a) of this section. The levy, collection, administration, and repeal of the tax authorized by this subsection shall be in accordance with the provisions of this act. Cherokee County may not levy a tax under this subsection unless it also levies the tax authorized under subsection (a) of this section.

'Sec. 3. Administration of Tax. – A tax levied under this act shall be levied, collected, administered, and repealed as provided in G.S. 153A-155. The penalties provided in G.S. 153A-155 apply to a tax levied under this act.

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

~~(b) Any person, firm, corporation, or association who fails or refuses to file the return required by this act shall pay a penalty of ten dollars ($10.00) for each day's omission.~~

~~(c) In case of failure or refusal to file the return or pay the tax for a period of 30 days after the time required for filing the return or for paying the tax, there shall be an additional tax, as a penalty, of five percent (5%) of the tax due in addition to the penalty prescribed in subsection (b), with an additional tax of five percent (5%) for each additional month or fraction thereof until the occupancy tax is paid.~~

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

~~'Sec. 4. Collection of Tax. Every operator of a business subject to the tax levied pursuant to this act shall collect the tax on and after the effective date of the levy of the tax.~~

~~This tax shall be collected as part of the charge for the furnishing of any taxable accommodations. The tax shall be stated and charged separately from the sales records, and shall be paid by the purchaser to the operator of the business as trustee for and on account of Cherokee County. The room occupancy tax levied under this act shall be added to the sales price and shall be passed on to the purchaser instead of being borne by the operator of the business. The county shall design, print, and furnish to all~~

~~appropriate businesses in the county the necessary forms for filing returns and instructions to ensure the full collection of the tax.~~

'Sec. 5. ~~Disposition of Taxes Collected.~~Distribution and use of tax revenue. – Cherokee County ~~shall~~ shall, on a quarterly basis, remit the net proceeds of ~~all revenues received from~~ the room occupancy tax to the Cherokee County Tourism Development Authority.~~Authority appointed pursuant to this act.~~ The Authority shall use at least two-thirds of the funds remitted to it under this act to promote travel and tourism in Cherokee County and shall use the remainder for tourism-related expenditures. ~~"Net proceeds" means gross proceeds less the cost to the county of administering and collecting the tax. The Authority may expend these funds only to further the development of travel, tourism, and conventions in the county through advertising and promotion.~~

The following definitions apply in this section:

(1) Net proceeds. – Gross proceeds less the cost to the county of administering and collecting the tax, as determined by the finance officer, not to exceed three percent (3%) of the first five hundred thousand dollars ($500,000) of gross proceeds collected each year and one percent (1%) of the remaining gross receipts collected each year.

(2) Promote travel and tourism. – To advertise or market an area or activity, publish and distribute pamphlets and other materials, conduct market research, or engage in similar promotional activities that attract tourists or business travelers to the area. The term includes administrative expenses incurred in engaging in the listed activities.

(3) Tourism-related expenditures. – Expenditures that, in the judgment of the Tourism Development Authority, are designed to increase the use of lodging facilities, meeting facilities, or convention facilities in a county or to attract tourists or business travelers to the county. The term includes tourism-related capital expenditures.

'Sec. 6. ~~Appointment, Duties of~~ Cherokee County Tourism Development Authority.–

(a) Appointment and membership. – When the Cherokee County Board of Commissioners adopts a resolution levying a room occupancy ~~tax,~~ tax under this act, it shall also adopt a resolution creating a County Tourism Development ~~Authority composed of the director of the Cherokee County Chamber of Commerce and the following four members appointed by the Cherokee County Board of Commissioners:~~

~~(1) an owner of a hotel, motel, or other accommodations subject to the tax levied by this act;~~

~~(2) a member of the board of county commissioners;~~

~~(3) a town commissioner or the mayor of the Town of Murphy; and~~

~~(4) a town alderman or the mayor of the Town of Andrews.~~

~~The director of the Cherokee County Chamber of Commerce shall serve as an ex officio member of the Authority. The members appointed by the board of county commissioners shall serve three-year terms, except the initial appointees. Of the initial appointees, the board of commissioners shall designate one to serve a one-year term, two a two-year term, and one a three-year term. Vacancies created by an appointed~~

~~member shall be filled by the board of commissioners. Members appointed to fill vacancies shall serve the remainder of the unexpired term for which they are appointed to fill.~~ Authority, which shall be a public authority under the Local Government Budget and Fiscal Control Act. The resolution shall provide for the membership of the Authority, including the members' terms of office, and for the filling of vacancies on the Authority. At least one-third of the members must be individuals who are affiliated with businesses that collect the tax in the county, and at least one-half of the members must be individuals who are currently active in the promotion of travel and tourism in the county. The board of commissioners shall designate one member of the Authority as chair and shall determine the compensation, if any, to be paid to members of the Authority.

The Authority shall meet at the call of the chair and shall adopt rules of procedure to govern its meetings. The Finance Officer for Cherokee County shall be the ex officio finance officer of the Authority.

(b) Duties. – The Authority shall expend the net proceeds of the tax levied under this act for the purposes provided in this act. The Authority shall promote travel, tourism, and conventions in the county, sponsor tourist-related events and activities in the county, and finance tourist-related capital projects in the county. ~~The members of the Tourism Development Authority shall elect from its membership a chairman. The Authority shall meet at the call of the chairman and shall adopt rules of procedure to govern its meetings. The finance officer of Cherokee County shall serve ex officio as accountant for the Authority.~~

(c) Reports. – The ~~Tourism Development~~ Authority shall report quarterly and at the close of the fiscal year to the board of county commissioners on its receipts and disbursements for the preceding quarter and for the year in such detail as the board may require.

~~'Sec. 7. Repeal of Levy.~~

~~(a) The board of county commissioners may by resolution repeal the levy of the room occupancy tax in Cherokee County, but no repeal of taxes levied under this act is effective until the end of the fiscal year in which the repeal resolution was adopted.~~

~~(b) No liability for any tax levied under this act that attached prior to the date on which a levy is repealed is discharged as a result of the repeal, and no right to a refund of a tax that accrued prior to the effective date on which a levy is repealed may be denied as a result of the repeal.~~

'Sec. 8. This act is effective upon ratification."

SECTION 11. The catchline for Section 21(j) of S.L. 2007-527 reads as rewritten:

"**SECTION 21.(j)** Subsection (a) of Section 4 of Chapter 929 of the 1985 Session ~~Laws as amended by S.L.1985-929~~ Laws, as amended by Chapter 319 of the 1987 Session Laws, reads as rewritten:"

SECTION 12. Section 1(b) of S.L. 2005-68 reads as rewritten:

"**SECTION 1.(b)** Administration. – Except as otherwise provided in this act, a tax levied under this section shall be levied, administered, and collected as provided in Part IV of Chapter 908 of the 1983 Session Laws, as amended by Chapters 821 and 922

of the 1989 Session ~~Laws and S.L. 2001-402.~~ Laws, S.L. 2001-402, and Section 21(cc) of S.L. 2007-527. The penalties provided in Part IV of Chapter 908 of the 1983 Session Laws, as amended by Chapters 821 and 922 of the 1989 Session Laws and S.L. 2001-402, apply to a tax levied under this section."

MOTOR FUEL TAX CHANGES

SECTION 13. G.S. 105-449.72 is amended by adding a new subsection to read:

"(f) Exemption. – The requirement to obtain a bond or irrevocable letter of credit does not apply to a distributor, importer, or motor fuel transporter that supplies motor fuel when the market for motor fuel is disrupted and emergency supplies are needed, as identified by an executive order of the Governor."

SECTION 14. G.S. 105-449.121(b)(2) reads as rewritten:

"(2) Audit a distributor, a retailer, a ~~bulk end-user,~~ bulk end-user, or a motor fuel user that is not licensed under this Article."

SECTION 15. G.S. 105-449.136 reads as rewritten:

"**§ 105-449.136. Tax on alternative fuel.**

A tax at the motor fuel rate is imposed on liquid alternative fuel used to operate a highway vehicle by means of a vehicle supply tank that stores fuel only for the purpose of supplying fuel to operate the vehicle. A tax at the equivalent of the motor fuel rate is imposed on all other alternative fuel used to operate a highway vehicle. The Secretary must determine the equivalent rate. The exemptions from the tax on motor fuel in ~~G.S. 105-449.88(2), (3), and (4)~~ G.S. 105-449.88 apply to the tax imposed by this section. The refunds for motor fuel tax allowed by Part 5 of Article 36C of this Chapter apply to the tax imposed by this section, except that the refund allowed by G.S. 105-449.107(b) for certain vehicles that use power takeoffs does not apply to a vehicle whose use of alternative fuel is taxed on the basis of miles driven. The proceeds of the tax imposed by this section must be allocated in accordance with G.S. 105-449.125."

OTHER CHANGES

SECTION 16. Section 67(a) of S.L. 2008-134 reads as rewritten:

"**SECTION 67.(a)** G.S. ~~58-5-25(a)(2)~~58-6-25(a)(2) is repealed."

SECTION 17.(a) G.S. 153A-156.1 reads as rewritten:

"**§ 153A-156.1. (For effective date, see note) Heavy equipment gross receipts tax in lieu of property tax.**

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

(1) Heavy equipment. – Earthmoving, construction, or industrial equipment that is mobile, weighs at least 1,500 pounds, and meets any of the descriptions listed in this subdivision. The term includes an attachment for heavy equipment, regardless of the weight of the attachment.

a. It is a self-propelled vehicle that is not designed to be driven on a highway.

b. It is industrial lift equipment, industrial material handling equipment, industrial electrical generation equipment, or a similar piece of industrial equipment.

(2) Short-term lease or rental. – Defined in G.S. 105-187.1.

(b) Tax Authorized. – A county may, by ~~resolution,~~ordinance, impose a tax at the rate of one and two-tenths percent (1.2%) on the gross receipts from the short-term lease or rental of heavy equipment by a person whose principal business is the short-term lease or rental of heavy equipment at retail. The heavy equipment subject to this tax is exempt from property tax under G.S. 105-275, and this tax provides an alternative to a property tax on the equipment. A person is not considered to be in the short-term lease or rental business if the majority of the person's lease and rental gross receipts are derived from leases and rentals to a person who is a related person under G.S. 105-163.010.

The tax authorized by this section applies to gross receipts that are subject to tax under G.S. 105-164.4(a)(2). Gross receipts from the short-term lease or rental of heavy equipment are subject to a tax imposed by a county under this section if the place of business from which the heavy equipment is delivered is located in the county.

(c) Payment. – A person whose principal business is the short-term lease or rental of heavy equipment is required to remit a tax imposed by this section to the county finance officer. The tax is payable quarterly and is due by the last day of the month following the end of the quarter. The tax is intended to be added to the amount charged for the short-term lease or rental of heavy equipment and paid to the heavy equipment business by the person to whom the heavy equipment is leased or rented.

(d) Enforcement. – The penalties and collection remedies that apply to the payment of sales and use taxes under Article 5 of Chapter 105 of the General Statutes apply to a tax imposed under this section. The county finance officer has the same authority as the Secretary of Revenue in imposing these penalties and remedies.

(e) Effective Date. – A tax imposed under this section becomes effective on the date set in the ~~resolution~~ ordinance imposing the tax. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted.

(f) Repeal. – A county may, by ~~resolution,~~ ordinance, repeal a tax imposed under this section. The repeal is effective on the date set in the ~~resolution.~~ ordinance. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted."

SECTION 17.(b) G.S. 160A-215.2 reads as rewritten:

"**§ 160A-215.2. (For effective date, see note) Heavy equipment gross receipts tax in lieu of property tax.**

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

(1) Heavy equipment. – Defined in G.S. 153A-156.1.

(2) Short-term lease or rental. – Defined in G.S. 105-187.1.

(b) Tax Authorized. – A city may, by ~~resolution,~~ ordinance, impose a tax at the rate of eight tenths percent (0.8%) on the gross receipts from the short-term lease or

rental of heavy equipment by a person whose principal business is the short-term lease or rental of heavy equipment at retail. The heavy equipment subject to this tax is exempt from property tax under G.S. 105-275, and this tax provides an alternative to a property tax on the equipment. A person is not considered to be in the short-term lease or rental business if the majority of the person's lease and rental gross receipts are derived from leases and rentals to a person who is a related person under G.S. 105-163.010.

The tax authorized by this section applies to gross receipts that are subject to tax under G.S. 105-164.4(a)(2). Gross receipts from the short-term lease or rental of heavy equipment are subject to a tax imposed by a city under this section if the place of business from which the heavy equipment is delivered is located in the city.

(c) Payment. – A person whose principal business is the short-term lease or rental of heavy equipment is required to remit a tax imposed by this section to the city finance officer. The tax is payable quarterly and is due by the last day of the month following the end of the quarter. The tax is intended to be added to the amount charged for the short-term lease or rental of heavy equipment and paid to the heavy equipment business by the person to whom the heavy equipment is leased or rented.

(d) Enforcement. – The penalties and collection remedies that apply to the payment of sales and use taxes under Article 5 of Chapter 105 of the General Statutes apply to a tax imposed under this section. The city finance officer has the same authority as the Secretary of Revenue in imposing these penalties and remedies.

(e) Effective Date. – A tax imposed under this section becomes effective on the date set in the ~~resolution~~ ordinance imposing the tax. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted.

(f) Repeal. – A city may, by ~~resolution,~~ ordinance, repeal a tax imposed under this section. The repeal is effective on the date set in the ~~resolution.~~ ordinance. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted."

SECTION 17.(c) This section does not affect the rights or liabilities of a county or city, a taxpayer, or another person arising under G.S. 160A-215.2 or G.S. 153A-156.1 before the effective date of this section; nor does it affect the right to any refund or credit of a tax that accrued under G.S. 160A-215.2 or G.S. 153A-156.1 before the effective date of this section. All existing ordinances or resolutions enacted under G.S. 160A-215.2 or G.S. 153A-156.1 prior to the effective date of this section shall continue in full force and effect until repealed, modified, or amended.

EFFECTIVE DATE

SECTION 18. Except as otherwise provided, this act is effective when it becomes law.

BILL ANALYSIS

DRAFT BILL 2009-SVz-4: Revenue Laws Technical, Administrative, & Clarifying Changes

Committee:	Revenue Laws Study Committee	**Date:**	January 7, 2009
Introduced by:		**Summary by:**	Trina Griffin & Cindy Avrette Committee Counsel
Version:	Draft		

SUMMARY: ***This legislative proposal makes several technical, clarifying, and administrative changes to the revenue laws and related statutes.***

BILL ANALYSIS: This draft proposal makes the following technical, clarifying, and administrative changes:

Section	Explanation
Corporate, Excise, and Insurance Taxes	
1	Adds associate home inspectors to the State privilege license provision enacted last year for home inspectors so that associate home inspectors will be taxed similarly. S.L. 2008-206 imposed an annual State privilege license tax of $50 on a home inspector licensed under the Home Inspector Act. The Home Inspector Act also licenses associate home inspectors, which are defined separately. However, they were not included in the law change. Without this change, associate home inspectors would be subject to local privilege license tax in each city that levies the tax.
2	Changes the term 'nonbusiness activities' to 'activities producing nonapportionable income', which is a defined term in the statute that sets out the manner in which corporations must allocate and apportion their income to North Carolina for income tax purposes. In 2002, the terms 'business income' and 'nonbusiness income' were replaced by apportionable and nonapportionable. This subsection was missed when those changes were made.
3	Changes an incorrect statutory reference.
4	Corrects an effective date relating to changes made to the statute designating who may sign an income tax return. These changes were originally part of the major rewrite of the tax appeals procedure in 2007 (SB 242).
5(a) & (b)	Changes the date by which the State Treasurer must make a transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund. The current statute provides that ***within 75 days after the end of each fiscal year***, the Treasurer must transfer to the Fund an amount equal to the growth in net revenue from the gross premiums tax on insurance companies. Insurance tax returns are due by March 15. Insurance companies are also required to prepay their tax in installments. The first installment of the fiscal year is due by October 15. Therefore, until those installments are remitted, little or no funds are available for transfer. This section changes the date from within 75 days after the end of the fiscal year, or September 14, to November 1, as recommended by the Department of Revenue.

Sales and Use Tax Changes	
6	Replaces the word 'energy' with the word 'electricity' for consistency. This term appears in the statute enacted last year authorizing a sales tax refund for materials used to build a facility that manufactures solar electricity generating materials.
7	Corrects two incorrect statutory references.
Property Tax Changes	
8(a) & (b)	Reinserts the words 'shares' and 'residence', which were inadvertently deleted when changes were made in 2008 to the circuit breaker statute.
9	Makes a conforming change to the statute that sets out the application procedure for property tax exemption related to the exemption for drug samples enacted last year.
Occupancy Tax Changes	
10	Adds a Session Law reference that was inadvertently omitted when the Cherokee County local occupancy tax act was amended last year. In 2007, a number of local occupancy tax local acts were amended to change the due date for remitting occupancy tax proceeds and filing returns from the 15th to the 20th of the month to conform to current sales tax statutes. The Cherokee County local occupancy tax act was one of the acts so amended. However, when the rest of the local act was amended in 2008, the 2007 change was not incorporated. To make this technical change, the entire local act must be set out under drafting convention. However, no substantive change is being made.
11	Corrects an incorrect Session Law reference.
12	Adds to S.L. 2005-68, a Session Law reference to the 2007 act referenced above that made changes to a number of local occupancy tax acts related to the due date of the tax and return. S.L. 2005-68 is the act that authorized the additional occupancy tax to finance the NASCAR Hall of Fame Museum.
Motor Fuel Tax Changes	
13	Provides an exception to the requirement that a distributor, importer, or motor fuel transporter must obtain a bond or irrevocable letter of credit when the person is supplying motor fuel into the State because the market for motor fuel has been disrupted and emergency supplies are needed, as identified by an executive order of the Governor. The bonding requirement became an issue during the recent motor fuel supply shortages in the western part of the State.
14	Corrects a misspelled word.
15	Conforms the tax exemptions for alternative fuel to the tax exemptions for motor fuel.
Other Changes	
16	Corrects an incorrect statutory reference.
17(a) & (b)	Replaces the word 'resolution' with the word 'ordinance' in each of the statutes authorizing cities and counties to levy a gross receipts tax in lieu of a property tax on the short-term rental of heavy equipment.

REVENUE LAWS STUDY COMMITTEE
Tuesday, January 27, 2009
Room 1228, Legislative Building
9:30 a.m.

MINUTES

The Revenue Laws Study Committee met at 9:30 a.m. on Tuesday, January 27, 2009, in room 1228 of the Legislative Building. Eleven members of the committee were present. Representative Luebke presided as chair.

Approval of Minutes from the January 7 Meeting

Representative Hill motioned for the approval of the January 7, 2009 minutes and the motion carried. A copy of the minutes is attached.

Department of Revenue

Introduction of Secretary-Elect, Kenneth Lay

Kenneth Lay was recognized. He gave a brief work history and spoke favorably of working with the legislature in the future.

Revenue Generated from Captive REIT Provision

William Spencer, Department of Revenue's Policy Analysis and Statistics Division, was recognized to report on the amount of corporate income tax revenue generated by the addition of dividends paid by captive REITs in the 2007 taxable year. The amount is $12,805,806. A copy of his report is attached.

Small Business Protection Act, Quality Control Improvements

Linda Millsaps, Department of Revenue's Chief Operating Officer, was recognized to report on the Department's new customer service initiatives. A copy of her report is attached.

North Carolina Hospital Association

Hugh Tilson, NC Hospital Association's Senior Vice President, was recognized to report on charity care. He directed the committee to the Association's website which provides data on the amount of all charity being provided by NC hospitals. A copy of his report is attached.

Budget Outlook Update

Barry Boardman, a fiscal analyst with the Fiscal Research Division, was recognized to outline the incoming revenue shortfall of approximately $1.8 – 2.2 billion. He was available to answer questions.

Legislative Proposals for Consideration

IRC Update

Heather Fennell, a staff attorney with the Research Division, was recognized to explain the proposed bill draft, which updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. Senator Brunstetter made a motion to include the proposal in the committee's report to the 2009 Session. Senator Hartsell seconded and the motion carried. A copy of the proposed bill draft, the summary and the fiscal note is attached.

Modernize Corporate Income Tax Filings

Cindy Avrette, a staff attorney with the Research Division, was recognized to explain the proposed bill draft which requires corporations to file a combined income tax report. Senator Clodfelter offered a clarifying revision. Senator Clodfelter made a motion to include the revised proposed bill draft in the committee's report and the motion carried. A copy of the original proposed bill draft and the summary is attached.

Streamlined Sales and Use Tax Update

Cindy Avrette was recognized to explain the proposed bill draft which urges the 111th Congress to grant states the ability to require collection of sales and use tax by remote retailers and updates the reference to the Streamlined Sales and Use Tax Agreement. Representative Weiss moved to include the proposed bill draft in the committee's report and the motion carried. A copy of the proposed bill draft and the summary is attached.

Real Property Sales Information

Martha Walston, a staff attorney with the Fiscal Research Division, was recognized to explain the proposed bill draft which assists counties and the Department of Revenue in obtaining accurate real property sales information needed for property tax appraisals by requiring a report of sales information when real property is transferred. Representative Brubaker moved to include the proposed bill draft in the committee's report and the motion carried. A copy of the proposed bill draft and the summary is attached.

Modernize Sales Tax Statutes/Digital Products

Trina Griffin, a staff attorney with the Research Division, was recognized to explain the proposed bill draft. The draft modernizes the sales and use tax statutes by treating music, movies, computer software, and books that are delivered electronically the same as those that are purchased in a tangible medium and revises the "mail order" sales tax provision to include specific references to internet sales. A copy of the proposed bill draft, the summary, and the fiscal note is attached. Brooks Raiford, President and CEO of the NC Technology Association, was recognized. He pointed out that taxation during an economic downturn could impact consumers and commerce; did not want the technology sector "singled out" for new taxation; and noted that digital purchases are "green" as they reduce packaging and shipping costs. A copy of his statements is attached. Senator Clodfelter moved to include the proposed bill draft in the committee's report and the motion carried.

Revenue Laws Technical, Administrative and Clarifying Changes

Trina Griffin was recognized to explain the draft's changes to the revenue laws and related statutes. Martha Walston was recognized to explain the property tax changes. Senator Clodfelter proposed to move Section 3 of the draft to the approved bill draft, "Modernize Corporate Income Tax Filings". Representative Luebke asked for objections and finding none the committee agreed with Senator Clodfelter's recommendation. Representative McGee moved to include the proposed bill draft in the committee's report and the motion carried. A copy of the proposed bill draft and the two summaries is attached.

Approval of Final Report

Representative Brubaker moved to approve the report including the items discussed and approved at today's meeting. The motion carried. A copy of the draft report is attached.

The meeting adjourned at 11:39 a.m.

Representative Paul Luebke, ~~P~~residing Chair

DeAnne Mangum, Committee Clerk

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Tuesday, January 27, 2009
Room 1228, Legislative Building
9:30 a.m.

I. **Approval of Minutes from January 7 Meeting**

II. **Department of Revenue**
- Introduction of Secretary-Elect, Kenneth Lay
- Reports:
  - Revenue Generated from Captive REIT Provision, *William Spencer, Department of Revenue*
  - Small Business Protection Act, Quality Control Improvements, *Linda Millsaps, Department of Revenue*

III. **North Carolina Hospital Association**
- Report on Charity Care and Community Benefit Data, *Hugh Tilson*

IV. **Budget Outlook Update**
- Barry Boardman, Fiscal Research Division

V. **Legislative Proposals For Consideration**
- #1: IRC Update
  Heather Fennell, Research Division
- #2: Modernize Corporate Income Tax Filings
  Cindy Avrette, Research Division
- #3: Streamlined Sales and Use Tax Update
  Cindy Avrette, Research Division
- #4: Real Property Sales Information
  Martha Walston, Fiscal Research Division
- #5: Modernize Sales Tax Statutes/Digital Products
  Trina Griffin, Research Division
  - *Comments from Brooks Raiford, President & CEO, NC Technology Association*

- #6: Revenue Laws Technical, Administrative, & Clarifying Changes -
  - Part I – *Trina Griffin, Research Division*
  - Part II (Property Tax Changes) – *Martha Walston, Fiscal Research Division*

VI. Approval of Final Report

VII. Adjournment

House Pages

Name Of Committee: Revenue Study Date: 1/27/09

1. Name: _____

   County: _____

   Sponsor: _____

2. Name: _____

   County: _____

   Sponsor: _____

3. Name: _____

   County: _____

   Sponsor: _____

4. Name: _____

   County: _____

   Sponsor: _____

5. Name: _____

   County: _____

   Sponsor: _____

Sgt-At-Arms

House

1. Name: Earl Cocker

2. Name: David Shearon

3. Name: _____

4. Name: _____

Senate

Ronald Spann

Charles Marsalis

Wade Anders

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

January 27, 2009
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Chip Kellum	Nelson Mullins
Greg Radford	NC DOR
Kay Hobart	NC DOJ
John Sadoff	NC DOR

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — January 27, 2009

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Cady Thomas	NCAR
Ken Boyd	NCBA
Ram Carpenter	Self
John McKay	GOV OFFICE
Elizabeth Dalton	NCREMT
DAVID BARNES	Poyner Spruill
Renee Wimbish	LA for Rep Folwell
Pam Melton	EMBARQ
AMANDA GARRETT	NC ASSOC OF REGISTER OF DEEDS
Kim Hargrove	NC Assoc of Register of Deeds
Andy Sasol	NCDOR
Lennie Collins	DOR
Donna Powell	DOR

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

January 27, 2009
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Amy McConkey	Smith Anderson
Doug Heron	Williams Mullen
Katherine Coley	Moore + Van Allen
Paul Stam	NCBA
Allison Waller	Charlotte Chamber
Sharon Miller	CUCA
Stan Duncan	Henderson Co. Assessor
Pete Rodda	Forsyth County Tax Assessor/Collector
David Baker	NCDOR
Bill Wilkes	NC DOR
Amy Schilder	MWC

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

January 27, 2009
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Amy Fullbright	Hunton & Williams
John McAlister	NC Chamber
[illegible]	NMRS
David Heiken	NC Center for Nonprofits
Billy Warren	Comms & Imagination Group
Ed [illegible]	BP
Brooks Rafford	NC Technology Association
Patrick Buffkin	NMRS
Tammy Roberson	TWC-NMRS-NC
Meg Gray	NC BTC
Elaine Majid	NC BTC

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee — January 27, 2009

Name of Committee — **Date**

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Janice W Davidson	NC DOR
Donna Alderman	NCDOR
Alan Felton	NCDOR
Michael Houser	NCDOR
Bill Spencer	NCDOR
Kelli Kukura	NC League of Municipalities
Brooks Rainford	NC Technology Assn.
W. David Auburn	
Julia Leggett	The Arc of NC
Michael Haley	Commerce
CS 86115	K of C Bates

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

January 27, 2009
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
	WCSR
HUGH TILSON	NCMA
	NCADA
	Edwin. Wade
Dana Sipes	Smith Anderson
Dean Plunkett	NCBWWA
Ken Melton	Ken Melton & Assoc.
JOHN GOODMAN	NC CHAMBER
	NC Chamber
	[illegible] Assoc

VISITOR REGISTRATION SHEET

Revenue Laws Study Committee
Name of Committee

January 27, 2009
Date

VISITORS: PLEASE SIGN IN BELOW AND RETURN TO DeANNE MANGUM

NAME	FIRM OR AGENCY AND ADDRESS
Warren Plonk	OSBM
Karl Knapp	NCLM
Jim Johnson	Blount Street Advisors
Linda Andrews	NCFB

REVENUE LAWS STUDY COMMITTEE
Wednesday, January 07, 2009
Room 544, Legislative Office Building
9:30 a.m.

MINUTES

The Revenue Laws Study Committee met at 9:30 a.m. on Wednesday, January 07, 2009, in room 544 of the Legislative Office Building. Twelve members of the committee were present. Senator Clodfelter presided as chair.

Approval of Minutes from the December 15 Meeting

Representative Brubaker motioned for the approval of the December 15, 2008 minutes and the motion carried. A copy of the minutes is attached.

Review of Property Tax Recommendations

Martha Walston, a staff attorney with the Fiscal Research Division, was recognized. She outlined property tax reappraisal schedule current law, methods of revaluations, the advantages and disadvantages of advanced schedules, schedules of other states and possible recommendations. A copy of the proposed bill draft and the county information handout is attached.

IRC Update

Heather Fennell, a staff attorney with the Research Division, was recognized to outline federal changes to the Internal Revenue Code and the effects on North Carolina revenue laws. A copy of her power point and a summary is attached.

Barry Boardman, a fiscal analyst with the Fiscal Research Division, was recognized to provide estimated financial impacts of the federal changes on North Carolina revenue.

Taxation for the Digital Age

Trina Griffin, a staff attorney with the Research Division, was recognized to explain how antiquated tax laws are not keeping up with technology leading to a loss of taxable sales. Sandra Johnson, a fiscal analyst with the Fiscal Research Division, was recognized to answer questions. A copy of Ms. Griffin's power point is attached.

Resale of Tickets via the Internet & 2009 Sunset

Cindy Avrette, a staff attorney with the Research Division, was recognized for an update on internet ticket sales/resales and the June 2009 expiration of the law. A copy of her handout is attached.

Update on Streamlined Sales Tax Project

Andy Sabol, Sales and Use Tax Division Director – NC Department of Revenue, was recognized for an update on the Streamlined Sales and Use Tax Governing Board

activities. He defined the project, its history, its current situation on the federal level and requested that the state be a serious advocate at the federal level for the project. A copy of his remarks is attached.

Comments on Changing the Corporate Tax Structure

Andy Ellen, Retail Merchants Association general counsel, was recognized. He is pleased about the streamlined projects, since it may bring tax equity to all merchants, storefront and digital. He expressed concern about privilege license tax inconsistencies and the need for the laws to be fixed. A copy of his remarks is attached.

Mark Prak, Brooks Pierce McLendon Humphrey and Leonard, was recognized. He feels that privilege license taxes are confusing and unequally applied which leads to impediments for new business startups.

John McAlister, NC Chamber, was recognized. He feels that corporate tax laws are a complex series of issues with varying views on clarification.

Joseph Crosby, Council on State Taxation, was recognized to discuss combined reporting. He said that its proponents see tax planning benefits while its opponents think it is too complex. It should be thoroughly evaluated before being adopted. A copy of his handout is attached.

Elaine Mejia, NC Justice Center Project Director, was recognized. She supports combined reporting and said many North Carolina businesses are already participating in other states where they do business.

The meeting adjourned at 11:50 a.m.

_____

Senator Daniel Clodfelter, Presiding Chair

_____

DeAnne Mangum, Committee Clerk

North Carolina Department of Revenue

Beverly Eaves Perdue
Governor

Kenneth R. Lay
Secretary

January 27, 2009

Report to

The Revenue Laws Study Committee

Amount of Corporate Income Tax Revenue Generated by the Requirement that Captive REITS Add Dividends Paid to Taxable Income

Tax Year 2007

As required by Section 31.18.(d) of Session Law 2007-323, this is to report that the amount of corporate income tax revenue generated in the 2007 taxable year by the addition of dividends paid by captive REITs to taxable income required by G.S. 105-130.5(a)(19) is $ 12,805,806.

P.O. Box 871, Raleigh, North Carolina 27602-0871
State Courier 51-71-00
Website: www.dornc.com
An Equal Opportunity Employer

North Carolina Department of Revenue

Beverly Eaves Perdue
Governor

Kenneth R. Lay
Secretary

January 27, 2009

MEMORANDUM

TO: The Honorable Marc Basnight
President Pro Tempore

Senator John H. Kerr, III
Revenue Laws Study Committee Chairman

The Honorable Joe Hackney
Speaker of the House

Representative Paul Luebke
Revenue Laws Study Committee Chairman

FROM: Kenneth R. Lay
Secretary of Revenue

SUBJECT: Customer Service Initiatives

This report is prepared pursuant to Session Law 2008-107, Section 28.16(i) and addresses customer service initiatives undertaken by the Department of Revenue. The report covers five specific reporting requirements contained in the statute.

The Department has taken a comprehensive approach to customer service improvement. Delivering quality service to taxpayers and other constituents is a key strategic objective of the agency. The Department, in an effort to focus attention on this strategic objective, conducted service excellence training sessions in the fall of 2008. Over 1,400 agency personnel attended a total of 57 training sessions. This training emphasized the need to provide quality customer service in all instances, equipped employees with several tools and techniques for providing such service, and provided feedback on additional training and quality improvement issues to be considered in future efforts made by the agency regarding this important issue.

The agency also crafted a service excellence vision and nine guiding principles supporting this vision. This information became a focal point of the training efforts and other discussions about customer service improvement.

The remainder of this report provides specific information related to the five reporting requirements contained in Section 28.16(i):

P.O. Box 25000, Raleigh, North Carolina 27640
Phone (919) 733-7211
State Courier 51-71-00
Website: www.dornc.com
An Equal Opportunity Employer

1. *Efforts to ensure that inquiries on complicated tax matters are handled or reviewed by appropriate personnel within the Department.*

Standard operating procedures for taxpayer inbound calls have been reviewed and enhanced. The procedures cover agency employees located at our Taxpayer Assistance and Call Center (TACC) and Taxpayer Assistance personnel located in Raleigh and in our service centers across the state. These procedures insure that employees with the requisite technical knowledge address complicated tax matters for various tax types.

The improved procedures also addressed several relevant points:

(a) Additional and frequent training for personnel
(b) Development of frequently asked questions with periodic updates
(c) Enhancement and evaluations of the competency level of personnel responding to tax matters
(d) Improved internal communication flow for complex tax matters
(e) Consultation with Tax Administration divisions on complex tax issues

At each service center location across the state, Taxpayer Assistance managers serve as the primary contact for complicated tax matters. The managers address tax matters in consultation with administrative officers with this division based in Raleigh.

2. A review of the Department's efforts to provide accurate and timely information regarding changes in tax law resulting from legislative changes, court decisions, or revised interpretations.

The Department's efforts to provide accurate and timely information are noted in the following actions:

(1) The 2008 Tax Law Changes publication was placed on the DOR website on September 12, 2008. The publication documents the law changes enacted in 2008 and laws changes enacted in prior legislative sessions that affect 2008 tax returns. (applies to all tax schedules)

(2) The Corporate, Excise and Insurance Tax Division published a 2008 Supplement to the 2007/2008 Rules and Bulletins that modified the sections of the Rules and Bulletins that were affected by law changes enacted during the 2008 legislative session. The supplement was posted to the Department's website on September 26, 2008.

(3) Our Corporate, Excise and Insurance Tax Division developed a document titled "Important Notice Regarding Requirement for Licensed Home Inspectors to Obtain a State Privilege License" which was sent via e-mail to the North Carolina Home Inspector Licensure Board. The Board subsequently distributed the document to all of its licensed home inspectors. Form B-202A, Application for State Privilege License, was revised to include home inspectors in the list of occupations that requires a license.

(4) Created and added to the Department's website a Hot Topic titled "Internet Resale of Admission Tickets". Form TR-110, Internet Resale of Admission Tickets Report, was developed and added to the website.

(5) Refund of Unsaleable Other Tobacco Products - Form B-A-101R, was renamed and revised to reflect that the refund provision is no longer limited to cigars.

(6) Tax forms and instructions are revised each year to reflect law changes. The instructions include a section titled "Important Legislative Changes for 2008" that addresses law changes.

(7) The Department maintains on its website information about the tax credit allowed to a film production company in the form of frequently asked questions. That information was revised on August 22, 2008 to reflect legislative changes in 2008 and other policy changes.

(8) The Corporate, Excise and Insurance Tax Division published two Directives during 2008, both of which are available on the Department's website. Directive CD 08-1, dated January 23, 2008, addressed the allocation of premium income from group life insurance policies. Directive CD 08-2, dated September 15, 2008, revised the Department's guidelines for renewable energy tax credit

(9) The Personal Taxes Division revised the Individual Income, Gift, and Estate Tax Bulletins to reflect all law and administrative tax changes and posted the info to the website, including a special notice about the new earned income tax credit.

(10) All general information for Personal Taxes schedules on the website has been updated to reflect any law or administrative changes.

(11) The 2008 individual income tax return instructions include language on the front of the booklet highlighting the law changes.

(12) Personal Taxes posted a notice to the website on Jan. 6, 2009 regarding the administrative position on the addback treatment for bonus depreciation.

(13) Motor Fuels provides all licensed taxpayers with an annual notice of tax law changes. This is usually mailed to the taxpayer in the Fall. We also send these notices to the NC Petroleum Marketers Association and the NC Trucking Association to be included in their monthly newsletters. All correspondence is placed on the web for further reference.

3. A review of the Department's outreach efforts designed to assist taxpayers, particularly small business taxpayers, in complying with the State's tax laws.

The Department's outreach efforts to small businesses fall into two primary categories:

- Creating new communications and outreach channels to small business owners and entrepreneurs
- Improving the Department's existing outreach and education efforts

New Communication and Outreach Channels

The Department established a partnership with the Community College System in August 2008 in an effort to assist small businesses to better under tax laws by providing free seminars at each of the 58 community college locations across our state. The seminars continue in 2009 and cover five key topics:

1. Tax implications for starting a business
2. Tax implications for growing a business
3. The basics of sales and use tax
4. The basics of withholding taxes
5. Dealing with the N.C. Department of Revenue.

In the first four months of the program, more than 250 small business owners and entrepreneurs attended tax seminars at the community colleges. Feedback from the attendees has been very positive, with most of the seminars rated as excellent or very good.

The N.C. Community College System Small Business Center Network also launched a website, www.sbcn.nc.gov, with a section dedicated to tax information provided by the Revenue Department. The site is a one-stop resource for small business owners and offers a variety of helpful information such as entrepreneurship training, guides and tools for starting a business, information on government contracts and business publications. Small business owners can sign up for confidential one-on-one counseling through the website.

The site also features a section from the Department of Revenue that focuses specifically on tax issues for small business owners. The key items are tax obligations, current announcements from the Department, a tax checklist for starting a business, a guide for getting tax assistance and a list of helpful links for small businesses. The tax section is located at: www.sbcn.nc.gov/taxInfo/default.aspx

The Department has also begun issuing "plain-English" announcements about topics such as tax law changes, new electronic services, compliance issues and new reporting and filing requirements. Some of these announcements are more general and others are targeted at specific types of businesses. The announcements are similar to news releases and are designed for organizations to use in newsletters or on websites. They offer easy-to-understand explanations of complex tax issues and links to the Department's website for additional information. They are specifically designed for small business owners who operate without the help of accountants, attorneys or tax preparers.

The announcements that apply to most businesses are sent to a network of organizations that include the North Carolina Chamber of Commerce, the North Carolina Retail Merchants Association (more than 25,000 members), local chambers of commerce across the state, business incubator organizations like the Upper Coastal Plains Council of Governments and the Rural Center. They have been sent by these organizations to members in e-mails, have appeared on websites, been published in newsletters and have gone out in broadcast faxes. The announcements have covered topics including:

1. The introduction of the new online file and pay system for businesses.
2. The introduction of the new online business registration system.
3. The introduction of the partnership with the Small Business Center Network.
4. The sales tax holiday.
5. A change in reporting for alcoholic beverage excise tax returns.
6. The phase-out of the excise tax on piped natural gas.

Many of these same announcements are also sent to tax preparer organizations like the N.C. Association of CPAs and the N.C. Society of Tax Professionals. These organizations also use the announcements frequently, which helps the Department reach businesses that employ professional tax preparation assistance.

Improving Existing Outreach Efforts

Department representatives have always been available to speak to groups of taxpayers about tax issues. This year the Department began offering public speaking training to its tax experts to improve the quality of its outreach efforts. This training covers the basics of public speaking, translating tax jargon into plain language and answering questions effectively in light of the Small Business Protection Act. It also includes a practical exercise in which the attendees make a presentation to their colleagues and receive feedback. Approximately 50 people have gone through the training and the feedback has been tremendous. Many of the attendees have reported back on how their presentations have improved and on the positive responses from their audiences.

The Department offers a comprehensive website as an information resource for taxpayers (including small business owners). Newcomers to the site often report that it is difficult to navigate and that they don't know which tax laws apply to them. In one of the first steps toward improving the site, the Department launched a Taxpayer Education section on the site. This new section helps taxpayers (including small business owners) navigate the site and find the information they need. It provides shortcuts to:

- Information about Tax Seminars and Presentations offered by the Department
- Current Tax Announcements
- Technical Bulletins, Directives and Notices
- Brochures and other Publications

This section was just launched recently. The Department will continue adding more content to make the section more robust and useful for small business owners.

Our Motor Fuels Division conducts annual motor carrier seminars throughout the State, usually during the month of August. In 2008, we conducted 2 seminars in Hickory, 1 in

Charlotte, 1 in Asheboro, 1 in Greenville, 1 in Wilmington, and 1 in Cary. There was 56% attendance based on registration forms. Approximately 400 taxpayers attended the seminars. We have been conducting motor carrier seminars since 1999.

4 A review of the Department's efforts to ensure that taxpayers are informed of their rights to request written advice from the Department upon which they may reasonably rely.

The Department maintains a website section entitled "Verbal Advice" that addresses both verbal and written advice. It explains how a taxpayer can request written advice, as well as when and how the Department will document verbal advice given to a taxpayer.

This information is also included in the Department's 2008 Tax Law Change document. It was included in the sales and use tax law change information sent to all registered taxpayers.

Our tax seminars conducted at the Small Business Centers also include information on how to get help and information from the Department. Most of the instructors cover written advice regardless of the seminar topic. The seminar on Dealing with the Department covers the common interactions small business owners have with the Department. It includes specific information on how a taxpayer can request written advice.

5. A review of the Department's plan to record telephone calls at the Department's Taxpayer Assistance Center.

The Department has evaluated call recording software for the TACC. A Service Level Request for call recording will be submitted after a final price quote is provided by ITS.

KRL/at

Mr. Don Dalton, All NCHA

ANDI Participation Update **Requests** **Reports** **Help** **Log Out**

Community Benefit Report

Hospital or Group Name	All NCHA Members
Time Period	FY 2007
Statistic Type	Total
Last Updated	1/27/2009 9:39 am
Number of Completed Surveys	106

Community Benefits

A. Estimated Costs of Treating Charity Care Patients*	$503,021,411
B. Estimated Unreimbursed Costs of Treating Medicare Patients*	$653,578,040
C. This includes an adjustment in this period's Medicare revenues for extraordinary adjustments[2] of:	$54,731,976
D. Without this Medicare adjustment, Medicare Losses would have been (B + C):	$708,484,530
E. Estimated Unreimbursed Costs of Treating Medicaid Patients*	$324,342,641
F. This includes an adjustment in this period's Medicaid revenues for extraordinary adjustments[2] of:	$69,822,891
G. Without this Medicaid adjustment, Medicaid Losses would have been (E + F):	$394,165,532
H. Estimated Unreimbursed Costs of Treating Patients from Other Non-Negotiated Government Programs*	$23,003,141
I. This includes an adjustment in this period's Other Non-Negotiated Government Programs revenues for extraordinary adjustments[2] of:	$12,519,835
J. Without this adjustment, Other Non-Negotiated Government Programs Losses would have been (H + I):	$35,522,976
K. Community Health Improvement Services & Community Benefit Operations	$44,251,356
L. Health Professions Education	$258,608,026
M. Subsidized Health Services[3]	$280,629,382

N. Research Costs	$4,071,920
O. Cash and In-kind Contributions to Community Groups	$49,245,465
P. Community Building Activities[4]	$9,203,559
Q. Total Community Benefits[1] with Settlements and Extraordinary Adjustments (A + B + E + H + K + L + M + N + O + P)	**$2,148,889,482**
R. Total Community Benefits[1] without Settlements and Extraordinary Adjustments (A + D + G + J + K + L + M + N + O + P)	**$2,286,138,698**

Bad Debt Costs

S. Estimated Costs of Treating Bad Debt Patients*	**$592,347,112**

Notes:

(1) Grant monies received to support any community benefit activities. These amounts have not been netted from Total Community Benefits.	$61,789,218
(2) Notes about prior period adjustments	
(3) Notes about Subsidized Health Services	
(4) Notes about Community Building Activities	
(5) URL with additional information about this community benefits report	
(6) Other Notes	

«Back To Reports

If you see any statistic in any report that looks odd to you, please email andi@ncha.org us and let us know. All we need is the column and line description that looks suspicious. Thank you.

Report Error Key

divide by zero error	The formula for this item includes division and when your value was being calculated, it was determined to have a denominator value of zero.
N/A	There is an error in your hospital's response to this report item and no answer will be returned until corrected.

n/a error	This number cannot be calculated. Possible reasons include • It is (0/0) • you have asked for a standard deviation based on one number (2 is minimum number of valid responses required in order to calculate a standard deviation.) • A necessary threshold of variation has not been met. • A facility "weight" statistics has been requested, but there is an error in the facility's answer (so it can't be used in the weighted average).
no supporting survey error	This report item is dependent upon information in another survey which has not been released yet, or is for a pre-ANDI (prior to Fiscal Year 2003) time period.
not answered error	One or more of the questions needed to calculate this report item were not answered in this survey. Often this is because the question was accidentally left blank (signifying "Missing Value") rather than having a zero in it.
not completed error	This survey has not been completed by this hospital.
not in survey error	One or more of the questions needed to calculate this report item were not asked in this survey (so ANDI could not calculate a value). Try selecting a different survey.
out of range error	Your value for this report item is considered either too high or too low and is suspected of being incorrect. If the value is correct, please contact me so that I can adjust the range to accept this value.
too few resp error	The number of valid responses is less that the group's minimum number of facilities needed to calculate aggregate or rank statistics. In the first five years of ANDI we learned how many responses are needed to get a stable average (one that doesn't change much when another facility marks its survey complete). In general averages reach the first level of stability at 65%, but they really stop moving with each newly completed survey at 80% (this is the overall reponse rate statistic). We have restricted ANDI to not show averages where participation rates are below that first threshold (65%). In this way you can have more confidence that the averages you can see today are relatively stable averages. We recommend that you always add a column for the overall response rate when asking for any group statistic.

Export Options

HTML Table Export — The HTML Table option outputs the data from this page into a new Web page. Most ANDI users will be able to select the commands in the *Edit* menu to

Select All, and then *Copy*, the data, then switch to Excel and *Paste* the data into a spreadsheet. For detailed export instructions, please see the FAQ.

Delimited Export

The Semicolon-Delimited option outputs the data into a new Web page with semicolon-delimited values. Most ANDI users will be able to select the commands in the *Edit* menu to *Select All*, and then *Copy*, the data, then switch to Excel and *Paste* the data into a spreadsheet. For detailed export instructions, please see the FAQ.

This page was generated on January 29, 2009 8:37 AM

LEGISLATIVE PROPOSAL #1

IRC UPDATE

LEGISLATIVE PROPOSAL #1

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

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

SHORT TITLE: IRC Update.

SPONSORS:

BRIEF OVERVIEW: This proposal would update from May 1, 2008 to January 1, 2009, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. By doing so, North Carolina would conform to changes made by five federal acts, except the bill would not conform to the new additional standard deduction for real property taxes authorized by the Housing Assistance Tax Act. The five federal acts are as follows:

1) Heartland, Habitat, Harvest, and Horticulture Act of 2008.
2) Heroes Earnings Assistance and Relief Tax Act of 2008.
3) Housing Assistance Tax Act of 2008.
4) Emergency Economic Stabilization Act of 2008.
5) Worker, Retiree, and Employer Recovery Act of 2008.

FISCAL IMPACT: Based on the analysis of the Joint Committee on Taxation, the bill is expected to have an impact on the State's General Fund. The fiscal impact on the State's General Fund of conforming to all five acts except the new additional standard deduction for real property taxes would be a combined loss of approximately $177.7 million for the 2009-10 and 2010-11 fiscal years. The methodology used begins with the Joint Tax Committee estimates of the nationwide federal impact by federal fiscal year (Federal fiscal years run from October through September). Fiscal Research adjusted

these numbers back to an approximate calendar year tax impact. The next step was to prorate the national numbers to the state impact. The Department of Revenue undertook this process using taxpayer data and North Carolina economic data.

After calculating the estimated State tax year impacts, the numbers were converted to state fiscal year by assuming that the traditional FRD method of putting 45% of a calendar year tax liability in the January-June period that finishes up one fiscal year and the allocating the remainder to the following fiscal year. There were not adjustments made to the JCT's estimates based on level of taxpayer compliance. Therefore, the fiscal estimates assume 100 percent taxpayer compliance with the tax law changes.

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

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-TDx-3 [v.4] (01/21)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/26/2009 9:28:49 AM

Short Title: IRC Update. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

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

The General Assembly of North Carolina enacts:

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

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

...

(1b) Code. – The Internal Revenue Code as enacted as of ~~May 1, 2008,~~January 1, 2009 including any provisions enacted as of that date which become effective either before or after that date."

SECTION 2. Notwithstanding Section 1 of this act, any amendments to the Internal Revenue Code enacted after May 1, 2008, that increase North Carolina taxable income for the 2008 taxable year become effective for taxable years beginning on or after January 1, 2009.

SECTION 3. G.S. 105-134.6(c) reads as rewritten:

"(c) Additions. – The following additions to taxable income shall be made in calculating North Carolina taxable income, to the extent each item is not included in taxable income:

...

(11) The amount of the taxpayer's additional standard deduction for real property taxes under section 63(c)(1)(C) of the Code."

SECTION 4. This act is effective when it becomes law.

Draft 2009-TDx-3: IRC Update

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Heather Fennell Committee Counsel
Version:			

SUMMARY: ***This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2008 to January 1, 2009. By doing so, North Carolina would conform to the changes made by five federal acts, except the bill would not conform to the new additional standard deduction for real property taxes. This bill would become effective when it became law.***

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

BILL ANALYSIS:

This bill would change the reference date to January 1, 2009, effective when the bill becomes law. Changing the reference date to January 1, 2009 would incorporate the changes made in the following acts:

- The Heartland, Habitat, Harvest, and Horticulture Act of 2008, signed into law May 22, 2008 (P.L. 110-234).
- The Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245);
- The Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289);
- The Emergency Economic Stabilization Act of 2008 signed into law October 3, 2008
- (P.L. 110-343);
- The Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458) signed into law December 23, 2008.

In addition to the preceding acts, an action by the Treasury Department may affect State revenue. On September 30, 2008 the IRS issued Notice 2008-84. This notice provides a potential tax break to purchasers of banks with outstanding bad debt.

---

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

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

Heartland, Habitat, Harvest, and Horticulture Act of 2008

Endangered species recovery expense. – The act creates a new deduction for endangered species recovery expenditures for expenses incurred after December 31, 2008. Farmers may currently claim a deduction for qualifying soil and water conservation expenditures and land erosion prevention expenditures. The deduction is limited to 25% of gross income derived from farming during the tax year but can be carried forward indefinitely. This act adds endangered species recovery expenditures to the category of expenditures that qualify for the deduction. The expenditures must be paid or incurred by a farmer after December 31, 2008 for the purpose of site-specific management actions recommended in recovery plans approved pursuant to the Endangered Species Act of 1973. Depreciable structures, appliances, or facilities do not qualify for the deduction.

Charitable Contributions of Real Property for Conservation Purposes. – The act extends the increased deduction for charitable contributions of real property for conservation purposes for tax years beginning before January 1, 2009. The deduction for capital gain appreciated real property is generally limited to 30% of the donor's adjusted gross income if the donor uses the fair market value of the donated property. If the donor's basis is used as the value of the property, and the property is donated to a "maximum deduction" organization, the deduction is limited to 50% of the donor's adjusted gross income.[3] Deductions for donations to non-maximum donation organizations are limited to 20% of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years. The Pension Protection Act of 2006 increased the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50% of adjusted gross income, with a 15-year carryforward for any excess. A "qualified farmer or rancher" may deduct the value of the gift up to 100% of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming is greater than 50% of the taxpayer's gross income for the tax year. The land donated by a farmer or rancher also must "be available" for agricultural use, but it need not be used for that purpose. This act extends these provisions through December 31, 2009.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Heroes Earnings Assistance and Relief Tax Act of 2008

State or Local Bonuses for Combat Veterans. – The act excludes state or local bonuses for combat veterans from gross income for income tax purposes. Generally all income is included in gross income unless the income is explicitly excluded. "Qualified military benefits" are excluded from gross income. These benefits generally include allowances or in-kind benefits provided to family members and former members of the armed services, or their dependents by reason of the member's service, including housing, moving, and travel allowances. This act expands the definition of "qualified military benefits" to include bonus payments by a state or local government to a member or former member of the armed services, or to a dependent of a member. To qualify for the exclusion, the payment must have been made for the member's service in a combat zone.[4]

Contributions of Military Death Gratuities to Roth IRAs and Coverdell ESAs. – The act allows military death gratuities to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs. Upon notification of the death

---

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

[4] A combat zone is defined as any area the president has by executive order designated an area in which the Armed Forces are or have engaged in combat.

of military personnel on active duty or on inactive duty training, a death gratuity is paid to or for the person's survivor. The death gratuity is a qualified military benefit and excluded from income. Roth IRAs are subject to annual contribution limits equal to the lesser of the statutory dollar amount or 100% of taxable income. For 2008, the annual limit on contributions is $5,000 for individuals, with an additional catch up contribution of $1,000 allowed for individuals over age 50. Sums may be rolled-over from eligible retirement plans to Roth IRAs, subject to income-phase out limitations. For 2008, rollovers are allowed for individuals whose gross adjusted income does not exceed $100,000. A Coverdell Education Savings Account is a tax-exempt trust created for paying the education expenses of the trust's designated beneficiary. Annual contributions to Coverdell ESAs may not exceed $2,000. This act allows the gratuity to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Housing Assistance Tax Act of 2008

Real Property Tax Deduction for Non-itemizers. – The act creates a deduction for real property taxes paid by non-itemizers for any tax year beginning in 2008. Taxpayers can take either the basic standard deduction, or itemize deductions, but not both. Taxpayers who itemize deductions may deduct state and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. This act allows taxpayers who take the standard deduction to claim an additional deduction for state and local real property taxes for any tax year beginning in 2008. The deduction is the lesser of (1) the amount allowable as a deduction for state and local taxes if the taxpayer claimed itemized deductions, or (2) $500 for individuals, $1000 for joint returns.

► ***BILL ANALYSIS:*** The bill does not conform to the provision of this act providing an additional standard deduction for state and local real property taxes.

Emergency Economic Stabilization Act of 2008

Executive Compensation Limits for Financial Institutions Participating in Troubled Asset Relief Program (TARP). – The act restricts certain financial institutions that sell troubled assets to the Treasury Department by means of a public action from deducting more than $500,000 for executive compensation and prohibits the firms from contracting for new golden parachute payments. Firms that sell troubled assets directly to the government must exclude incentives for executive officers to take unnecessary risks; must recover bonuses to senior executives based on materially inaccurate information; and may not make any golden parachute[5] payments to senior executives while the government holds an equity or debt position in the firm.

Previously, there were three limits in the IRC for executive compensation:

(1) A publicly held corporation cannot deduct applicable employee remuneration that exceeds $1 million per tax year.

(2) A corporation cannot deduct excess golden parachute payments paid to a disqualified individual that were triggered by a change in ownership or control.

(3) Excess payments are subject to a 20% excise tax paid by the recipient.

This act imposes new restrictions on executive compensation for financial institutions that sell troubled assets as part of TARP.

---

[5] A parachute payment is any payment in the nature of compensation paid to a disqualified individual that either is contingent upon a change in ownership of the corporation and equals or exceeds 3 times the individual's base pay, or is made under an agreement that violates securities laws or regulation.

Limits when financial institutions sell troubled assets through a public auction. – If a firm sells troubled assets through a TARP managed public auction to the Treasury, and has assets in excess of $300 million, the firm must adhere to the following limits on executive compensation.

(1) $500,000 limit on the deductibility of executive compensation, including incentive and commission pay.

(2) No deduction for excess golden parachute payments; excess payments are also subject to a 20% excise tax paid by the recipient.

(3) Prohibition from entering into a new employment contract that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership.

Limits when sales made directly to the Treasury: If a firm sells troubled assets directly to the Treasury, the firm must adhere to the following standards for compensation and benefits paid to senior executive officers for the duration of time the government holds the assets:[6]

(1) Limits on compensation that exclude incentives for executives to take unnecessary and excessive risks that threaten the value of the firm.

(2) Recovery of any bonus or incentive compensation paid to an executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate.

(3) Prohibition on golden parachutes.

Extension of Income Exclusion for Discharged Indebtedness on Principal Residence. – The act extends the exclusion from income for discharged indebtedness on principal residences for discharges occurring before January 1, 2013. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the unpaid mortgage debt, the canceled debt is considered income under the Code. There is no income limitation but no more than $2 million in mortgage debt is eligible for exclusion. The exclusion from income for discharged indebtedness related to a principal residence is for the three-year period beginning January 1, 2007 and ending December 31, 2009. This act extends the exclusions for discharged indebtedness related to a principal residence for the period beginning January 1, 2007 and ending on December 31, 2012.

Qualified Charitable Distribution from IRAs. – The act extends the favorable treatment of qualified charitable distributions from IRAs for two years, for distributions made in 2008 and 2009. Generally, to make a charitable donation from an IRA, a distribution must be taken and the applicable rules regarding taxable income apply. The distribution is included in taxable income to the extent the distributions are not attributable to a return of nondeductible contributions. The standard charitable deduction rules then apply to the donation. The Pension Protection Act of 2006 provided that individuals 70 ½ or older could distribute up to $100,000 per taxable year from their IRAs to charitable institutions without recognizing the income. The distribution must be made directly to the charitable organization from the trustee. This distribution counts towards the required minimum distribution. This is extended by the act for distributions in 2008 and 2009.

Transportation Fringe Benefit for Bicycle Commuters. – The act allows a new transportation fringe benefit for bicycle commuters. In general, commuting expenses to and from a place of business are not deductible. Transportation fringe benefits can defray some of an employee's commuting expenses with either pre-tax dollars that reduce otherwise taxable compensation, or with direct, employer-subsidized amounts that are considered tax free. This act adds qualified bike commuting reimbursements to the type of qualified transportation fringe benefits that an employer may provide to an employee who commutes to work using a bike.

Extension of certain deductions. –

---

[6] A senior executive officer is an individual who is one of the top five highly paid executives of a public company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1394.

Deduction for Qualified Tuition and Related Expenses. – The act extends the deduction for qualified tuition and related expenses for tax years beginning before January 1, 2010. The expenses eligible for the deduction include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or dependent at an eligible institution of higher education. The maximum deduction is $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 for joint filers) and $2,000 for taxpayers whose AGI does not exceed $80,000 ($160,000 for joint filers).

Above-the-Line Deduction for Certain Expenses of School Teachers. – The act extends the above-the-line deduction for eligible educators for tax years beginning in 2008 and 2009. The $250 deduction is allowed for books, supplies, and computer equipment purchased by an eligible educator for use in the classroom.

Enhanced Deduction for Charitable Contributions of Computers. – The act extends the enhanced deduction for charitable contributions of computers for tax years beginning in 2008 and 2009. C corporations that make qualified contributions of computer technology and equipment may claim and enhanced deduction equal to the corporation's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. The enhanced deduction may not exceed twice the corporation's basis in the property.

Enhanced Deduction for Charitable Contributions of Food Inventory. – The act extends the enhanced deduction for charitable contributions of food inventory for tax years beginning in 2008 and 2009. Taxpayers may take a deduction for donated food inventory equal to the lesser of (1) the donated item's basis plus one-half of the amount of gain that would be realized if the donated food item was sold at fair market value, or (2) two times the donated item's basis. The deduction is limited to 10% of the taxpayer's net income, however, the 10% limitation is suspended for contributions made by farmers or ranchers between October 3, 2008 and January 1, 2009.

Enhanced Deduction for Charitable Contributions of Book Donations. – The act extends the enhanced deduction for charitable contributions of book donations for tax years beginning in 2008 or 2009. Any corporation, other than an S corporation, can take an enhanced deduction for contributions of book inventory equal to the lesser of (1) the donated inventory item's basis plus one-half of the item's appreciation, or (2) two times the donated inventory item's basis.

Deduction for Environmental Remediation Costs. – The act extends the election to deduct environmental remediation costs to cover expenditures paid or incurred in 2008 and 2009. A taxpayer may elect to deduct certain environmental cleanup costs in the tax year paid or incurred, rather than capitalize them. The election only applies to costs that are incurred in connection with the abatement or control of hazardous substances at a "qualified containment site," also called a "brownfield site."

Deduction for Energy Efficient Commercial Buildings. – The act extends the deduction for energy-efficient commercial building property for five years and is available for qualified property placed into service after December 31, 2005 and before January 1, 2014. The deduction applies to "energy efficient commercial building property," which is defined as depreciable property that is installed as part of a building's (1) interior lighting systems, (2) heating, cooling, ventilation, and hot water systems, or (3) envelope, and is part of a certified plan to reduce the total annual energy and power costs of these systems by at least 50%. The deduction is limited to the product of $1.80 and the total square footage of the building, reduced by the aggregate amount deducted in any prior year.

Gain on Sales or Dispositions to Implement FERC or State Electric Restructuring Policy. – The act extends the special gain recognition rule for qualifying electric transmission transactions that implement FERC or state electric restructuring policy for two years for qualified electric utilities to sales or dispositions prior to January 1, 2010. A qualified electric utility can elect to recognize qualified gain from a qualifying electric transmission transaction over an eight-year period to the extent the amount realized from the sale is used to purchase exempt utility property within an applicable period.

Treatment of RIC Dividends Paid to Foreign Persons. – The act extends the exemption from the 30% tax on regulated investment company (RIC)[7] dividends that are designated as interest-related or short-term capital gains for two years to tax years beginning before January 1, 2010. Generally, US income paid to a nonresident alien or foreign corporation that is not connected with a US trade or business is subject to a flat 30% tax which is collected through withholding. Dividends that are designated as interest-related or short-term capital gains are exempt from the 30% tax.

15-Year MACRS Recovery period for Qualified Leasehold Improvements, Qualified Restaurant Improvements and Buildings, and Qualified Retail Improvement Property. – The act extends the 15-year Modified Adjusted Cost Recovery System (MACRS) recovery period for qualified leasehold improvements and restaurant improvements and buildings for two years and applies to property placed in service before January 1, 2009. The act also creates 15-year a MACRS recovery period for qualified retail improvement property and applies to property placed in service after December 31, 2007 and before January 1, 2009. Before these provisions, the improvements would generally be considered a structural component of the building and would be depreciated over a 39 year period.

Tax Treatment of Certain Payments to Controlling Exempt Organizations. – The act extends the special rules that permit the exclusion of qualifying payments by a controlled entity to a tax-exempt organization from that tax exempt organization's unrelated business income (UBTI) for two years through December 31, 2009. Tax-exempt organizations are taxed on UBTI, including amounts paid by a controlled entity. Only the excess amount of certain qualifying payments of rent, royalties, annuities, or interest income is included. Qualifying payments must be made in connection with a contract that is in effect August 17, 2006. Payments that exceed the amount that would be paid in an arms-length transaction are included in the UBTI.

Basis adjustment to stock of S corporations making charitable contributions of property. – The act extends the provision providing that the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation equals the shareholder's pro rata share of the adjusted basis of the contributed property for two years and applies to tax years beginning before January 1, 2009. This change preserves the intended benefit without causing the shareholder to recognize a gain or reduced loss that is attributable to the appreciation upon the subsequent sale of stock.

Seven-Year Depreciation Period for Motorsports Facilities. – The act extends the 7 year MACRS recovery period for motorsports entertainment complexes to property placed in service in 2008 and 2009. Historically, race tracks and facilities were treated by the IRS the same as theme and amusement parks. The American Jobs Creation Act of 2004 codified this treatment. A "motorsports entertainment complex" is a racing track facility that is permanently situated on land, hosts at least one racing event for cars of any type, trucks, or motorcycles during the 36-month period following the first day of the month in which it is put in service, and is open to the public for an admission fee.

Extend and Modify Treatment of Certain Qualified Film and Television Productions. – The act extends the expensing election related to film and television productions for one year for productions

---

[7] A RIC is commonly known as a mutual fund.

that begin before January 1, 2010, and allows the election to be made, in part, for productions with aggregate costs over the dollar production limit. A taxpayer may deduct the production costs of a qualifying film or television production. To qualify for the election, the aggregate production cost may not exceed $15 million. This act modifies the provision so that the first $15 million of otherwise qualifying film or television productions may be treated as an expense even if the aggregate cost of production exceeds $15 million.

Certain Farming Equipment Business Machinery or Equipment Treated as Five-Year Property. –The act provides that certain machinery or equipment used in a farming business is treated as five-year property for purposes of claiming MACRS depreciation. The equipment does not include grain bins, cotton ginning assets, fences or land improvements. Property that is used in a farming business can be depreciated under the General Depreciation System (GDS) using the 150-percent declining-balance method. Farm machinery and equipment generally has a recovery period of 10 years and has a straight-line recovery method.

Disaster Relief. -

Relief for Midwestern Disaster Areas. – The act modifies and extends many of the tax benefits extended to the victims of Katrina, Wilma, and Rita hurricanes to the victims of storms that hit the Midwest in the summer of 2008. These include the extension of special expensing for qualified property, an enhanced low-income housing credit, and flexible tax-exempt bond financing rules.

Casualty Losses Attributable to Federally Declared Disasters. – The act increases the deduction for casualty losses attributable to federally declared disasters for tax years beginning after December 31, 2007. Personal casualty losses are deductible to the extent the losses exceed $100 per casualty and the sum of the casualty losses exceed 10% of the taxpayer's AGI. For tax years beginning after December 31, 2007, the standard deduction is increased by the amount of any disaster loss amount for casualty losses attributable to a federally declared disaster occurring in 2008 and 2009. The losses are deductible without regard to whether the losses exceed 10% of a taxpayer's adjusted gross income. The deduction for any casualty attributable to a federally declared disaster occurring in 2009 is limited to the amount of the loss that exceeds $500.

Expensing of Qualified Disaster Costs. – The act allows a taxpayer to elect to expense qualified disaster expenses after 2007, rather than capitalizing them. Qualified disaster expenses include any expenditure that is all of the following:

(1) Paid or incurred in connection with a trade, business, or business-related property.
(2) Otherwise chargeable to a capital account.
(3) Made for any of the following:
    (a) The abatement or control of hazardous substances that were released on account of a federally declared disaster.
    (b) The removal of debris from, or the demolition of structures on, business-related property that is damaged as the result of a federally declared disaster.
    (c) The repair of business-related property damaged as a result of a federally declared disaster.

Net Operating Losses Attributable to Federally Declared Disasters. – The act creates a special five-year carryback period for net operating losses (NOLs) has been created for a qualified disaster loss. In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year.

Special Depreciation Allowance for Qualified Disaster Assistance Property. – The act allows an additional 50% depreciation allowance can be claimed for real and personal business property that is purchased to rehabilitate or replace similar property that is destroyed or condemned as a result of a residentially declared disaster for property placed in service after December 31, 2007, with respect to disasters declared after that date and occurring before January 1, 2010.

Increased Expensing for Qualified Disaster Assistance Property. – The act increases the maximum section 179 expense allowance and investment limitation amount for qualified section 179 disaster property placed in service after 2007. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Internal Revenue Code. To be eligible, the property must be tangible personal property which is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take expensing first and claim section 168(k) depreciation on any remaining basis. First year expensing is increased for disaster property:

(1) The section 179 expense deduction ($250,000 for 2008) is increased by the lesser of $100,000 or the cost of the qualified section 170 disaster assistance property placed in service during the tax year.

(2) The amount of the investment limitation ($250,000 for 2008) is increased by the lesser of $600,000 or the cost of qualified section 179 disaster assistance property placed in service during the tax year.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Worker, Retiree, and Employer Recovery Act of 2008

Required Minimum Distribution. – The act eliminates the required minimum distribution for calendar year 2009 for individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans. Employer-provided qualified retirement plans and individual retirement accounts are subject to minimum distribution rules. Generally, required minimum distributions must begin by April 1 of the year following the calendar year in which the individual reaches 70 ½. The required minimum distribution for each year is determined by a formula that includes the account balance and the individual and individual's designated beneficiary's expected lifetime. Failure to make a required minimum distribution results in a 50% excise tax.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

IRS Notice 2008-83

The IRS issued Notice 2008-83 on September 30, 2008. The notice suspends a rule that limits the use of built-in losses of banks following a change in ownership of the bank. Section 382 limits a corporation's ability to deduct its net operating losses against taxable income when the corporation undergoes an ownership change. An ownership change is defined as an increase in the percentage of a corporation's stock owned by one or more 5 percent shareholders by more than 50 percentage points within a 3-year period. After an ownership change, the deduction for the amount of losses attributable to the period before the ownership change is limited. The limit is generally equal to the value of the loss corporation at the time of the change multiplied by the applicable federal long-term tax-exempt interest rate. This notice provides that losses on loans or bad debts will not be limited by section 382 for banks that undergo an ownership change.

► ***TECHNICAL CONSIDERATIONS:*** The IRS notice is not a legislative change to the Code, rather it is a technical explanation meant to provide guidance on existing provisions of the Code as explained by the Treasury Department. Some practitioners believe this Notice goes beyond guidance on existing provisions and makes substantial changes to the Code. This bill does not address North Carolina's conformity to the provisions of the Notice.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

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, 2009

TO: Revenue Laws Study Committee

FROM: Barry Boardman
Fiscal Research Division

RE: IRC Update

FISCAL IMPACT

	Yes (X)	No ( )	No Estimate Available ( )		
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
REVENUES:					
Heartland, Habitat, Harvest, and Horticulture Act of 2008	(0.5)	(1.0)	(0.8)	(0.5)	(0.5)
Heroes Earnings Assistance and Relief Tax Act of 2008	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Emergency Economic Stabilization Act of 2008					
Extensions of Certain Deductions	(9.4)	(18.6)	(8.6)	0.0	0.0
MACRS recovery period and other business expensing	(8.5)	(18.2)	(13.6)	(8.3)	(7.4)
Disaster Relief	(7.2)	(16.7)	(15.4)	(5.8)	3.4
Other	(5.7)	(10.8)	(7.4)	(8.5)	(8.4)
EESA TOTAL	(30.9)	(64.3)	(45.0)	(22.7)	(12.5)
Workers, Retiree, and Employer Recovery Act 2008	(36.0)	(44.0)			
TOTAL	**(67.9)**	**(109.8)**	**(46.3)**	**(23.7)**	**(13.5)**
EXPENDITURES:					

POSITIONS
(cumulative):

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

EFFECTIVE DATE: January 1, 2009

BILL SUMMARY: This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2008 to January 1, 2009. By doing so, North Carolina would conform to the changes made by five federal acts, except the bill would not conform to the new additional standard deduction for real property taxes. This bill would become effective when it became law.

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

BILL ANALYSIS:

This bill would change the reference date to January 1, 2009, effective when the bill becomes law. Changing the reference date to January 1, 2009 would incorporate the changes made in the following acts: the Heartland, Habitat, Harvest, and Horticulture Act of 2008, signed into law May 22, 2008 (P.L. 110-234); the Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245); the Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289); the Emergency Economic Stabilization Act of 2008 signed into law October 3, 2008 (P.L. 110-343); and the Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458) signed into law December 23, 2008.

Heartland, Habitat, Harvest, and Horticulture Act of 2008

Endangered species recovery expense. – Farmers may currently claim a deduction for qualifying soil and water conservation expenditures and land erosion prevention expenditures. The deduction is limited to 25% of gross income derived from farming during the tax year but can be carried forward indefinitely. This act adds endangered species recovery expenditures to the category of

---

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

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

expenditures that qualify for the deduction. The expenditures must be paid or incurred by a farmer after December 31, 2008 for the purpose of site-specific management actions recommended in recovery plans approved pursuant to the Endangered Species Act of 1973. Depreciable structures, appliances, or facilities do not qualify for the deduction.

Charitable Contributions of Real Property for Conservation Purposes. - The deduction for capital gain appreciated real property is generally limited to 30 percent of the donor's adjusted gross income if the donor uses the fair market value of the donated property. If the donor's basis is used as the value of the property, and the property is donated to a "maximum deduction" organization, the deduction is limited to 50 percent of the donor's adjusted gross income.[3] Deductions for donations to non-maximum donation organizations are limited to 20 percent of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years. The Pension Protection Act of 2006 increased the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50 percent of adjusted gross income, with a 15-year carryforward for any excess. A "qualified farmer or rancher" may deduct the value of the gift up to 100 percent of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming is greater than 50 percent of the taxpayer's gross income for the tax year. The land donated by a farmer or rancher also must "be available" for agricultural use, but it need not be used for that purpose. This act extends these provisions through December 31, 2009.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Heroes Earnings Assistance and Relief Tax Act of 2008

State or Local Bonuses for Combat Veterans. – The act excludes state or local bonuses for combat veterans from gross income for income tax purposes. Generally all income is included in gross income unless the income is explicitly excluded. "Qualified military benefits" are excluded from gross income. These benefits generally include allowances or in-kind benefits provided to family members and former members of the armed services, or their dependents by reason of the member's service, including housing, moving, and travel allowances. This act expands the definition of "qualified military benefits" to include bonus payments by a state or local government to a member or former member of the armed services, or to a dependent of a member. To qualify for the exclusion, the payment must have been made for the member's service in a combat zone.[4]

Contributions of Military Death Gratuities to Roth IRAs and Coverdell ESAs. – The act allows military death gratuities to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs. Upon notification of the death of military personnel on active duty or on inactive duty training, a death gratuity is paid to or for the person's survivor. The death gratuity is a qualified military benefit and

---

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

[4] A combat zone is defined as any area the president has by executive order designated an area in which the Armed Forces are or have engaged in combat.

excluded from income. Roth IRAs are subject to annual contribution limits equal to the lesser of the statutory dollar amount or 100% of taxable income. For 2008, the annual limit on contributions is $5,000 for individuals, with an additional catch up contribution of $1,000 allowed for individuals over age 50. Sums may be rolled-over from eligible retirement plans to Roth IRAs, subject to income-phase out limitations. For 2008, rollovers are allowed for individuals whose gross adjusted income does not exceed $100,000. A Coverdell Education Savings Account is a tax-exempt trust created for paying the education expenses of the trust's designated beneficiary. Annual contributions to Coverdell ESAs may not exceed $2,000. This act allows the gratuity to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Housing Assistance Tax Act of 2008

Real Property Tax Deduction for Non-itemizers. – The act creates a deduction for real property taxes paid by non-itemizers for any tax year beginning in 2008. Taxpayers can take either the basic standard deduction, or itemize deductions, but not both. Taxpayers who itemize deductions may deduct state and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. This act allows taxpayers who take the standard deduction to claim an additional deduction for state and local real property taxes for any tax year beginning in 2008. The deduction is the lesser of (1) the amount allowable as a deduction for state and local taxes if the taxpayer claimed itemized deductions, or (2) $500 for individuals, $1000 for joint returns.

► ***BILL ANALYSIS:*** The bill ***does not conform*** to the provision of this act providing an additional standard deduction for state and local real property taxes.

Emergency Economic Stabilization Act of 2008

Executive Compensation Limits for Financial Institutions Participating in Troubled Asset Relief Program (TARP). – The act restricts certain financial institutions that sell troubled assets to the Treasury Department by means of a public action from deducting more than $500,000 for executive compensation and prohibits the firms from contracting for new golden parachute payments. Firms that sell troubled assets directly to the government must exclude incentives for executive officers to take unnecessary risks; must recover bonuses to senior executives based on materially inaccurate information; and may not make any golden parachute[5] payments to senior executives while the government holds an equity or debt position in the firm.
Previously, there were three limits in the IRC for executive compensation:

(1) A publicly held corporation cannot deduct applicable employee remuneration that exceeds $1 million per tax year.

(2) A corporation cannot deduct excess golden parachute payments paid to a disqualified individual that were triggered by a change in ownership or control.

[5] A parachute payment is any payment in the nature of compensation paid to a disqualified individual that either is contingent upon a change in ownership of the corporation and equals or exceeds 3 times the individual's base pay, or is made under an agreement that violates securities laws or regulation.

(3) Excess payments are subject to a 20% excise tax paid by the recipient.

This act imposes new restrictions on executive compensation for financial institutions that sell troubled assets as part of TARP.

Limits when financial institutions sell troubled assets through a public auction. – If a firm sells troubled assets through a TARP managed public auction to the Treasury, and has assets in excess of $300 million, the firm must adhere to the following limits on executive compensation.

(1) $500,000 limit on the deductibility of executive compensation, including incentive and commission pay.

(2) No deduction for excess golden parachute payments; excess payments are also subject to a 20% excise tax paid by the recipient.

(3) Prohibition from entering into a new employment contract that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership.

Limits when sales made directly to the Treasury: If a firm sells troubled assets directly to the Treasury, the firm must adhere to the following standards for compensation and benefits paid to senior executive officers for the duration of time the government holds the assets:[6]

(1) Limits on compensation that exclude incentives for executives to take unnecessary and excessive risks that threaten the value of the firm.

(2) Recovery of any bonus or incentive compensation paid to an executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate.

(3) Prohibition on golden parachutes.

Extension of Income Exclusion for Discharged Indebtedness on Principal Residence. – The act extends the exclusion from income for discharged indebtedness on principal residences created by the Mortgage Forgiveness Act of 2007 for discharges occurring before January 1, 2013. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the unpaid mortgage debt, the canceled debt is considered income under the Code. There is no income limitation but no more than $2 million in mortgage debt is eligible for exclusion. The exclusion from income for this discharged indebtedness related to a principal residence for the three-year period beginning January 1, 2007 and ending December 31, 2009. This act extends the exclusions for discharged indebtedness related to a principal residence for the period beginning January 1, 2007 and ending on December 31, 2012.

Qualified Charitable Distribution from IRAs. – The act extends the favorable treatment of qualified charitable distributions from IRAs for two years, for distributions made in 2008 and 2009. Generally, to make a charitable donation from an IRA, a distribution must be taken and the applicable rules regarding taxable income apply. The distribution is included in taxable income to the extent the distributions are not attributable to a return of nondeductible contributions. The standard charitable deduction rules then apply to the donation. The Pension Protection Act of 2006 provided that individuals 70 ½ or older could distribute up to $100,000 per taxable year from their IRAs to charitable institutions without recognizing the income. The distribution must be

---

[6] A senior executive officer is an individual who is one of the top five highly paid executives of a public company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1394.

made directly to the charitable organization from the trustee. This distribution counts towards the required minimum distribution. This is extended by the act for distributions in 2008 and 2009.

Transportation Fringe Benefit for Bicycle Commuters. – The act allows a new transportation fringe benefit for bicycle commuters. In general, commuting expenses to and from a place of business are not deductible. Transportation fringe benefits can defray some of an employee's commuting expenses with either pre-tax dollars that reduce otherwise taxable compensation, or with direct, employer-subsidized amounts that are considered tax free. This act adds qualified bike commuting reimbursements to the type of qualified transportation fringe benefits that an employer may provide to an employee who commutes to work using a bike.

Extension of certain deductions. –

Deduction for Qualified Tuition and Related Expenses. – The act extends the deduction for qualified tuition and related expenses for tax years beginning before January 1, 2010. The expenses eligible for the deduction include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or dependent at an eligible institution of higher education. The maximum deduction is $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 for joint filers) and $2,000 for taxpayers whose AGI does not exceed $80,000 ($160,000 for joint filers).

Above-the-Line Deduction for Certain Expenses of School Teachers. – The act extends the above-the-line deduction for eligible educators for tax years beginning in 2008 and 2009. The $250 deduction is allowed for books, supplies, and computer equipment purchased by an eligible educator for use in the classroom.

Enhanced Deduction for Charitable Contributions of Computers. – The act extends the enhanced deduction for charitable contributions of computers for tax years beginning in 2008 and 2009. C corporations that make qualified contributions of computer technology and equipment may claim and enhanced deduction equal to the corporation's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. The enhanced deduction may not exceed twice the corporation's basis in the property.

Enhanced Deduction for Charitable Contributions of Food Inventory. – The act extends the enhanced deduction for charitable contributions of food inventory for tax years beginning in 2008 and 2009. Taxpayers may take a deduction for donated food inventory equal to the lesser of (1) the donated item's basis plus one-half of the amount of gain that would be realized if the donated food item was sold at fair market value, or (2) two times the donated item's basis. The deduction is limited to 10% of the taxpayer's net income, however, the 10% limitation is suspended for contributions made by farmers or ranchers between October 3, 2008 and January 1, 2009.

Enhanced Deduction for Charitable Contributions of Book Donations. – The act extends the enhanced deduction for charitable contributions of book donations for tax years beginning in 2008 or 2009. Any corporation, other than an S corporation, can take an enhanced deduction for contributions of book inventory equal to the lesser of (1) the

donated inventory item's basis plus one-half of the item's appreciation, or (2) two times the donated inventory item's basis.

Deduction for Environmental Remediation Costs. – The act extends the election to deduct environmental remediation costs to cover expenditures paid or incurred in 2008 and 2009. A taxpayer may elect to deduct certain environmental cleanup costs in the tax year paid or incurred, rather than capitalize them. The election only applies to costs that are incurred in connection with the abatement or control of hazardous substances at a "qualified containment site," also called a "brownfield site."

Deduction for Energy Efficient Commercial Buildings. – The act extends the deduction for energy-efficient commercial building property for five years and is available for qualified property placed into service after December 31, 2005 and before January 1, 2014. The deduction applies to "energy efficient commercial building property," which is defined as depreciable property that is installed as part of a building's (1) interior lighting systems, (2) heating, cooling, ventilation, and hot water systems, or (3) envelope, and is part of a certified plan to reduce the total annual energy and power costs of these systems by at least 50%. The deduction is limited to the product of $1.80 and the total square footage of the building, reduced by the aggregate amount deducted in any prior year.

Gain on Sales or Dispositions to Implement FERC or State Electric Restructuring Policy. – The act extends the special gain recognition rule for qualifying electric transmission transactions that implement FERC or state electric restructuring policy for two years for qualified electric utilities to sales or dispositions prior to January 1, 2010. A qualified electric utility can elect to recognize qualified gain from a qualifying electric transmission transaction over an eight-year period to the extent the amount realized from the sale is used to purchase exempt utility property within an applicable period.

Treatment of RIC Dividends Paid to Foreign Persons. – The act extends the exemption from the 30% tax on regulated investment company (RIC)[7] dividends that are designated as interest-related or short-term capital gains for two years to tax years beginning before January 1, 2010. Generally, US income paid to a nonresident alien or foreign corporation that is not connected with a US trade or business is subject to a flat 30% tax which is collected through withholding. Dividends that are designated as interest-related or short-term capital gains are exempt from the 30% tax.

15-Year MACRS Recovery period for Qualified Leasehold Improvements, Qualified Restaurant Improvements and Buildings, and Qualified Retail Improvement Property. – The act extends the 15-year Modified Adjusted Cost Recovery System (MACRS) recovery period for qualified leasehold improvements and restaurant improvements and buildings for two years and applies to property placed in service before January 1, 2009. The act also creates 15-year a MACRS recovery period for qualified retail improvement property and applies to property placed in service after December 31, 2007 and before January 1, 2009. Before these provisions, the improvements would generally be considered a structural component of the building and would be depreciated over a 39 year period.

---

[7] A RIC is commonly known as a mutual fund.

Tax Treatment of Certain Payments to Controlling Exempt Organizations. – The act extends the special rules that permit the exclusion of qualifying payments by a controlled entity to a tax-exempt organization from that tax exempt organization's unrelated business income (UBTI) for two years through December 31, 2009. Tax-exempt organizations are taxed on UBTI, including amounts paid by a controlled entity. Only the excess amount of certain qualifying payments of rent, royalties, annuities, or interest income is included. Qualifying payments must be made in connection with a contract that is in effect August 17, 2006. Payments that exceed the amount that would be paid in an arms-length transaction are included in the UBTI.

Basis adjustment to stock of S corporations making charitable contributions of property. – The act extends the provision providing that the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation equals the shareholder's pro rata share of the adjusted basis of the contributed property for two years and applies to tax years beginning before January 1, 2009. This change preserves the intended benefit without causing the shareholder to recognize a gain or reduced loss that is attributable to the appreciation upon the subsequent sale of stock.

Seven-Year Depreciation Period for Motorsports Facilities. – The act extends the 7 year MACRS recovery period for motorsports entertainment complexes to property placed in service in 2008 and 2009. Historically, race tracks and facilities were treated by the IRS the same as theme and amusement parks. The American Jobs Creation Act of 2004 codified this treatment. A "motorsports entertainment complex" is a racing track facility that is permanently situated on land, hosts at least one racing event for cars of any type, trucks, or motorcycles during the 36-month period following the first day of the month in which it is put in service, and is open to the public for an admission fee.

Extend and Modify Treatment of Certain Qualified Film and Television Productions. – The act extends the expensing election related to film and television productions for one year for productions that begin before January 1, 2010, and allows the election to be made, in part, for productions with aggregate costs over the dollar production limit. A taxpayer may deduct the production costs of a qualifying film or television production. To qualify for the election, the aggregate production cost may not exceed $15 million. This act modifies the provision so that the first $15 million of otherwise qualifying film or television productions may be treated as an expense even if the aggregate cost of production exceeds $15 million.

Certain Farming Equipment Business Machinery or Equipment Treated as Five-Year Property. –The act provides that certain machinery or equipment used in a farming business is treated as five-year property for purposes of claiming MACRS depreciation. The equipment does not include grain bins, cotton ginning assets, fences or land improvements. Property that is used in a farming business can be depreciated under the General Depreciation System (GDS) using the 150-percent declining-balance method. Farm machinery and equipment generally has a recovery period of 10 years and has a straight-line recovery method.

Disaster Relief. -

Relief for Midwestern Disaster Areas. – The act modifies and extends many of the tax benefits extended to the victims of Katrina, Wilma, and Rita hurricanes to the victims of storms that hit the Midwest in the summer of 2008. These include the extension of special expensing for qualified property, an enhanced low-income housing credit, and flexible tax-exempt bond financing rules.

Casualty Losses Attributable to Federally Declared Disasters. – The act increases the deduction for casualty losses attributable to federally declared disasters for tax years beginning after December 31, 2007. Personal casualty losses are deductible to the extent the losses exceed $100 per casualty and the sum of the casualty losses exceed 10% of the taxpayer's AGI. For tax years beginning after December 31, 2007, the standard deduction is increased by the amount of any disaster loss amount for casualty losses attributable to a federally declared disaster occurring in 2008 and 2009. The losses are deductible without regard to whether the losses exceed 10% of a taxpayer's adjusted gross income. The deduction for any casualty attributable to a federally declared disaster occurring in 2009 is limited to the amount of the loss that exceeds $500.

Expensing of Qualified Disaster Costs. – The act allows a taxpayer to elect to expense qualified disaster expenses after 2007, rather than capitalizing them. Qualified disaster expenses include any expenditure that is all of the following:

(1) Paid or incurred in connection with a trade, business, or business-related property.

(2) Otherwise chargeable to a capital account.

(3) Made for any of the following:

- (a) The abatement or control of hazardous substances that were released on account of a federally declared disaster.
- (b) The removal of debris from, or the demolition of structures on, business-related property that is damaged as the result of a federally declared disaster.
- (c) The repair of business-related property damaged as a result of a federally declared disaster.

Net Operating Losses Attributable to Federally Declared Disasters. – The act creates a special five-year carryback period for net operating losses (NOLs) has been created for a qualified disaster loss. In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year.

Special Depreciation Allowance for Qualified Disaster Assistance Property. – The act allows an additional 50% depreciation allowance can be claimed for real and personal business property that is purchased to rehabilitate or replace similar property that is destroyed or condemned as a result of a residentially declared disaster for property placed in service after December 31, 2007, with respect to disasters declared after that date and occurring before January 1, 2010.

Increased Expensing for Qualified Disaster Assistance Property. – The act increases the maximum section 179 expense allowance and investment limitation amount for qualified section 179 disaster property placed in service after 2007. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Internal Revenue Code. To be eligible, the property must be tangible personal property which is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take expensing first and claim section 168(k) depreciation on any remaining basis. First year expensing is increased for disaster property:

(1) The section 179 expense deduction ($250,000 for 2008) is increased by the lesser of $100,000 or the cost of the qualified section 170 disaster assistance property placed in service during the tax year.

(2) The amount of the investment limitation ($250,000 for 2008) is increased by the lesser of $600,000 or the cost of qualified section 179 disaster assistance property placed in service during the tax year.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Worker, Retiree, and Employer Recovery Act of 2008

Required Minimum Distribution. – The act eliminates the required minimum distribution for calendar year 2009 for individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans. Employer-provided qualified retirement plans and individual retirement accounts are subject to minimum distribution rules. Generally, required minimum distributions must begin by April 1 of the year following the calendar year in which the individual reaches 70 ½. The required minimum distribution for each year is determined by a formula that includes the account balance and the individual and individual's designated beneficiary's expected lifetime. Failure to make a required minimum distribution results in a 50% excise tax.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

ASSUMPTIONS AND METHODOLOGY: The methodology used begins with the Joint Tax Committee estimates of the nationwide federal impact by federal fiscal year (Federal fiscal years run from October through September). Fiscal Research adjusted these numbers back to an approximate calendar year tax impact. The next step was to prorate the national numbers to the state impact. The Department of Revenue undertook this process using taxpayer data and North Carolina economic data.

After calculating the estimated State tax year impacts, the numbers were converted to state fiscal year by assuming that the traditional FRD method of putting 45% of a calendar year tax liability in the January-June period that finishes up one fiscal year and the allocating the remainder to the

following fiscal year. There were no adjustments made to the Joint Committee on Taxation's estimates based on the level of taxpayer compliance. Therefore, the fiscal estimates assume 100 percent taxpayer compliance with the tax law changes.

SOURCES OF DATA: US Joint Committee on Taxation, NC Department of Revenue

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #2

MODERNIZE CORPORATE INCOME TAX FILINGS

LEGISLATIVE PROPOSAL #2

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

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

SHORT TITLE: Modernize Corporate Income Tax Filings.

SPONSORS:

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

FISCAL IMPACT:

EFFECTIVE DATE: The proposal would become effective for taxable years beginning on or after January 1, 2010.

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-RBxz-9 [v.1] (12/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/26/2009 3:23:37 PM

Short Title: Modernize Corporate Income Tax Filings. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

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

The General Assembly of North Carolina enacts:

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

"**§ 105-130.2. Definitions.**

The following definitions apply in this Part:

...

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

a. Receipts from a casual sale of property.
b. Receipts allocated under subsections (c) through (h) of this section.
c. Receipts exempt from taxation.
d. The portion of receipts realized from the sale or maturity of securities or other obligations that represents a return of principal.

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

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

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

a. A unity of ownership, operation, or use.
b. An interdependence in their functions."

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

"(b) A corporation having income from business activity which is taxable both within and without this State shall allocate and apportion its net income or net loss as provided in this

~~section.~~ section and G.S. 105-130.4A. For purposes of allocation and apportionment, a corporation is taxable in another state if (i) the corporation's business activity in that state subjects it to a net income tax or a tax measured by net income, or (ii) that state has jurisdiction based on the corporation's business activity in that state to subject the corporation to a tax measured by net income regardless whether that state exercises its jurisdiction. ~~For purposes of this section, "business activity" includes any activity by a corporation that would establish a taxable nexus pursuant to 15 United States Code section 381.~~"

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

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

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

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

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

"**§ 105-130.4A. Apportionment of income of combined group.**

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

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

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

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

apportionment factors associated with the combined group's unitary business.

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

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

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

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

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

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

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

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

SECTION 7. This act becomes effective for taxable years beginning on or after January 1, 2010.

BILL DRAFT 2009-RBxz-9: Modernize Corporate Income Tax Filing

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Draft		Committee Staff

SUMMARY: Draft 2009-RBxz-9 would change the way North Carolina determines the net income of a corporation. Under current law, a corporation files as a separate entity. Under this proposal, a corporation that is part of an affiliated group engaged in a single trade or business would file a combined report and its net income would be based upon the combined income of the group apportioned to this State. The proposal would become effective for taxable years beginning on or after January 1, 2010.

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

Separate entity filing gives corporations with subsidiaries in multiple states the ability to devise ways to shift income from a high effective tax rate state to a low effective state rate state, often through the use of passive investment companies and intercompany transactions. Over the past several years, the General Assembly has enacted changes to the State's corporate income tax laws to address the shifting of income between states of multistate corporations. In 2001, the State enacted the royalty income reporting option. That legislation provided that income from using trademarks in this State is taxable to this State, regardless of where the corporation that holds the trademark is located. That legislation has been 'tweaked' and expanded since 2001, but the problem of income shifting between multi-state corporations continues to be an issue. Under G.S. 105-134.6, the Department of Revenue has the ability to require a corporation to file a consolidated return when it believes the corporation's true net income attributable to this State is not accurately reflected on its separate entity filing return.

Taxpayers, seeking clarity on the law, have filed lawsuits contesting the Department's authority to force combinations. Taxpayers express concern that the statute is vague and there are no administrative rules or directives to provide guidance or certainty to taxpayers as to when a combined reporting is required, who is required to be included in the combined report, or how the combination is to be accomplished.

A more comprehensive way to address the issue of income shifting between affiliated corporations is through the use of combined reporting. The Governor's Commission to Modernize State Finances recommended this change in 2001; the Income Tax Subcommittee of State and Local Fiscal Modernization Study Commission recommended the change in 2007; and Governor Easley included combined reporting in his 2007 budget recommendations. The Multistate Tax Commission adopted a model uniform statute for combined reporting in 2006. Since 2004, six states have adopted combined reporting; today, 22 states require combined reporting.

BILL ANALYSIS: This proposal would require mandatory combined reporting. Combined reporting is a method of calculating the income of a group of related corporations for tax purposes. It looks beyond the legal structure of separate incorporations to determine whether two or more related

corporations are engaged in a single unitary business. Mandatory combined reporting would ensure that the income of a multi-state corporation is computed and apportioned in the same manner as a single corporate business.

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

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

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

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

- U.S. corporations
- Non-U.S. corporations whose business activity inside the United States is 20% or more of its total business activity.
- Corporations doing business in a tax haven country, as defined in G.S. 143-59.1.[1]
- Related intangible holding companies.

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

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

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

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

OUTSTANDING ISSUES: The proposal seeks to provide a vehicle through which the 2009 General Assembly can begin discussing the merits of combined reporting. The proposal does not differ from the proposal recommended by the Revenue Laws Study Committee to the 2007 General Assembly. The proposal does not address all of the issues that would need to be addressed if this tax law change is enacted. Some of the outstanding issues that will need to be decided include the following:

- The fiscal impact. – If the proposal results in an increase in the corporate income tax collections, the General Assembly could make a policy decision to lower the corporate income tax rate to a sufficient level to make the change revenue-neutral.
- Excluded corporations. – Which, if any, corporations should be excluded from combined reporting?
- Special apportionment formulas. – Current law provides special apportionment formulas for certain taxpayers, such as public utility companies. How will combined reporting affect the special apportionment formulas?
- Franchise tax. – What should the relationship be between the corporate income tax and the corporate franchise tax? Should combined reporting be used for franchise tax purposes also?
- Transitional issues.
- Administrative and compliance issues.

LEGISLATIVE PROPOSAL #3

STREAMLINED SALES AND USE TAX UPDATE

LEGISLATIVE PROPOSAL #3

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO URGE THE 111TH CONGRESS TO GRANT STATES THE ABILITY TO REQUIRE COLLECTION OF SALES AND USE TAX BY REMOTE RETAILERS AND TO UPDATE THE REFERENCE TO THE STREAMLINED SALES AND USE TAX AGREEMENT

SHORT TITLE: Streamlined Sales and Use Tax Update.

SPONSORS:

BRIEF OVERVIEW: The proposal would do two things:

- It would encourage the 111th Congress to enact the provisions of the Sales Tax Fairness and Simplification Act (STFSA), which would give states that have adopted the uniformity and simplification measures of the Streamlined Sales and Use Tax Agreement (Agreement) the ability to require collection of use tax by remote sellers.
- It would update the statutory reference to the Agreement by changing the date from June 23, 2007, to September 5, 2008. North Carolina does not need to amend its sales and use tax laws to conform to any of the changes made in the Agreement since June 23, 2007.

FISCAL IMPACT: No impact.

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

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-RBz-5 [v.6] (01/07)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/26/2009 3:01:20 PM

Short Title: Streamlined Sales and Use Tax Update. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO URGE THE 111TH CONGRESS TO GRANT STATES THE ABILITY TO REQUIRE COLLECTION OF SALES AND USE TAX BY REMOTE RETAILERS AND TO UPDATE THE REFERENCE TO THE STREAMLINED SALES AND USE TAX AGREEMENT.

The General Assembly of North Carolina enacts:

SECTION 1. The General Assembly strongly encourages Congress to grant states the ability to require collection of sales and use tax by remote retailers by enacting the provisions of the Sales Tax Fairness and Simplification Act, a bipartisan bill introduced in the 110th Congress as H.R. 3396 by Rep. William Delahunt (D-MA) and as S. 34 by Senator Mike Enze (R-WY), for the following reasons:

(1) As Congress works to develop an economic stimulus package to provide much needed relief to businesses, individuals, and states, the Sales Tax Fairness and Simplification Act would provide tens of billions of dollars in funding to many states and local governments at minimal or no cost to the federal government.

(2) The Sales Tax Fairness and Simplification Act would ensure a fairer and more equitable sales tax system by requiring all retailers, both Main Street brick-and-mortar retailers and remote retailers, to collect and remit state sales and use taxes.

(3) Under previous United States Supreme Court decisions, the states' ability to collect sales and use taxes from remote retailers is restricted. However, the Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote retailers.

(4) In an effort to address the collection issues identified by the United States Supreme Court, North Carolina is one of 22 states that have enacted legislation to simplify their sales and use tax laws to conform to the uniformity requirements of the Streamlined Sales and Use Tax Agreement

(5) North Carolina has collected thirty-six million dollars ($36,000,000) in revenues since October 2005 through the voluntary remittance of sales and use taxes by remote sellers under the Streamlined Sales and Use Tax Agreement. This amount is far less than the estimated amount the State is not collecting from sales by remote sellers.

SECTION 2. G.S. 105-164.3(45a) reads as rewritten:

"(45a) Streamlined Agreement. – The Streamlined Sales and Use Tax Agreement as amended as of ~~June 23, 2007.~~September 5, 2008."

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

BILL DRAFT 2009-RBz-5: Streamlined Sales and Use Tax Update

BILL ANALYSIS

Committee: Revenue Laws Study Committee
Introduced by:
Version: Bill Draft

Date:
Summary by: Cindy Avrette
Committee Staff

SUMMARY: This bill draft would do two things:

- *It would encourage the 111th Congress to enact the provisions of the Sales Tax Fairness and Simplification Act, which would give states that have adopted the uniformity and simplification measures of the Streamlined Sales and Use Tax Agreement the ability to require collection of use tax by remote sellers.*
- *It would update the statutory reference to the Agreement by changing the date from June 23, 2007, to September 5, 2008. North Carolina does not need to amend any of its sales and use tax laws to conform to any of the changes made in the Agreement since June 23, 2007.*

The bill would become effective when it becomes law.

CURRENT LAW: The Streamlined Sales and Use Tax Project (Project) is entering its ninth year of efforts to provide simplification and uniformity to the administration of sales and use tax. The adoption of the Streamlined Sales and Use Tax Agreement (Agreement) in 2002 provided the framework for participating states to achieve the uniformity and simplification measures initially established by a coalition of states, local governments, and businesses. The goal of the Project is to achieve sufficient simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in those states that have adopted the uniform provisions of the Agreement. Based on decisions by the United States Supreme Court, states cannot require remote sellers that do not have a physical presence in the state to collect and remit its use tax.

North Carolina is one of twenty-two states represented on the Streamlined Sales Tax Governing Board. A state becomes a member of the Governing Board when its sales and use tax laws are found to conform to the uniformity and simplification measures in the Agreement. The Governing Board established a central registration system in October 2005 that allows sellers to register for sales and use tax purposes in all member states. Over 1,000 sellers have registered since the system's inception.

Since October 2005, North Carolina has collected approximately $36 million in use tax revenue from remote sellers. The State has received $7.9 million during the 2008-2009 fiscal year to date. The amounts collected voluntarily are far less than the estimated amounts the State is not collecting in use tax revenue from sales by remote sellers. A University of Tennessee study, commissioned a few years ago, estimated a revenue loss to state and local governments of more than $30 billion a year from uncollected use taxes on remote sales. The Governing Board has recently commissioned a study to provide an update on this estimate.

The United States Supreme Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote sellers. Sen. Mike Enzi (R-WY) and Rep. William Delahunt (D-MA) introduced a bipartisan bill in the 110th Congress to provide the necessary authorization to those states that had adopted the simplification and uniformity measures established in the Agreement. Although Congress did not enact the legislation last biennium, the

Governing Board believes that the 111th Congress may represent the best opportunity for action on the Streamlined-related legislation, known as the Sales Tax Fairness and Simplification Act (STFSA). The National Conference of State Legislatures has recommended that Congress include the provisions of the STFSA as part of the economic stimulus legislation it is working to develop. The provisions of the STFSA would provide tens of billions of dollars in funding to states and local governments at a minimal or no cost to the federal government.

BILL ANALYSIS: The Revenue Laws Study Committee recognizes this year may be the best opportunity for action by Congress on the STFSA. Section 1 of the proposal would encourage Congress to consider and implement the provisions of the STFSA. The proposal provides both policy and fiscal reasons to support the enactment of the legislation. Not only would the legislation ensure a fairer and more equitable sales tax system for both Main Street brick-and-mortar retailers and remote retailers, but also

Section 2 of the proposal would update the State's statutory reference to the Agreement from June 23, 2007, to September 5, 2008. North Carolina does not need to amend its sales and use tax laws to conform to the changes made in the Agreement since June 23, 2007. A copy of the Agreement, as well as a document summarizing the changes made to the Agreement since June 23, 2007, may be found on the Streamlined Sales Tax Project's website: www.streamlinedsalestax.org.

LEGISLATIVE PROPOSAL #4

REAL PROPERTY SALES INFORMATION

LEGISLATIVE PROPOSAL #4

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED.

SHORT TITLE: Real property sales information.

SPONSORS:

BRIEF OVERVIEW: This proposal would assist the counties and Department of Revenue in obtaining the true value or market value of real property for property tax appraisal purposes by requiring that a sales information report be filed with the county whenever property changes hands.

FISCAL IMPACT:

EFFECTIVE DATE: This act would become effective January 1, 2010.

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-LAz-5 [v.4] (1/6)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/7/2009 8:56:13 AM

Short Title: Real property sales information. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED.

Whereas, the Constitution of North Carolina requires that property must be taxed by uniform rule and that every classification must be made by general law uniformly applicable in every county, city and town, and other unit of local government; and

Whereas, the North Carolina General Statutes require that all property, real and personal, must so far as practicable be appraised or valued at its true value which is interpreted as meaning market value; and

Whereas, taxes levied by all counties and municipalities must be levied uniformly on assessments determined by the true value of most property; and

Whereas, to help ensure that tax values of real property reflect fair market value when the counties value their property for property tax purposes, the North Carolina Department of Revenue must conduct annual studies of the ratio of the appraised value of real property to its true value and establish for each county the median ratio as determined by the study for each calendar year; and

Whereas, one of the most accurate and cost efficient methods of producing a fair revaluation of property based on the true value of the property is to require that sales information reports be filed with the county whenever property changes hands; Now, therefore,

The General Assembly of North Carolina enacts:

SECTION 1. Article 19 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-317.2. Report on transfers of real property.**

To facilitate the accurate appraisal of real property for taxation, the information listed in this section must be reported to the county tax assessor on a form developed by the Department of Revenue. G.S. 161-32 prohibits recording a deed until the report is filed. The following information is required:

(1) The name of each grantor and grantee.
(2) A brief description of the property.
(3) The total sales price.
(4) Whether the transaction involves family members or affiliated companies.
(5) A listing of any personal property conveyed with the transaction.
(6) Whether the transaction is the result of a forced sale."

SECTION 2. Article 2 of Chapter 161 of the General Statutes is amended by adding a new section to read:

"**§ 161-32. Report on transfer of real property.**

The register of deeds may not accept for registration a deed transferring real property unless the county tax assessor certifies that a sales information report required by G.S. 105-317.2 has been filed. Failure to comply with this section does not affect the validity of a duly recorded deed."

SECTION 3. This act becomes effective January 1, 2010.

BILL DRAFT 2009-LAz-5:
Real Property Sales Information

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Martha Walston
Version:	Draft		Committee Counsel

SUMMARY: This proposal would assist the counties and Department of Revenue in obtaining the true value or market value of real property for property tax appraisal purposes by requiring that a sales information report be filed with the county whenever property changes hands.

CURRENT LAW: Real property must be appraised for property tax purposes at least every eight years. The appraisal value must be its market or true value as of January 1 of the year of the general reappraisal.[1] Market or true value is the price at which property would change hands between a willing and financially able buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all the uses to which property is adapted and for which it is capable of being used. To assist the counties in determining the true value, the Department of Revenue conducts yearly sales assessment ratio studies for each county. These studies compare the appraised value of parcels with the sales price. The closer the comparison is to 100%, the closer the property's appraised value is to the fair market value. Consequently, more frequent reappraisal schedules lessen the discrepancy between the appraised value of the property and the true value of the property.

Prior to the 2008 Session, the Revenue Laws Study Committee adopted a proposal to change the eight year appraisal cycle to a four year cycle. The version of this proposal ratified in S.L. 2008-146 requires advancement of the eight year schedule only for a county with a population of 75,000 or greater and when the sales assessment ratio for that county drops below .85 or becomes greater than 1.15.[2] For these counties, new values must be implemented by January 1 of the third year following notice by the Department of the sales assessment ratio study. All other counties retain the eight-year schedule.

BILL ANALYSIS: This bill would require that the following information be reported to and certified by the county tax assessor before a deed transferring property may be accepted by the county's register of deeds:

1. The name of each grantor and grantee.
2. A brief description of the property.
3. The total sales price.
4. Whether the transaction involves family members or affiliated companies.
5. A listing of any personal property conveyed with the transaction.
6. Whether the transaction is the result of a forced sale.

The above information would be reported on a form developed by the Department of Revenue.

---

[1] The following types of property are appraised at their use value: farmland, working waterfront property, and wildlife conservation property.

[2] Based upon the 2007 population estimates and 2008 sales ratios, only ten counties are affected by the 2008 legislation.

This proposed statewide sales information report is supported by comments made during meetings with tax assessors from large urban counties and smaller rural counties. Staff from the Revenue Laws Study Committee and the Property Tax Division within the Department of Revenue recently made field trips to the tax offices of Mecklenburg County and Chowan County. There they met with the tax assessors from those counties and surrounding counties to get the assessors' input on advancing the property tax appraisal schedule. The counties agreed that the advantage of advancing the schedule is that the appraised value of the property will be more equivalent to the fair market value of the property. However, the smaller more rural counties pointed out that revaluations are expensive and that they do not have the manpower or revenue to conduct them. The group discussed several recommendations to help them meet the statutory fair market appraisal standard. They concluded that one of the most helpful and cost efficient recommendations would be to require a statewide sales information report. They felt that the information on these reports could be used to generate a sales information list which would certainly help the counties obtain appraisal values that are closer to the true value of the property in the counties. Based upon information compiled by the Department of Revenue, 50 counties are already sending out letters requesting information to confirm a property transfer and six counties are requiring a transfer affidavit.[3]

EFFECTIVE DATE: This proposal would become effective January 1, 2010.

[3] Five of the six counties that require an affidavit also assess a local land transfer tax. They are Camden, Chowan, Currituck, Dare, and Pasquotank.

LEGISLATIVE PROPOSAL #5

MODERNIZE SALES TAX STATUTES/ DIGITAL PRODUCTS

LEGISLATIVE PROPOSAL #5

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO MODERNIZE THE SALES AND USE TAX STATUTES BY TREATING MUSIC, MOVIES, COMPUTER SOFTWARE, AND BOOKS THAT ARE DELIVERED ELECTRONICALLY THE SAME AS THOSE THAT ARE PURCHASED IN A TANGIBLE MEDIUM AND BY REVISING THE "MAIL ORDER" SALES TAX PROVISION TO INCLUDE SPECIFIC REFERENCES TO INTERNET SALES.

SHORT TITLE: Modernize Sales Tax Statutes/ Digital Products.

SPONSORS:

BRIEF OVERVIEW: This would apply the State and local general rate of sales and use tax audio works, audiovisual works, books, and computer software that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium. It also revises the "mail order sales" provision by setting out specifically circumstances under which remote retailers are presumed to be soliciting business in this State for purposes of collecting sales tax.

FISCAL IMPACT: This proposal is estimated to generate in FY 2009-2010 a General Fund gain of $8.4 million and a gain of $3.7 million in local revenues.

EFFECTIVE DATE: The revisions to the mail order sale provisions become effective when the act becomes law. The remainder of the act becomes effective January 1, 2010, and applies to sales made on or after that date.

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-SVxz-5 [v.7] (01/23)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/27/2009 1:35:05 AM

Short Title: Modernize Sales Tax Stat/Digital Products. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODERNIZE THE SALES AND USE TAX STATUTES BY TREATING MUSIC, MOVIES, BOOKS, AND COMPUTER SOFTWARE THAT ARE DELIVERED ELECTRONICALLY THE SAME AS THOSE THAT ARE PURCHASED IN A TANGIBLE MEDIUM AND BY REVISING THE "MAIL ORDER" SALES TAX PROVISIONS TO INCLUDE SPECIFIC REFERENCES TO INTERNET SALES.

The General Assembly of North Carolina enacts:

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

"**§ 105-164.3. Definitions.**

The following definitions apply in this Article:

...

(1b) Audio work. – A series of musical, spoken, or other sounds, including a ringtone.

(1c) Audiovisual work. – A series of related images and any sounds accompanying the images, that impart an impression of motion when shown in succession.

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

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

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

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

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

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

~~(1d)~~(1e) Business. – Includes any activity engaged in by any person or caused to be engaged in by him with the object of gain, profit, benefit or advantage, either direct or indirect. The term "business" shall not be construed in this Article

to include occasional and isolated sales or transactions by a person who does not hold himself out as engaged in business.

...

(7a) Digital code. – A code that gives a purchaser of the code a right to receive electronic delivery an item by electronic delivery or electronic access. A digital code may be obtained by an electronic means or by tangible means. A digital code does not include a gift certificate or a gift card.

~~(7a)~~(7h) Direct mail. – Printed material delivered or distributed by the United States Postal Service or other delivery service to a mass audience or to addresses on a mailing list provided by the purchaser or at the direction of the purchaser when the cost of the items is not billed directly to the recipients. The term includes tangible personal property supplied directly or indirectly by the purchaser to the direct mail seller for inclusion in the package containing the printed material. The term does not include multiple items of printed material delivered to a single address.

...

~~(17a) Load and leave. – Delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser.~~

...

(35f) Ringtone. – A digitized sound file that is downloaded onto a device and that may be used to alert the user of the device with respect to a communication.

..."

SECTION 2. G.S. 105-164.4(a) reads as rewritten:

"(a) A privilege tax is imposed on a retailer at the following percentage rates of the retailer's net taxable sales or gross receipts, as appropriate. The general rate of tax is four and one-half percent (4.5%).

...

(6b) The general rate applies to the sales price of an item that is listed in this subdivision, is delivered or accessed electronically, and would be taxable under this Article if sold in a tangible medium. The retail sale of a digital code that is used to obtain any of the items taxed by this subdivision is considered a sale of that item. The tax applies regardless of whether the purchaser of the item has a right to redistribute it, to use it permanently, or to use it without making continued payments. The tax does not apply to an item that is taxed under another subdivision of this subsection or under G.S. 105-164.4C. A person who sells an item that is taxable under this subdivision is considered a retailer under this Article. The following items are subject to tax under this subdivision:

a. An audio work.
b. An audiovisual work.
c. A book.
d. Computer software."

SECTION 3.(a) G.S. 105-164.3(18) is recodified as G.S. 105-164.3(33g) and reads as rewritten:

"~~(18)~~(33g) ~~Mail order~~ Remote sale. – A sale of tangible personal property, ordered by mail, by telephone, ~~computer link,~~ via the Internet, or other similar method, to a purchaser who is in this State at the time the order is remitted, from a retailer who receives the order in another state and transports the property or causes it to be transported to a person in this State. It is presumed

that a resident of this State who remits an order was in this State at the time the order was remitted."

SECTION 3.(b) The catchline of G.S. 105-164.8 reads as rewritten:

"**§ 105-164.8. Retailer's obligation to collect tax; ~~mail order~~ remote sales subject to tax.**"

SECTION 3.(c) G.S. 105-164.8(b) reads as rewritten:

"(b) ~~Mail Order~~ Remote Sales. – A retailer who makes a ~~mail order~~ remote sale is engaged in business in this State and is subject to the tax levied under this Article if at least one of the following conditions is met:

(1) The retailer is a corporation engaged in business under the laws of this State or a person domiciled in, a resident of, or a citizen of, this State.

(2) The retailer maintains retail establishments or offices in this State, whether the ~~mail order~~ remote sales thus subject to taxation by this State result from or are related in any other way to the activities of such establishments or offices.

(3) The retailer ~~has representatives in this State who solicit business or transact business on behalf of the retailer,~~ solicits or transacts business in this State by employees, independent contractors, agents, or other representatives whether the ~~mail order~~ remote sales ~~thus~~ subject to taxation by this State result from or are related in any other way to ~~such~~ the solicitation or transaction of business. A retailer is presumed to be soliciting or transacting business by an independent contractor, agent, or other representative if the retailer enters into an agreement with a resident of this State under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, if the cumulative gross receipts from sales by the retailer to purchasers in this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of ten thousand dollars ($10,000.00)during the preceding four quarterly periods. This presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the seller that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question.

(4) Repealed by Session Laws 1991, c. 45, s. 16.

(5) The retailer, by purposefully or systematically exploiting the market provided by this State by any media-assisted, media-facilitated, or media-solicited means, including direct mail advertising, distribution of catalogs, computer-assisted shopping, television, radio or other electronic media, telephone solicitation, magazine or newspaper advertisements, or other media, creates nexus with this State.

(6) Through compact or reciprocity with another jurisdiction of the United States, that jurisdiction uses its taxing power and its jurisdiction over the retailer in support of this State's taxing power.

(7) The retailer consents, expressly or by implication, to the imposition of the tax imposed by this Article. For purposes of this subdivision, evidence that a retailer engaged in the activity described in subdivision (5) shall be prima facie evidence that the retailer consents to the imposition of the tax imposed by this Article.

(8) The retailer is a holder of a wine shipper permit issued by the ABC Commission pursuant to G.S. 18B-1001.1."

SECTION 4. G.S. 105-164.13(43a) is repealed.

SECTION 5. G.S. 105-467(a) is amended by adding a new subdivision to read:

"(8) The sales price of an audio work, audiovisual work, a book, and computer software that is subject to the general rate of tax under G.S. 105-164.4(a)(6b)."

SECTION 6. Section 4 of Chapter 1096 of the 1967 Session Laws, as amended, reads as rewritten:

"Sec. 4. Scope of Sales Tax. The sales tax which may be imposed under this division after the holding of a special election is limited to a tax at the rate of one per cent (1%) of: (1) the sale price of those articles of tangible personal property now subject to the general rate of sales tax imposed by the State under G. S. ~~105-164.4(a)(1) and (4b);~~ 105-164.4(a)(1), (4b), and (6b); (2) the gross receipts derived from the lease or rental of tangible personal property when the lease or rental of the property is subject to the general rate of sales tax imposed by the State under G.S. 105-164.4(a)(2); (3) the gross receipts derived from the rental of any room or lodging furnished by any hotel, motel, inn, tourist camp or other similar public accommodations now subject to the general rate of sales tax imposed by the State under G. S. 105-164.4(a)(3); (4) the gross receipts derived from services rendered by laundries, dry cleaners, cleaning plants and similar type businesses now subject to the general rate of sales tax imposed by the State under G. S. 105-164.4(a)(4); (5) The sales price of food and other items that are not otherwise exempt from tax pursuant to G.S. 105-164.13 but are exempt from the State sales and use tax pursuant to G.S. 105-164.13B; and (6) The sales price of prepaid telephone calling service taxed as tangible personal property under G.S. 105-164.4(a)(4d). The taxes authorized by this division do not apply to sales that are taxable by the State under G.S. 105-164.4 but are not specifically listed in this section.

"The exemptions and exclusions contained in G.S. 105-164.13 and the sales and use tax holiday contained in G.S. 105-164.13C apply with equal force and like manner to the local sales tax authorized to be imposed and levied under this division. The county shall have no authority, with respect to the local sales and use tax imposed under this division, to change, alter, add, or delete any exemptions or exclusions contained under G.S. 105-164.13.

"The local sales tax authorized to be imposed and levied under the provisions of this division shall be applicable to such retail sales, leases, rentals, rendering of services, furnishing of lodging or accommodations and other taxable transactions which are made, furnished or rendered by retailers whose place of business is located within the taxing county. The tax imposed shall apply to the furnishing of rooms, lodging or other accommodations within the county which are rented to transients. The sourcing principles in G.S. 105-164.4B apply in determining whether the local sales tax applies to a transaction. Provided, however, no tax shall be imposed where the tangible personal property sold is delivered by the retailer or his agent to the purchaser at a point outside this State."

SECTION 7. Section 3 of this act is effective when it becomes law. The remainder of this act becomes effective January 1, 2010, and applies to sales made on or after that date.

DRAFT 2009-SVxz-5:
Modernize Sales Tax Statutes/Digital Products

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Trina Griffin Committee Counsel
Version:	Draft Proposal 2009-SVxz-5		

SUMMARY: ***This legislative proposal would apply the State and local general rate of sales and use tax to audio works (music and ringtones), audiovisual works (movies), books, and computer software that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium. The draft also revises the mail order sale statute to specifically set out certain circumstances that constitute soliciting business in this State for purposes of requiring a remote retailer to collect sales tax.***

CURRENT LAW: Under current law, the general rate of State and local sales and use tax applies to the sale, lease, or rental of tangible personal property and some services. Tangible personal property is defined as "personal property that may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses." Digital goods, such as downloaded music and movies, are not tangible personal property, and, therefore, are not taxed. Prewritten computer software is specifically included within the definition of tangible personal property, but it is exempt from sales tax when it is delivered electronically or by load and leave.[1]

G.S. 105-164.8 sets out the circumstances under which a "remote" retailer is required to collect sales tax on mail order sales. Generally speaking, a remote retailer is one that does not maintain a "brick and mortar" establishment in this State. This statute reflects principles enunciated in a series of cases that set out circumstances under which a retailer has sufficient nexus with a state to require it to collect sales tax. Several of these cases involved businesses that used independent contractors or other commissioned agents to solicit orders in a state in which the business was not physically located. One of the leading cases in this area is *Scripto v. Carson*, in which the United States Supreme Court held that a state could require tax collection by a remote retailer that had contracts with 10 in-state residents deemed independent contractors who solicited orders for products on its behalf. This principle has been codified in G.S. 105-164.8, which states, in part, that a retailer who makes a mail order sale must collect the sales tax if:

> "The retailer has representatives in this State who solicit business or transact business on behalf of the retailer, whether the mail order sales thus subject to taxation by this State result from or are related in any other way to such solicitation or transaction of business."

BILL ANALYSIS: This proposal does the following three things:

- It applies the general rate of State and local sales tax to certain digital goods when the tangible equivalent of the good would be subject to sales tax.
- It eliminates the sales and use tax exemption on prewritten computer software delivered electronically or via load and leave.

[1] The term "load and leave" is defined as "delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser."

- It revises the "mail order sale" provision by modernizing the terminology and by providing that a retailer is presumed to be soliciting business in this State when it enters into certain commission agreements with in-State residents and the contractual arrangement generates in excess of $10,000 in sales to the retailer.

The proposal imposes the general rate of sales and use tax on audio works, audiovisual works, books, and computer software that is delivered or accessed electronically and that would be taxable if purchased in a tangible format. The tax applies regardless of whether the purchaser has a right to redistribute it, to use it permanently, or to use it without making continued payments. The tax does not apply to a product that is taxed under another sales tax provision or the telecommunications statute. The purchase of a digital code used to obtain one of these items is considered a sale of that item.

The proposal also revises the mail order sales provision in two ways. First, it changes the term "mail order sale" to "remote sale," which covers all transactions that are not "face-to-face" but reflects more modern terminology and the prevalence of Internet sales. Second, it provides that a retailer is presumed to solicit or transact business in this State and is, therefore, required to collect sales tax if all of the following conditions are met:

1. The retailer has entered into an agreement with a resident of this State.
2. Under the agreement, the resident receives a commission or other consideration in exchange for directly or indirectly referring potential customers, whether by a link on an Internet website or otherwise, to the retailer.
3. The cumulative gross receipts from sales by the retailer to purchasers in this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of $10,000 during the preceding four quarterly periods.

This presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution.

In a recent New York Supreme Court[2] case, Amazon challenged an identical provision in the New York sales tax statutes alleging that it violates the Commerce Clause of the United States Constitution as well as both the Federal and State Constitutions' Due Process and Equal Protection Clauses. The court dismissed the complaint for failure to state a cause of action. The court disagreed with Amazon's assertion that the commissioned agents were mere advertisers concluding that the provision requires tax collection only when an out-of-state seller avails itself of the benefit of in-state contractors who are compensated for referrals and who generate actual business for the seller. Moreover, the court stated that "Amazon should not be permitted to escape tax collection indirectly, through use of an incentivized New York sales force to generate revenue, when it would not be able to achieve tax avoidance directly through the use of New York employees engaged in the very same activities."

EFFECTIVE DATE: Section 3, which revises the mail order provisions, becomes effective when the act becomes law. The remainder of the act becomes effective January 1, 2010, and applies to sales made on or after that date.

[2] The New York Supreme Court is a trial-level court.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

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, 2009

TO: 2009 Revenue Laws Study Committee

FROM: Sandra Johnson
Fiscal Research Division

RE: The Taxation of Digital Downloads

FISCAL IMPACT ($ In Millions)

	Yes (X)	No ( )	No Estimate Available ( )		
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
REVENUES:					
State	$ 8.4	9.2	10.2	11.3	12.7
Local	$3.7	4.1	4.5	5.1	5.7
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE: July 1, 2010

BILL SUMMARY:

ASSUMPTIONS AND METHODOLOGY: Fiscal Research estimates that North Carolina's digital download sales during the 2009-10 fiscal year will generate roughly $8.4 million in tax revenue. The outline below reviews the data sources and methodology used to estimate digital download sales tax revenue for each of the six products: 1) music, 2) video games, 3) movies and other filmed entertainment, 4) books, 5) computer software via digital download and 6) computer software provided through load and leave services.

It is important to note that the $8.4 million in estimated tax revenue only focuses on the tax collected from vendors with a North Carolina nexus. Use taxes, the tax revenue from sales by vendors outside of the state, if remitted, would increase General Fund availability by an additional $3.7 million for a total of $12.1 million in FY 2009-10. In determining nexus versus non-nexus digital sales, the California Board of Equalization, in estimates that 65% of E-commerce sales are from vendors with nexus, a brick and mortar affiliation, in the state. The remaining 35% of E-commerce sales, according to the Board, are by out-of-state vendors and require individual purchasers to remit a use tax. Use taxes from online purchases are reported at a minimal rate.

To estimate North Carolina's digital download sales, Fiscal Research made state level inferences from national retail trends. North Carolina's retail sales represented roughly 3% of the nation's retail sales during the most recent Economic Census in 2002.

Music

North Carolina's digital music sales are expected to generate roughly $1.6 million in tax revenue during the 2009-10 fiscal year. Assuming that the State represents 2.9% of all U.S. retail sales and a 16% annual growth rate, this figure could represent $2.9 million by 2013.

The International Federation of the Phonographic Industry (IFPI), Digital Music Report 2009 estimates that international music sales via online and mobile channels rose from zero to $3.7 billion within six years, making music more digitally advanced than any entertainment sector except games. Digital music now accounts for roughly 20 percent of all music sales and the 2009 IFPI report cites the U.S. as the world's biggest digital music market. America's online and mobile music sales account for $1.9 billion or 50% of international revenues.

The U.S. Census, in addition to a state level economic census every five years, tracks the nation's annual retail sales including E-commerce and mail order sales. Mail-order and E-commerce music sales increased by 16% between 2005 and 2006. The fiscal estimate assumes a 16% percent annual growth rate in digital music sales based on the 2005-2006 trend.

Video Games

North Carolina's digital gaming industry is expected to generate roughly $2.7 million in sales tax revenue during the 2009-10 fiscal year, a figure that will grow by 6.3% annually to represent $3.5 million dollars in 2013. This fiscal estimate is based on information provided by the 2008 IFPI Music Industry report and PricewaterhouseCoopers' *Global Entertainment and Media Outlook: 2008-2012* report.

According to PricewaterhouseCoopers, the U.S. video game industry is being driven by the next generation of platforms, online and wireless games. The video and online gaming industry

represented $8.6 billion in 2007 and will increase at an average annual rate of 6.3 percent to $11.7 billion in 2012. While PricewaterhouseCoopers projects $11.7 billion in overall video game sales, the IFPI Digital Music Report 2008, estimates that digital downloads represents $4 billion, 35 percent, of the video game industry.

Movies and Other Filmed Entertainment

Data on digital downloaded filmed entertainment also comes from the PricewaterhouseCoopers' *Global Entertainment and Media Outlook: 2008-2012* report. The report states that, "Download-to-own movies streamed over the Internet will increase rapidly from a small base, rising at a compound annual growth rate of 51.4 percent equaling $900 million in 2012, in the U.S." In North Carolina, digitally downloaded movies will generate approximately $0.21 million in sales tax revenue during the 2009-2010 fiscal year.

Books

North Carolina's digital book sales are expected to generate $0.4 million tax revenue during the 2009-10 fiscal year. Digital browsing and electronic books, according to PricewaterhouseCoopers, will revitalize the consumer book market, with consumer print books increasing from $21.7 billion in 2007 to $22.5 billion in 2012. PricewaterhouseCoopers also projects that the consumer and educational book market will grow by 0.8% annually. IFPI estimates that, $434 million, or roughly 2% of all book sales are in the form of digital media.

Computer Software

According the U.S. Census E-stats program, Americans purchased roughly $2 billion in computer software through online vendors in 2006 an increase from $1.5 billion in 2004. Between 2004 and 2006, online computer software purchases increased at rate of 12% annually. Using historical growth rates in online commerce and assuming that 80 percent of online computer software purchases are digitally downloaded, North Carolina can expect to collect roughly $2.5 million in tax revenue from digital computer software sales.

Computer Software provided through Load and Leave

The digital download legislation would also repeal the sales and use tax exemption for computer software included in G.S. 164.13 (43a). The statute currently exempts software delivered electronically or by load and leave from the sales and use tax. A repeal of G.S. 164.13 (43a) would generate roughly $1.3 million in tax revenue during the 2009-2010 fiscal year.

SOURCES OF DATA:

California Board of Equalization. Revenue Estimate: Electronic Commerce and Mail Order Sales. 2007. http://www.boe.ca.gov/legdiv/pdf/e-commerce-07.pdf

Condon, Stephanie. "States May Tax i-Tunes, Other Digital Downloads." CNET.com. Published August 12, 2008. Available at: http://news.cnet.com/8301-13578_3-10013327-38.html. Last accessed January 2009.

International Federation of the Phonographic Industry (IFPI). *Digital Music Report 2008.* Available at: http://www.ifpi.org/content/library/DMR2008.pdf.

International Federation of the Phonographic Industry (IFPI). *Digital Music Report 2009*. January 2009. Available at: http://www.ifpi.org/content/library/DMR2009.pdf.

PricewaterhouseCoopers, *Global Entertainment and Media Outlook: 2008-2012*, Available at: http://www.pwc.com/extweb/pwcpublications.nsf/docid/5AC172F2C9DED8F5852570210044EEA7?opendocument&vendor=none

U.S. Census. E-Stats Program. Table 6. "U.S. Electronic Shopping and Mail-Order Houses (NAICS 4541) - Total and E-commerce Sales by Merchandise Line: 2006 and 2005." Available at: http://www.census.gov/eos/www/2006/2006tables.html. Last accessed January 2009.

TECHNICAL CONSIDERATIONS: None

North Carolina General Assembly

Revenue Laws Study Committee

January 27, 2009

Remarks from:

Brooks Raiford, President & CEO
North Carolina Technology Association

Mr. Chairman, thank you for the opportunity to speak briefly today about the issue of digital taxation.

My name is Brooks Raiford, and I serve as the new president of the North Carolina Technology Association, known as NCTA, which has 400 member companies of all sizes, primarily from the technology sector. We just had our Annual Meeting a couple of weeks ago, and noted to our Members that our agenda for 2009 is driven by three things: jobs, jobs, and jobs. A significant number of people in North Carolina depend on the technology sector to support them and their families. Not only are there over 100,000 information technology workers in North Carolina, but many technology-oriented companies of course have non-IT workers as well who depend on the financial health of their employer.

So as you consider changes to the tax laws, we want to offer some comments. We don't come today with a blanket objection to taxes – our member firms pay income, payroll, and property taxes, among others. We do ask that as you explore revisions to the tax structure, that you remain mindful of several considerations:

- We're concerned about the impact on both the consumer and on commerce of new or increased taxes during an economic downturn, so would urge that new taxes not be imposed .
- We would emphasize the importance of the technology sector to the state's current and future economy, and would object to the technology sector being singled out for new taxation when there are dozens of examples of other cases of various sales tax exemptions.
- As you consider digital taxation, we would encourage you to note that purchasing digital products encourages "green" commerce – it avoids packaging, along with reducing the need for buildings and physical infrastructure to support the sale and distribution of hard copies of software, books, etc.

The General Assembly has been a great partner over the years in recognizing the impact of these companies and these workers. For example:

- This past Session, you encouraged the creation of jobs and growth of companies here by extending the R&D Tax Credit for five years, and raised the cap on the Qualified Business Ventures credit, which encourages investment in early-stage companies.
- In the 2007 Session, you encouraged software development in North Carolina by reducing the sales tax for equipment used in R&D for software development.
- Also in that Session, you encouraged research at our colleges and universities by increasing the tax credit percentage for R&D done in North Carolina, including at our colleges and universities.

So there is a history of tax policy that enhances the growth of the increasingly important technology sector in our state.

We understand the desire to streamline and make the imposition of sales taxes more fair, and appreciate the willingness of the Committee and staff to hear from those affected. Our request is that the technology sector not be singled out for changes, and that deliberate care is taken to avoid any unintended consequences of changing the definitions of what is taxed and how.

Mr. Chairman, you and the Committee staff have been generous in allowing our input to this point, and we'd ask that we continue to be included in discussions as legislation moves forward. Thank you for giving me these few minutes to share our comments.

For more information, please contact:

Brooks Raiford, President & CEO
North Carolina Technology Association
4020 Westchase Boulevard, Suite 350
Raleigh, NC 27650
919-856-0393, ext. 224
braiford@nctechnology.org

www.nctechnology.org

LEGISLATIVE PROPOSAL #6
PARTS I & II

REVENUE LAWS TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES

LEGISLATIVE PROPOSAL #6

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

SHORT TITLE: Revenue Laws Technical, Clarifying, and Administrative Law Changes.

SPONSORS:

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

FISCAL IMPACT:

EFFECTIVE DATE: Except as otherwise specifically provided, the act is effective when it becomes law.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2009

U D

BILL DRAFT 2009-SVz-4 [v.8] (12/31)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/7/2009 7:51:32 AM

Short Title: Rev Laws Technical & Admin Changes. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-41(a) reads as rewritten:

"(a) Every individual in this State who practices a profession or engages in a business and is included in the list below must obtain from the Secretary a statewide license for the privilege of practicing the profession or engaging in the business. A license required by this section is not transferable to another person. The tax for each license is fifty dollars ($50.00).

...

(12) A home inspector or an associate home inspector licensed under Article 9F of Chapter 143 of the General Statutes."

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

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

SECTION 3. G.S. 105-130.18 reads as rewritten:

"**§ 105-130.18. Failure to file returns; supplementary returns.**

If the Secretary determines that a corporation has failed to file a return or to include in a return filed, either intentionally or through error, items of taxable income, the Secretary may require from the corporation a return or supplementary return, under affirmation, of all the items of income that the corporation received during the year for which the return is made, whether or not taxable under this Part. If from a supplementary return or otherwise the Secretary finds that any items of income, taxable under this Part, have been omitted from the original return, that any items returned as

taxable are not taxable, or that any item of taxable income is overstated or understated, the Secretary may require that the item be disclosed under affirmation of the corporation, and be added to or deducted from the original return. The filing of a supplementary return and the correction of the original return does not relieve the corporation from any of the penalties under G.S. 105-236. The Secretary may proceed under the provisions of G.S. ~~105-241.1,~~ 105-241.9, whether or not the Secretary requires a return or a supplementary return under this section."

SECTION 4. Section 4(b) of S.L. 2008-134 reads as rewritten:

"**SECTION 4.(b)** This section is effective for taxable years beginning on or after January 1, ~~2009.~~2008."

SECTION 5.(a) G.S. 105-228.5B reads as rewritten:

"**§ 105-228.5B. (Effective until June 30, 2010) Proceeds credited to High Risk Pool.**

~~Within 75 days after the end of each fiscal year,~~ By November 1 of each year, the State Treasurer must transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund established in G.S. 58-50-225 an amount equal to the growth in net revenue from the tax applied to gross premiums under G.S. 105-228.5(d)(2). The growth in revenue from this tax is the difference between the amount of revenue collected during the preceding fiscal year on premiums taxed under that subdivision less $475,545,413, which is the amount of revenue collected during fiscal year 2006-2007 on premiums taxed under that subdivision. The Treasurer must draw the amount required under this section from revenue collected on premiums taxed under that subdivision."

SECTION 5.(b) G.S. 105-228.5B, as amended by S.L. 2008-118, reads as rewritten:

"**§ 105-228.5B. (Effective June 30, 2010) Distribution of part of tax proceeds to High Risk Pool.**

~~Within 75 days after the end of each fiscal year,~~ By November 1 of each year, the State Treasurer must transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund established in G.S. 58-50-225 an amount equal to thirty percent (30%) of the growth in revenue from the tax applied to gross premiums under G.S. 105-228.5(d)(2). The growth in revenue from this tax is the difference between the amount of revenue collected during the preceding fiscal year on premiums taxed under that subdivision less $475,545,413, which is the amount of revenue collected during fiscal year 2006-2007 on premiums taxed under that subdivision. The Treasurer must draw the amount required under this section from revenue collected on premiums taxed under that subdivision."

SECTION 5.(c) Subsections (a) and (c) of this section are effective when they become law. Subsection (b) of this section becomes effective June 30, 2010.

SALES TAX CHANGES

SECTION 6.(a) G.S. 105-164.14(j)(2)n. reads as rewritten:

"n. Solar electricity generating materials manufacturing. Solar ~~energy~~ electricity generating materials manufacturing means the development and production of one or more of the following:

1. Photovoltaic materials or modules used in producing electricity.
2. Polymers or polymer films primarily intended for incorporation into photovoltaic materials or modules used in producing electricity."

SECTION 6.(b) This section is effective July 1, 2008, and applies to purchases made on or after that date.

SECTION 7. G.S. 105-187.51C(c) reads as rewritten:

"(c) Forfeiture. – If the required level of investment to qualify as an eligible datacenter is not timely made, then the rate provided under this section is forfeited. If the required level of investment is timely made but any eligible machinery and equipment is not located and used at an eligible datacenter, then the rate provided for that machinery and equipment under this subdivision is forfeited. A taxpayer that forfeits a rate under this subdivision is liable for all past sales and use taxes avoided as a result of the forfeiture, computed at the combined general rate from the date the taxes would otherwise have been due, plus interest at the rate established under G.S. ~~105-241.1(i).~~ 105-241.21. If the forfeiture is triggered due to the lack of a timely investment required by this section, then interest is computed from the date the sales or use tax would otherwise have been due. For all other forfeitures, interest is computed at the combined general rate from the time as of which the machinery or equipment was put to a disqualifying use. A credit is allowed against the sales or use tax owed as a result of the forfeiture provisions of this subsection for privilege taxes paid pursuant to this section. For purposes of applying this credit, the fact that payment of the privilege tax occurred in a period outside the statute of limitations provided under G.S. ~~105-266~~ 105-241.6 shall not be considered. Interest shall not be computed against the amount of taxes offset by this credit. The past taxes and interest are due 30 days after the date of forfeiture. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the provisions of G.S. 105-236."

PROPERTY TAX CHANGES

SECTION 8.(a) G.S. 105-273(6) reads as rewritten:

"(6) Corporation. – An organization having capital stock represented by shares or an incorporated, nonprofit organization."

SECTION 8.(b) G.S. 105-277.1B(i) reads as rewritten:

"(i) Disqualifying Events. – Each of the following constitutes a disqualifying event:

(1) The owner transfers the residence. Transfer of the residence is not a disqualifying event if (i) the owner transfers the residence to a co-owner of the residence or, as part of a divorce proceeding, to his or her spouse and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(2) The owner dies. Death of the owner is not a disqualifying event if (i) the owner's share passes to a co-owner of the residence or to his or her

spouse ~~residence~~ and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(3) The owner ceases to use the property as a permanent residence."

SECTION 9.(a) G.S. 105-282.1(a)(1) reads as rewritten:

"(1) No application required. – Owners of the following exempt or excluded property do not need to file an application for the exemption or exclusion to be entitled to receive it:

a. Property exempt from taxation under G.S. 105-278.1 or G.S. 105-278.2.

b. Special classes of property excluded from taxation under G.S. 105-275(15), (16), (26), (31), (32a), (33), (34), (37), (40), ~~or (42).~~(42), or (44).

c. Property classified for taxation at a reduced valuation under G.S. 105-277(g) or G.S. 105-277.9."

SECTION 9.(b) This section is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

OCCUPANCY TAX CHANGES

SECTION 10. Section 1 of S.L. 2008-33 reads as rewritten:

"**SECTION 1.** Chapter 1055 of the 1983 Session ~~Laws~~ Laws, as amended by Section 21(e) of S.L. 2007-527, reads as rewritten:

'Section 1. ~~Levy of Tax.~~ Occupancy Tax. –

(a) Authorization and scope. – The Cherokee County Board of Commissioners may ~~by resolution, after not less than 10 days' public notice and after a public hearing held pursuant thereto,~~ levy a room occupancy and tourism development ~~tax.~~

~~(b) Collection of the tax, and liability therefor, shall begin and continue only on and after the first day of a calendar month set by the Cherokee County Board of Commissioners in the resolution levying the tax, which in no case may be earlier than the first day of the second succeeding calendar month after the date of adoption of the resolution.~~

~~'Sec. 2. Occupancy Tax.~~

~~(a) The county room occupancy and tourism development tax that may be levied under this act shall be a percentage~~ tax of three percent (3%) of the gross receipts derived from the rental of any room, lodging, or similar accommodation furnished by any hotel, motel, inn, tourist camp, or other similar place within the county ~~now~~ that is subject to ~~the three percent (3%)~~ sales tax imposed by the State under G.S. ~~105-164.4(3).~~ 105-164.4(a)(3). ~~During the first year in which a tax levied under this act is in effect, the tax shall be three percent (3%) of the gross receipts derived from the rental of taxable accommodations in the county. Thereafter, the rate of tax shall continue to be three percent (3%) unless the Cherokee County Board of Commissioners, by resolution, adopts a rate of less than three percent (3%). A change in the occupancy tax rate adopted by the board of commissioners becomes effective the first day of the second succeeding calendar month following the date of adoption of the resolution. The~~

~~Cherokee County Board of Commissioners may not change the occupancy tax rate more than once a year.~~

~~(b)~~ The occupancy tax is in addition to any State or local sales tax. This tax does not apply to accommodations furnished by nonprofit charitable, educational, ~~benevolent,~~ or religious organizations.

(b) Authorization of additional tax. – In addition to the tax authorized by subsection (a) of this section, the Cherokee County Board of Commissioners may levy an additional room occupancy tax of up to three percent (3%) of the gross receipts derived from the rental of accommodations taxable under subsection (a) of this section. The levy, collection, administration, and repeal of the tax authorized by this subsection shall be in accordance with the provisions of this act. Cherokee County may not levy a tax under this subsection unless it also levies the tax authorized under subsection (a) of this section.

'Sec. 3. Administration of Tax. – A tax levied under this act shall be levied, collected, administered, and repealed as provided in G.S. 153A-155. The penalties provided in G.S. 153A-155 apply to a tax levied under this act.

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

~~(b) Any person, firm, corporation, or association who fails or refuses to file the return required by this act shall pay a penalty of ten dollars ($10.00) for each day's omission.~~

~~(c) In case of failure or refusal to file the return or pay the tax for a period of 30 days after the time required for filing the return or for paying the tax, there shall be an additional tax, as a penalty, of five percent (5%) of the tax due in addition to the penalty prescribed in subsection (b), with an additional tax of five percent (5%) for each additional month or fraction thereof until the occupancy tax is paid.~~

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

~~'Sec. 4. Collection of Tax. Every operator of a business subject to the tax levied pursuant to this act shall collect the tax on and after the effective date of the levy of the tax.~~

~~This tax shall be collected as part of the charge for the furnishing of any taxable accommodations. The tax shall be stated and charged separately from the sales records, and shall be paid by the purchaser to the operator of the business as trustee for and on account of Cherokee County. The room occupancy tax levied under this act shall be added to the sales price and shall be passed on to the purchaser instead of being borne by the operator of the business. The county shall design, print, and furnish to all~~

~~appropriate businesses in the county the necessary forms for filing returns and instructions to ensure the full collection of the tax.~~

'Sec. 5. ~~Disposition of Taxes Collected.~~Distribution and use of tax revenue. – Cherokee County ~~shall~~ shall, on a quarterly basis, remit the net proceeds of ~~all revenues received from~~ the room occupancy tax to the Cherokee County Tourism Development Authority.~~Authority appointed pursuant to this act.~~ The Authority shall use at least two-thirds of the funds remitted to it under this act to promote travel and tourism in Cherokee County and shall use the remainder for tourism-related expenditures. ~~"Net proceeds" means gross proceeds less the cost to the county of administering and collecting the tax. The Authority may expend these funds only to further the development of travel, tourism, and conventions in the county through advertising and promotion.~~

The following definitions apply in this section:

(1) Net proceeds. – Gross proceeds less the cost to the county of administering and collecting the tax, as determined by the finance officer, not to exceed three percent (3%) of the first five hundred thousand dollars ($500,000) of gross proceeds collected each year and one percent (1%) of the remaining gross receipts collected each year.

(2) Promote travel and tourism. – To advertise or market an area or activity, publish and distribute pamphlets and other materials, conduct market research, or engage in similar promotional activities that attract tourists or business travelers to the area. The term includes administrative expenses incurred in engaging in the listed activities.

(3) Tourism-related expenditures. – Expenditures that, in the judgment of the Tourism Development Authority, are designed to increase the use of lodging facilities, meeting facilities, or convention facilities in a county or to attract tourists or business travelers to the county. The term includes tourism-related capital expenditures.

'Sec. 6. ~~Appointment, Duties of~~ Cherokee County Tourism Development Authority.~~–~~

(a) Appointment and membership. – When the Cherokee County Board of Commissioners adopts a resolution levying a room occupancy ~~tax,~~ tax under this act, it shall also adopt a resolution creating a County Tourism Development ~~Authority composed of the director of the Cherokee County Chamber of Commerce and the following four members appointed by the Cherokee County Board of Commissioners:~~

~~(1) an owner of a hotel, motel, or other accommodations subject to the tax levied by this act;~~

~~(2) a member of the board of county commissioners;~~

~~(3) a town commissioner or the mayor of the Town of Murphy; and~~

~~(4) a town alderman or the mayor of the Town of Andrews.~~

~~The director of the Cherokee County Chamber of Commerce shall serve as an ex officio member of the Authority. The members appointed by the board of county commissioners shall serve three- year terms, except the initial appointees. Of the initial appointees, the board of commissioners shall designate one to serve a one-year term, two a two-year term, and one a three-year term. Vacancies created by an appointed~~

~~member shall be filled by the board of commissioners. Members appointed to fill vacancies shall serve the remainder of the unexpired term for which they are appointed to fill.~~ Authority, which shall be a public authority under the Local Government Budget and Fiscal Control Act. The resolution shall provide for the membership of the Authority, including the members' terms of office, and for the filling of vacancies on the Authority. At least one-third of the members must be individuals who are affiliated with businesses that collect the tax in the county, and at least one-half of the members must be individuals who are currently active in the promotion of travel and tourism in the county. The board of commissioners shall designate one member of the Authority as chair and shall determine the compensation, if any, to be paid to members of the Authority.

The Authority shall meet at the call of the chair and shall adopt rules of procedure to govern its meetings. The Finance Officer for Cherokee County shall be the ex officio finance officer of the Authority.

(b) Duties. – The Authority shall expend the net proceeds of the tax levied under this act for the purposes provided in this act. The Authority shall promote travel, tourism, and conventions in the county, sponsor tourist-related events and activities in the county, and finance tourist-related capital projects in the county. ~~The members of the Tourism Development Authority shall elect from its membership a chairman. The Authority shall meet at the call of the chairman and shall adopt rules of procedure to govern its meetings. The finance officer of Cherokee County shall serve ex officio as accountant for the Authority.~~

(c) Reports. – The ~~Tourism Development~~ Authority shall report quarterly and at the close of the fiscal year to the board of county commissioners on its receipts and disbursements for the preceding quarter and for the year in such detail as the board may require.

'~~Sec. 7. Repeal of Levy.~~

~~(a) The board of county commissioners may by resolution repeal the levy of the room occupancy tax in Cherokee County, but no repeal of taxes levied under this act is effective until the end of the fiscal year in which the repeal resolution was adopted.~~

~~(b) No liability for any tax levied under this act that attached prior to the date on which a levy is repealed is discharged as a result of the repeal, and no right to a refund of a tax that accrued prior to the effective date on which a levy is repealed may be denied as a result of the repeal.~~

'Sec. 8. This act is effective upon ratification."

SECTION 11. The catchline for Section 21(j) of S.L. 2007-527 reads as rewritten:

"**SECTION 21.(j)** Subsection (a) of Section 4 of Chapter 929 of the 1985 Session ~~Laws as amended by S.L.1985-929~~ Laws, as amended by Chapter 319 of the 1987 Session Laws, reads as rewritten:"

SECTION 12. Section 1(b) of S.L. 2005-68 reads as rewritten:

"**SECTION 1.(b)** Administration. – Except as otherwise provided in this act, a tax levied under this section shall be levied, administered, and collected as provided in Part IV of Chapter 908 of the 1983 Session Laws, as amended by Chapters 821 and 922

of the 1989 Session ~~Laws and S.L. 2001-402.~~ Laws, S.L. 2001-402, and Section 21(cc) of S.L. 2007-527. The penalties provided in Part IV of Chapter 908 of the 1983 Session Laws, as amended by Chapters 821 and 922 of the 1989 Session Laws and S.L. 2001-402, apply to a tax levied under this section."

MOTOR FUEL TAX CHANGES

SECTION 13. G.S. 105-449.72 is amended by adding a new subsection to read:

"(f) Exemption. – The requirement to obtain a bond or irrevocable letter of credit does not apply to a distributor, importer, or motor fuel transporter that supplies motor fuel when the market for motor fuel is disrupted and emergency supplies are needed, as identified by an executive order of the Governor."

SECTION 14. G.S. 105-449.121(b)(2) reads as rewritten:

"(2) Audit a distributor, a retailer, a ~~bulk end user,~~ bulk end-user, or a motor fuel user that is not licensed under this Article."

SECTION 15. G.S. 105-449.136 reads as rewritten:

"**§ 105-449.136. Tax on alternative fuel.**

A tax at the motor fuel rate is imposed on liquid alternative fuel used to operate a highway vehicle by means of a vehicle supply tank that stores fuel only for the purpose of supplying fuel to operate the vehicle. A tax at the equivalent of the motor fuel rate is imposed on all other alternative fuel used to operate a highway vehicle. The Secretary must determine the equivalent rate. The exemptions from the tax on motor fuel in ~~G.S. 105-449.88(2), (3), and (4)~~ G.S. 105-449.88 apply to the tax imposed by this section. The refunds for motor fuel tax allowed by Part 5 of Article 36C of this Chapter apply to the tax imposed by this section, except that the refund allowed by G.S. 105-449.107(b) for certain vehicles that use power takeoffs does not apply to a vehicle whose use of alternative fuel is taxed on the basis of miles driven. The proceeds of the tax imposed by this section must be allocated in accordance with G.S. 105-449.125."

OTHER CHANGES

SECTION 16. Section 67(a) of S.L. 2008-134 reads as rewritten:

"**SECTION 67.(a)** G.S. ~~58-5-25(a)(2)~~58-6-25(a)(2) is repealed."

SECTION 17.(a) G.S. 153A-156.1 reads as rewritten:

"**§ 153A-156.1. (For effective date, see note) Heavy equipment gross receipts tax in lieu of property tax.**

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

(1) Heavy equipment. – Earthmoving, construction, or industrial equipment that is mobile, weighs at least 1,500 pounds, and meets any of the descriptions listed in this subdivision. The term includes an attachment for heavy equipment, regardless of the weight of the attachment.

a. It is a self-propelled vehicle that is not designed to be driven on a highway.

b. It is industrial lift equipment, industrial material handling equipment, industrial electrical generation equipment, or a similar piece of industrial equipment.

(2) Short-term lease or rental. – Defined in G.S. 105-187.1.

(b) Tax Authorized. – A county may, by ~~resolution,~~ordinance, impose a tax at the rate of one and two-tenths percent (1.2%) on the gross receipts from the short-term lease or rental of heavy equipment by a person whose principal business is the short-term lease or rental of heavy equipment at retail. The heavy equipment subject to this tax is exempt from property tax under G.S. 105-275, and this tax provides an alternative to a property tax on the equipment. A person is not considered to be in the short-term lease or rental business if the majority of the person's lease and rental gross receipts are derived from leases and rentals to a person who is a related person under G.S. 105-163.010.

The tax authorized by this section applies to gross receipts that are subject to tax under G.S. 105-164.4(a)(2). Gross receipts from the short-term lease or rental of heavy equipment are subject to a tax imposed by a county under this section if the place of business from which the heavy equipment is delivered is located in the county.

(c) Payment. – A person whose principal business is the short-term lease or rental of heavy equipment is required to remit a tax imposed by this section to the county finance officer. The tax is payable quarterly and is due by the last day of the month following the end of the quarter. The tax is intended to be added to the amount charged for the short-term lease or rental of heavy equipment and paid to the heavy equipment business by the person to whom the heavy equipment is leased or rented.

(d) Enforcement. – The penalties and collection remedies that apply to the payment of sales and use taxes under Article 5 of Chapter 105 of the General Statutes apply to a tax imposed under this section. The county finance officer has the same authority as the Secretary of Revenue in imposing these penalties and remedies.

(e) Effective Date. – A tax imposed under this section becomes effective on the date set in the ~~resolution~~ ordinance imposing the tax. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted.

(f) Repeal. – A county may, by ~~resolution,~~ ordinance, repeal a tax imposed under this section. The repeal is effective on the date set in the ~~resolution.~~ ordinance. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted."

SECTION 17.(b) G.S. 160A-215.2 reads as rewritten:

"**§ 160A-215.2. (For effective date, see note) Heavy equipment gross receipts tax in lieu of property tax.**

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

(1) Heavy equipment. – Defined in G.S. 153A-156.1.

(2) Short-term lease or rental. – Defined in G.S. 105-187.1.

(b) Tax Authorized. – A city may, by ~~resolution,~~ ordinance, impose a tax at the rate of eight tenths percent (0.8%) on the gross receipts from the short-term lease or

rental of heavy equipment by a person whose principal business is the short-term lease or rental of heavy equipment at retail. The heavy equipment subject to this tax is exempt from property tax under G.S. 105-275, and this tax provides an alternative to a property tax on the equipment. A person is not considered to be in the short-term lease or rental business if the majority of the person's lease and rental gross receipts are derived from leases and rentals to a person who is a related person under G.S. 105-163.010.

The tax authorized by this section applies to gross receipts that are subject to tax under G.S. 105-164.4(a)(2). Gross receipts from the short-term lease or rental of heavy equipment are subject to a tax imposed by a city under this section if the place of business from which the heavy equipment is delivered is located in the city.

(c) Payment. – A person whose principal business is the short-term lease or rental of heavy equipment is required to remit a tax imposed by this section to the city finance officer. The tax is payable quarterly and is due by the last day of the month following the end of the quarter. The tax is intended to be added to the amount charged for the short-term lease or rental of heavy equipment and paid to the heavy equipment business by the person to whom the heavy equipment is leased or rented.

(d) Enforcement. – The penalties and collection remedies that apply to the payment of sales and use taxes under Article 5 of Chapter 105 of the General Statutes apply to a tax imposed under this section. The city finance officer has the same authority as the Secretary of Revenue in imposing these penalties and remedies.

(e) Effective Date. – A tax imposed under this section becomes effective on the date set in the ~~resolution~~ ordinance imposing the tax. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted.

(f) Repeal. – A city may, by ~~resolution,~~ ordinance, repeal a tax imposed under this section. The repeal is effective on the date set in the ~~resolution.~~ ordinance. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted."

SECTION 17.(c) This section does not affect the rights or liabilities of a county or city, a taxpayer, or another person arising under G.S. 160A-215.2 or G.S. 153A-156.1 before the effective date of this section; nor does it affect the right to any refund or credit of a tax that accrued under G.S. 160A-215.2 or G.S. 153A-156.1 before the effective date of this section. All existing ordinances or resolutions enacted under G.S. 160A-215.2 or G.S. 153A-156.1 prior to the effective date of this section shall continue in full force and effect until repealed, modified, or amended.

EFFECTIVE DATE

SECTION 18. Except as otherwise provided, this act is effective when it becomes law.

BILL ANALYSIS

DRAFT BILL 2009-SVz-4: Revenue Laws Technical, Administrative, & Clarifying Changes

Committee: Revenue Laws Study Committee
Introduced by:
Version: Draft

Date: January 7, 2009
Summary by: Trina Griffin & Cindy Avrette Committee Counsel

SUMMARY: ***This legislative proposal makes several technical, clarifying, and administrative changes to the revenue laws and related statutes.***

BILL ANALYSIS: This draft proposal makes the following technical, clarifying, and administrative changes:

Section	Explanation
Corporate, Excise, and Insurance Taxes	
1	Adds associate home inspectors to the State privilege license provision enacted last year for home inspectors so that associate home inspectors will be taxed similarly. S.L. 2008-206 imposed an annual State privilege license tax of $50 on a home inspector licensed under the Home Inspector Act. The Home Inspector Act also licenses associate home inspectors, which are defined separately. However, they were not included in the law change. Without this change, associate home inspectors would be subject to local privilege license tax in each city that levies the tax.
2	Changes the term 'nonbusiness activities' to 'activities producing nonapportionable income', which is a defined term in the statute that sets out the manner in which corporations must allocate and apportion their income to North Carolina for income tax purposes. In 2002, the terms 'business income' and 'nonbusiness income' were replaced by apportionable and nonapportionable. This subsection was missed when those changes were made.
3	Changes an incorrect statutory reference.
4	Corrects an effective date relating to changes made to the statute designating who may sign an income tax return. These changes were originally part of the major rewrite of the tax appeals procedure in 2007 (SB 242).
5(a) & (b)	Changes the date by which the State Treasurer must make a transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund. The current statute provides that ***within 75 days after the end of each fiscal year***, the Treasurer must transfer to the Fund an amount equal to the growth in net revenue from the gross premiums tax on insurance companies. Insurance tax returns are due by March 15. Insurance companies are also required to prepay their tax in installments. The first installment of the fiscal year is due by October 15. Therefore, until those installments are remitted, little or no funds are available for transfer. This section changes the date from within 75 days after the end of the fiscal year, or September 14, to November 1, as recommended by the Department of Revenue.

Sales and Use Tax Changes	
6	Replaces the word 'energy' with the word 'electricity' for consistency. This term appears in the statute enacted last year authorizing a sales tax refund for materials used to build a facility that manufactures solar electricity generating materials.
7	Corrects two incorrect statutory references.
Property Tax Changes	
8(a) & (b)	Reinserts the words 'shares' and 'residence', which were inadvertently deleted when changes were made in 2008 to the circuit breaker statute.
9	Makes a conforming change to the statute that sets out the application procedure for property tax exemption related to the exemption for drug samples enacted last year.
Occupancy Tax Changes	
10	Adds a Session Law reference that was inadvertently omitted when the Cherokee County local occupancy tax act was amended last year. In 2007, a number of local occupancy tax local acts were amended to change the due date for remitting occupancy tax proceeds and filing returns from the 15th to the 20th of the month to conform to current sales tax statutes. The Cherokee County local occupancy tax act was one of the acts so amended. However, when the rest of the local act was amended in 2008, the 2007 change was not incorporated. To make this technical change, the entire local act must be set out under drafting convention. However, no substantive change is being made.
11	Corrects an incorrect Session Law reference.
12	Adds to S.L. 2005-68, a Session Law reference to the 2007 act referenced above that made changes to a number of local occupancy tax acts related to the due date of the tax and return. S.L. 2005-68 is the act that authorized the additional occupancy tax to finance the NASCAR Hall of Fame Museum.
Motor Fuel Tax Changes	
13	Provides an exception to the requirement that a distributor, importer, or motor fuel transporter must obtain a bond or irrevocable letter of credit when the person is supplying motor fuel into the State because the market for motor fuel has been disrupted and emergency supplies are needed, as identified by an executive order of the Governor. The bonding requirement became an issue during the recent motor fuel supply shortages in the western part of the State.
14	Corrects a misspelled word.
15	Conforms the tax exemptions for alternative fuel to the tax exemptions for motor fuel.
Other Changes	
16	Corrects an incorrect statutory reference.
17(a) & (b)	Replaces the word 'resolution' with the word 'ordinance' in each of the statutes authorizing cities and counties to levy a gross receipts tax in lieu of a property tax on the short-term rental of heavy equipment.

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-LAz-8 [v.14] (1/13)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/26/2009 6:30:14 PM

Short Title: Prop Tax Technical & Admin Changes. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE PROPERTY TAX LAWS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-275 reads as rewritten:

"**§ 105-275. Property classified and excluded from the tax base.**

The following classes of property are ~~hereby~~ designated special classes under ~~authority of~~ Article V, Sec. 2(2), of the North Carolina Constitution and ~~shall not be listed, appraised, assessed, or taxed~~are excluded from tax as provided in this section if they satisfy the application requirements in G.S. 105-282.1.

...."

SECTION 2.(a) G.S. 105-277.1(d) reads as rewritten:

"**§ 105-277.1. (Effective for taxes imposed for taxable years beginning before July 1, 2009) Property tax homestead exclusion.**

...

(d) Multiple Ownership. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of this exclusion notwithstanding that only one of them meets the age or disability requirements of this section. When a permanent residence is owned and occupied by two or more persons other than husband and wife as tenants by the entirety and one or more of the owners qualifies for this exclusion, each qualifying owner is entitled to the full amount of the exclusion not to exceed his or her proportionate share of the valuation of the property. No part of an exclusion available to one co-owner may be claimed by any other co-owner and in no event may the total exclusion allowed for a permanent residence exceed the exclusion amount provided in this section.

SECTION 2.(b) G.S. 105-277.1(d) and (e) read as rewritten:

"**§ 105-277.1. (Effective for taxes imposed for taxable years beginning on or after July 1, 2009) Elderly or disabled property tax homestead exclusion.**

...

(d) Ownership by ~~Spouses.~~Tenants by the Entirety. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of this exclusion notwithstanding that only one of them meets the age or disability requirements of this section.

(e) Other Multiple Owners. – This subsection applies to co-owners who are not husband and ~~wife.~~wife as tenants by the entirety. Each co-owner of a permanent residence must apply separately for the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and none of the co-owners qualifies for the exclusion allowed under G.S. 105-277.1C, each co-owner is entitled to the full amount of the exclusion allowed under this section. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and one or more of the co-owners qualify for the exclusion allowed under G.S. 105-277.1C, each co-owner who qualifies for the exclusion under this section is entitled to the full amount of the exclusion. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the greater of the exclusion allowed under this section and the exclusion allowed under G.S. 105-277.1C"

SECTION 3. G.S. 105-277.1B reads as rewritten:

"**§ 105-277.1B. (Effective for taxes imposed for taxable years beginning on or after July 1, 2009) Property tax homestead circuit breaker.**

(a) Classification. – A permanent residence owned and occupied by a qualifying owner is designated a special class of property under Article V, Section 2(2) of the North Carolina Constitution and is taxable in accordance with this section.

(b) Definitions. – The definitions provided in G.S. 105-277.1 apply to this section. 'Deferred taxes' means the principal amount of tax deferred under this section.

(c) Income Eligibility Limit. – The income eligibility limit provided in G.S. 105-277.1(a2) applies to this section.

(d) Qualifying Owner. – For the purpose of qualifying for the property tax homestead circuit breaker under this section, a qualifying owner is an owner who meets all of the following requirements as of January 1 preceding the taxable year for which the benefit is claimed:

(1) The owner has an income for the preceding calendar year of not more than one hundred fifty percent (150%) of the income eligibility limit specified in subsection (c) of this section.

(2) The owner has o~~wned and~~ occupied the property as a permanent residence for at least five ~~years.~~years and has owned the property as a permanent residence for at least five consecutive years.

(3) The owner is at least 65 years of age or totally and permanently disabled.

(4) The owner is a North Carolina resident.

(e) Multiple Owners. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of the property tax homestead circuit breaker notwithstanding that only one of them meets the length of occupancy ~~occupation~~ requirement and the age or disability requirement of this section. When a permanent residence is owned and occupied by two or more persons other than husband and ~~wife,~~wife as tenants by the entirety, no property tax homestead circuit breaker is allowed unless all of the owners qualify and elect to defer taxes under this section.

(f) Tax Limitation. – A qualifying owner may defer the portion of tax imposed on his or her permanent residence if it exceeds the percentage of the qualifying owner's income set out in the table in this subsection. If a permanent residence is subject to tax by more than one taxing unit and the total tax liability exceeds the tax limit imposed by this section, then both the taxes due under this section and the taxes deferred under this section must be apportioned

among the taxing units based upon the ratio each taxing unit's tax rate bears to the total tax rate of all units.

Income Over	Income Up To	Percentage
-0-	Income Eligibility Limit	4.0%
Income Eligibility Limit	150% of Income Eligibility Limit	5.0%

(g) Temporary Absence. – An otherwise qualifying owner does not lose the benefit of this circuit breaker because of a temporary absence from his or her permanent residence for reasons of health, or because of an extended absence while confined to a rest home or nursing home, so long as the residence is unoccupied or occupied by the owner's spouse or other dependent.

(h) Deferred Taxes. – The difference between the taxes due under this section and the taxes that would have been payable in the absence of this section are a lien on the real property of the taxpayer as provided in G.S. 105-355(a). The difference in taxes for the three fiscal years preceding the ~~current~~ tax year in which a disqualifying event occurs shall be carried forward in the records of the taxing unit or units as deferred taxes. The deferred taxes are due and payable in accordance with G.S. 105-277.1F when the property loses its eligibility for deferral because of the occurrence of a disqualifying event as provided in subsection (i) of this section. On or before September 1 of each year, the collector shall ~~notify each residence owner to whom a tax deferral has previously been granted of the accumulated sum of deferred taxes and interest.~~send to the mailing address of a residence on which taxes have been deferred a notice stating the amount of deferred taxes and interest that are due and payable upon the occurrence of a disqualifying event.

(i) Disqualifying Events. – Each of the following constitutes a disqualifying event:

(1) The owner transfers the residence. Transfer of the residence is not a disqualifying event if (i) the owner transfers the residence to a co-owner of the residence or, as part of a divorce proceeding, to his or her spouse and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(2) The owner dies. Death of the owner is not a disqualifying event if (i) the owner's share passes to a co-owner of the residence or to his or her spouse ~~residence~~ and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(3) The owner ceases to use the property as a permanent residence.

(j) Gap in Deferral. – If an owner of a residence on which taxes have been deferred under this section is not eligible for continued deferral for a tax year, the three years for which the deferred taxes ~~deferred from the prior tax years~~ are carried forward are not due and payable ~~but are carried forward~~ until a disqualifying event occurs. If the owner of the residence qualifies for deferral after one or more years in which he or she did not qualify for deferral, the years in which the owner did not qualify are disregarded in determining the three years for which the deferred taxes are carried forward.

(k) **(Repealed effective for taxes imposed for taxable years beginning on or after July 1, 2008)** Prepayment. – All or part of the deferred taxes and accrued interest may be paid to the tax collector at any time. Any partial payment is applied first to accrued interest. A residence owner to whom a tax deferral has previously been granted may revoke the application for deferral at any time by notifying the assessor in writing.

(l) Creditor Limitations. – A mortgagee or trustee that elects to pay any tax deferred by the owner of a residence subject to a mortgage or deed of trust does not acquire a right to foreclose as a result of the election. Except for requirements dictated by federal law or regulation, any provision in a mortgage, deed of trust, or other agreement that prohibits the owner from deferring taxes on property under this section is void.

(m) Construction. – This section does not affect the attachment of a lien for personal property taxes against a tax-deferred residence.

(n) Application. – An application for property tax relief provided by this section should be filed during the regular listing period, but may be filed and must be accepted at any time up to and through June 1 preceding the tax year for which the relief is claimed. Persons may apply for this property tax relief by entering the appropriate information on a form made available by the assessor under G.S. 105-282.1"

SECTION 4. G.S. 105-277.1C reads as rewritten:

"**§ 105-277.1C. (Effective for taxes imposed for taxable years beginning on or after July 1, 2009) Disabled veteran property tax homestead exclusion.**

(a) Exclusion. – A permanent residence owned and occupied by an owner who is a North Carolina resident and who is an honorably discharged disabled veteran or the unmarried surviving spouse of an honorably discharged disabled veteran is designated a special class of property under Article V, Section 2(2) of the North Carolina Constitution and is taxable in accordance with this section. The first forty-five thousand dollars ($45,000) of appraised value of the residence is excluded from taxation. An owner who receives an exclusion under this section may not receive other property tax relief.

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

(1) Disabled veteran. – A veteran who, as of January 1 preceding the taxable year for which the exclusion allowed by this section is claimed, ~~receives~~ received benefits under 38 U.S.C. § 2101 or has a veteran's disability certification.

(2) Owner. – Defined in G.S. 105-277.1.

(3) Permanent residence. – Defined in G.S. 105-277.1.

(4) Property tax relief. – Defined in G.S. 105-277.1.

(5) Veteran. – A veteran of any branch of the Armed Forces of the United States.

(6) Veteran's disability certification. – A certification by the United States Department of Veterans Affairs or another federal agency that a veteran has a permanent total disability that is service-connected.

(c) Temporary Absence. – An owner does not lose the benefit of this exclusion because of a temporary absence from his or her permanent residence for reasons of health or because of an extended absence while confined to a rest home or nursing home, so long as the residence is unoccupied or occupied by the owner's spouse or other dependent.

(d) Ownership by ~~Spouses.~~Tenants by the Entirety. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of this exclusion notwithstanding that only one of them meets the requirements of this section.

(e) Other Multiple Owners. – This subsection applies to co-owners who are not husband and ~~wife.~~as tenants by the entirety. Each co-owner of a permanent residence must apply separately for the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and none of the co-owners qualifies for the exclusion allowed under G.S. 105-277.1, each co-owner is entitled to the full amount of the exclusion allowed under this section. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and one or more of the co-owners qualify for the exclusion allowed under G.S. 105-277.1, each co-owner who qualifies for the exclusion allowed under this section is entitled to the full amount of the exclusion. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of

the exclusion allowed to all the co-owners may not exceed the greater of the exclusion allowed under this section and the exclusion allowed under G.S. 105-277.1.

(f) Application. – An application for the exclusion allowed under this section should be filed during the regular listing period, but may be filed and must be accepted at any time up to and through June 1 preceding the tax year for which the exclusion is claimed. An applicant for an exclusion under this section must establish eligibility for the exclusion by providing a copy of the veteran's disability certification or evidence of benefits received under 38 U.S.C. § 2101."

SECTION 5. G.S. 105-282.1(a) reads as rewritten:

"(a) Application. – Every owner of property claiming exemption or exclusion from property taxes under the provisions of this Subchapter has the burden of establishing that the property is entitled to it. If the property for which the exemption or exclusion is claimed is appraised by the Department of Revenue, the application shall be filed with the Department. Otherwise, the application shall be filed with the assessor of the county in which the property is situated. An application must contain a complete and accurate statement of the facts that entitle the property to the exemption or exclusion and must indicate the municipality, if any, in which the property is located. Each application filed with the Department of Revenue or an assessor shall be submitted on a form approved by the Department. Application forms shall be made available by the assessor and the Department, as appropriate.

Except as provided below, an owner claiming an exemption or exclusion from property taxes must file an application for the exemption or exclusion annually during the listing period.

(1) No application required. – Owners of the following exempt or excluded property do not need to file an application for the exemption or exclusion to be entitled to receive it:

a. Property exempt from taxation under G.S. 105-278.1 or G.S. 105-278.2.

b. Special classes of property excluded from taxation under G.S. 105-275(15), (16), (26), (31), (32a), (33), (34), (37), (40), ~~or (42).~~(42), (44), or 45.

c. Property classified for taxation at a reduced valuation under G.S. 105-277(g) or G.S. 105-277.9.

(2) **(Effective for taxes imposed for taxable years beginning before July 1, 2009)** Single application required. – An owner of one or more of the following properties eligible to be exempted or excluded from taxation must file an application for exemption or exclusion to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the exemption or exclusion:

a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 105-278.5, 105- 278.6, 105-278.7, or 105-278.8.

b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (31e), (35), (36), (38), (39), or (41) or under G.S. 131A-21.

c. Special classes of property classified for taxation at a reduced valuation under G.S. 105-277(h), 105-277.1, 105-277.10, 105-277.13, 105-278.

d. Property owned by a nonprofit homeowners' association but where the value of the property is included in the appraisals of property owned by members of the association under G.S. 105-277.8.

(2) **(Effective for taxes imposed for taxable years beginning on or after July 1, 2009 and before July 1, 2010)** Single application required. – An owner of one or more of the following properties eligible for a property tax benefit must file an application for the benefit to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the benefit.

a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 105-278.5, 105-278.6, 105-278.7, or 105-278.8.

b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (31e), (35), (36), (38), (39), or (41) or under G.S. 131A-21.

c. Special classes of property classified for taxation at a reduced valuation under G.S. 105-277(h), 105-277.1, 105-277.1C, 105-277.10, 105-277.13, 105-277.14, or 105-278.

d. Property owned by a nonprofit homeowners' association but where the value of the property is included in the appraisals of property owned by members of the association under G.S. 105-277.8.

e. Repealed by Session Laws 2008-35, s. 1.2, effective for taxes imposed for taxable years beginning on or after July 1, 2008.

(2) **(Effective for taxes imposed for taxable years beginning on or after July 1, 2010)** Single application required. – An owner of one or more of the following properties eligible for a property tax benefit must file an application for the benefit to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the benefit.

a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 105-278.5, 105-278.6, 105-278.7, or 105-278.8.

b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (31e), (35), (36), (38), (39), or (41) or under G.S. 131A-21.

c. Special classes of property classified for taxation at a reduced valuation under G.S. 105-277(h), 105-277.1, 105-277.1C, 105-277.10, 105-277.13, ~~105-278, or 105-277.15.~~105-277.14, 105-277.15, or 105-278.

d. Property owned by a nonprofit homeowners' association but where the value of the property is included in the appraisals of property owned by members of the association under G.S. 105-277.8.

e. Repealed by Session Laws 2008-35, s. 1.2, effective for taxes imposed for taxable years beginning on or after July 1, 2008."

SECTION 6. G.S. 105-277.14(d) is repealed.

SECTION 7. G.S. 105-361(a) reads as rewritten:

(a) Duty to Furnish a Certificate. – On the request of any of the persons prescribed in subdivision (a)(1), below, and upon the condition prescribed by subdivision (a)(2), below, the tax collector shall furnish a written certificate stating the amount of any taxes and special assessments owed for the current year and for any prior ~~years in his hands for collection (together with any penalties, interest, and costs accrued thereon) including the amount due under G.S. 105-277.4(c) if the property should lose its eligibility for the benefit of classification under G.S. 105-277.2 et seq. that are a lien on a parcel of real property in the taxing unit.~~years. The certificate shall include deferred taxes that are due and payable because of the occurrence of a disqualifying event.

(1) Who May Make Request. – Any of the following persons shall be entitled to request the certificate:

a. An owner of the real property;

b. An occupant of the real property;

c. A person having a lien on the real property;

d. A person having a legal interest or estate in the real property;

e. A person or firm having a contract to purchase or lease the property or a person or firm having contracted to make a loan secured by the property;

f. The authorized agent or attorney of any person described in subdivisions (a)(1)a through e above."

SECTION 8. This act is effective when it becomes law.

BILL ANALYSIS

DRAFT BILL 2009-LAz-8: Property Tax Technical, Administrative, & Clarifying Changes

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Martha Walston
Version:	Draft		Committee Counsel

SUMMARY: ***This legislative proposal makes several technical, clarifying, and administrative changes to the property tax statutes.***

BILL ANALYSIS: This draft proposal makes the following technical, clarifying, and administrative changes:

Section	Explanation
1	Clarifies that in order for property to be excluded from tax, it must first satisfy any statutory application requirements.
2(a) & (b)	Clarifies treatment of property owned by husband and wife as tenants by the entirety as opposed to tenants in common when qualifying for the homestead exclusion. If owned in tenancy by the entirety, only one spouse has to meet the age or disability requirement.
3	Makes the following clarifying and technical changes to the homestead circuit breaker: • Defines deferred taxes. • Clarifies that the property owned by a qualifying owner must have been the owner's permanent residence for at least five consecutive years but that the owner's five-year occupancy does not have to be consecutive. • Clarifies that the occupancy requirement refers to "length" of occupancy. • Removes an unnecessary word. • Clarifies that only the deferred taxes for the last three years prior to the disqualifying event become due and payable. • Clarifies that notice of the sum of deferred taxes and interest that are due and payable must be sent annually to the mailing address of the residence subject to the circuit breaker benefit as opposed to mailing notice to each owner of the property.
4	Makes the following clarifying changes to the disabled veteran homestead exclusion: • Clarifies that the exclusion is available to a disabled veteran who "received" instead of "receives" federal benefits to adapt his or her

	housing, since these benefits are generally a one-time payment. • Clarifies that if the permanent residence is owned by spouses as tenants by the entirety, only one spouse has to meet the exclusion requirements.
5	Makes the following conforming changes to the statute that sets out the application procedure for property tax exemptions: • Adds the exemptions for drug samples and for 80% of the value of solar energy electric systems to the list of exempt property not requiring an application. • Adds working waterfront property to the list of property classified for taxation at reduced valuation that must file a single application Makes a technical correction.
6	Repeals an unnecessary statute.
7	Clarifies that the amount of taxes that a tax collector must report on a tax certificate includes any deferred taxes.

REVENUE LAWS STUDY COMMITTEE

DRAFT



REPORT TO THE 2009 GENERAL ASSEMBLY OF NORTH CAROLINA 2009 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 ..... **

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

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

3. AN ACT TO URGE THE 111TH CONGRESS TO GRANT STATES THE ABILITY TO REQUIRE COLLECTION OF SALES AND USE TAX BY REMOTE RETAILERS AND TO UPDATE THE REFERENCE TO THE STREAMLINED SALES AND USE TAX AGREEMENT ..... **

4. AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED ..... **

5. AN ACT TO MODERNIZE THE SALES AND USE TAX STATUTES BY TREATING MUSIC, MOVIES, COMPUTER SOFTWARE, AND BOOKS THAT ARE DELIVERED ELECTRONICALLY THE SAME AS THOSE THAT ARE PURCHASED IN A TANGIBLE MEDIUM AND BY REVISING THE "MAIL ORDER" SALES TAX PROVISIONS TO INCLUDE SPECIFIC REFERENCES TO INTERNET SALES ..... **

6. AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.....**

Appendices*

A. Authorizing Legislation, Article 12L of Chapter 120 of the General Statutes
B. Meeting Agendas
C. Disposition of Committee's Recommendations to the 2008 Session
D. Real Property Disclosure Statement
E. Department of Revenue Report on Revenue Generated from Captive REIT Provision

*All of the meeting handouts, including Power Point presentations, may be accessed online at the Revenue Laws Study Committee website: http://www.ncleg.net/committees/



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

Senator John H. Kerr, III, Cochair

Representative Paul Luebke, Cochair

January 27, 2009

TO THE MEMBERS OF THE 2007 GENERAL ASSEMBLY:

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

Respectfully Submitted,

Rep. Paul Luebke, Co-Chair

Sen. John Kerr, Co-Chair

2007-2008

REVENUE LAWS STUDY COMMITTEE

MEMBERSHIP

Senator John H. Kerr, III, Cochair

Senator Peter Samuel Brunstetter
Senator Daniel Gray Clodfelter
Senator Walter H. Dalton
Senator Fletcher Lee Hartsell, Jr.
Senator David W. Hoyle
Mr. Leonard W. Jones
Mr. J. Micah Pate, III

Representative Paul Luebke, Cochair

Rep. Harold J. Brubaker
Rep. Becky Carney (Advisory)
Rep. Pryor Gibson
Rep. Dewey Lewis Hill
Rep. Daniel Francis McComas
Rep. William C. McGee
Rep. William L. Wainwright
Rep. Jennifer Weiss

Staff:

DeAnne Mangum, Committee Assistant
Cindy Avrette, Staff Attorney
Rodney Bizzell, Fiscal Analyst
Barry Boardman, Fiscal Analyst
Judy Collier, Research Assistant
Dan Ettefagh, Staff Attorney
Heather Fennell, Staff Attorney
Trina Griffin, Staff Attorney
Sandra Johnson, Fiscal Analyst
Brian Slivka, Fiscal Analyst

Martha Walston, Staff Attorney



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. Before it was created as a permanent legislative commission in 1997, the Revenue Laws Study Committee was a subcommittee of the Legislative Research Commission. It has studied the revenue laws every year since 1977. The Committee consists of sixteen members, eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. Committee members may be legislators or citizens. The co-chairs for 2007-2008 are Senator John Kerr and Representative Paul Luebke.

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

In 2002, the General Assembly established a permanent subcommittee under the Revenue Laws Study Committee to study and examine the property tax system.[1] The subcommittee consists of eight members, four appointed by the Senate chair of the Revenue Laws Study Committee and four appointed by the House chair of the Committee. The subcommittee may recommend changes in the property tax system to the full Committee for its consideration in its final report to the General Assembly. Although the Property Tax Subcommittee did not meet during the 2007-2008 interim, an

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

informal work group consisting of representatives from the Department of Revenue, the North Carolina Association of County Commissioners, the North Carolina Tax Assessors and Collectors Association, and the School of Government met several times on property tax issues.



COMMITTEE PROCEEDINGS

The Revenue Laws Study Committee met five times after the adjournment of the 2008 Regular Session of the 2007 General Assembly on July 18, 2008. Appendix B contains a copy of the Committee's agenda for each meeting. All of the materials distributed at the meetings may be viewed on the Committee's website: http://www.ncleg.net/committees/. The Committee received numerous requests from legislators, taxpayers, the Department of Revenue, and interest groups to study various issues of tax policy and tax administration. The Committee considered many issues but was unable to take up all of the issues suggested to it. The Committee considered all proposed tax changes in light of general principles of tax policy and as part of an examination of the existing tax structure as a whole.

REVIEW OF THE RECOMMENDATIONS MADE TO THE 2008 GENERAL ASSEMBLY

The 2008 General Assembly enacted 13 of the Revenue Laws Study Committee's 14 legislative proposals in whole or in part. Appendix C lists the Committee's recommendations and the action taken on them in 2008. A document entitled "**2008 Finance Law Changes**" summarizes all of the tax legislation enacted in 2008. It is available in the Legislative Library located in the Legislative Office Building. It may also be viewed on the Legislative Library's website: http://www.ncleg.net/LegLibrary under 'Studies and Reports,' 'Tax Law Changes (1996 - 2008)'.

IRC UPDATE

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[1] The General Assembly determines each year whether

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

to update its reference to the Code.[2] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The current reference to the Code is May 1, 2008. Since that date, Congress has enacted five pieces of legislation that made changes to the Code. This federal legislation includes the Heartland, Habitat, Harvest, and Horticulture Act of 2008, signed into law May 22, 2008 (P.L. 110-234); the Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245); the Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289); the Emergency Economic Stabilization Act of 2008 signed into law October 3, 2008 (P.L. 110-343); and the Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458) signed into law December 23, 2008. In addition to the preceding acts, an action by the Treasury Department may affect State revenue. On September 30, 2008 the IRS issued Notice 2008-84. This notice provides a potential tax break to purchasers of banks with outstanding bad debt.

The Committee began its discussion of conformity with an overview of the five federal acts. Specific attention was given to the Housing Assistance Tax Act (HATA) and the Emergency Economic Stabilization Act (EESA) in light of the substantial fiscal impact conformity would have on State revenues. The HATA includes a provision that allows an additional standard deduction to be taken by non-itemizers for State and local real property taxes paid. The EESA provides compensation limits for executives of financial institutions participating in the Troubled Asset Relief Program, extends various deductions for both individual sand businesses, and provides disaster relief for victims of federally declared disasters occurring in 2008 and 2009.

---

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

The fiscal impact on the State's General Fund of fully conforming to all five acts would be a combined loss of approximately $191 million for the 2009-10 and 2010-11 fiscal years. Of this loss to the General Fund, $13 million is associated with the additional standard deduction for real property taxes provision. The additional standard deduction would reduce the State's General Fund by approximately $3 million for FY 2008-09 and $10 for FY 2009-10.

In deciding whether to conform to the federal changes, the Committee balanced the benefits of conformity, which include improved compliance, tax simplicity, and ease of administration, against the General Assembly's responsibility to provide the necessary revenues to support the State's budget. In light of the cost of conformity, the unknowns associated with the budget outlook, and the possibility of further substantial Federal legislative changes to the Code, the Committee recommended Legislative Proposal 1, *IRC Update*. The proposal updates the Code reference to January 1, 2009, and conforms to all of the federal changes, with the exception of the additional standard deduction for real property taxes provision in HATA and extended by the EESA. Under this proposal taxpayers would be required to add back the additional standard deduction for real property taxes to federal taxable income for the purposes of determining State net income.

MODERNIZE CORPORATE INCOME TAX FILINGS

The Revenue Laws Study Committee recommended to the 2007 Session of the General Assembly that the State consider changing how a corporation determines its net income for corporate income tax purposes. Under current law, a corporation files as a separate entity, meaning it must determine its State net income as if a separate return had been filed for federal income tax purposes. Under the proposal recommended by the Committee to the 2007 General Assembly, a corporation that is part of an affiliated group engaged in a single trade or business would file a combined report.[3] The General

[3] Senate Bill 244 and House Bill 462.

Assembly did not enact the legislation last biennium because many of the outstanding issues that needed to be addressed by the proposal were left unresolved. The Committee continued its study of business taxation this interim. Although the unresolved issues remain, the Committee continues to believe the subject of mandatory combined reporting is one the 2009 Session of the General Assembly should have the opportunity to consider. Legislative Proposal 2, *Modernize Corporate Income Tax Filing*, contains the Committee's recommendation that the 2009 General Assembly consider moving from single entity reporting to combined reporting. The contents of the proposal are the same as the proposal recommended in 2007.

The Committee first began its study of the issue of corporate taxation with a directive from the General Assembly to review the authority of the Secretary of Revenue to require taxpayers to file consolidated returns and to consider whether the State should require corporations to file consolidated returns.[4] The Committee considered the issue at five meetings prior to the convening of the 2007 Session of the General Assembly: September 5, 2006, November 16, 2006, December 12, 2006, January 16, 2007, and January 23, 2007. The Committee considered the issue at four meetings prior to the convening of the 2009 General Assembly: November 19, 2008, December 15, 2008, January 7, 2009, and January 28, 2009. Over the course of the past three years, the Committee has heard from its staff, the Department of Revenue, and taxpayers. The Committee sought the experience of other states that have recently enacted legislation in this area, namely West Virginia and Texas.

The Committee learned that North Carolina's corporate income tax has been declining as a percentage of tax revenues for decades. The reason for the decline is twofold: tax policy decisions enacted by the General Assembly and tax shifting strategies of corporate taxpayers. North Carolina begins its calculation of corporate income tax with federal taxable income. In addition to policy decisions made at the

[4] S.L. 2006-196.

federal level that decrease federal taxable income5, such as accelerated depreciation, the General Assembly has amended the North Carolina tax laws to provide various corporate tax credits that reduce the amount of tax due to the State, such as the Article 3J tax credits. Business tax planning strategies also account for part of the decline in corporate tax revenues as a percentage of overall tax revenues. North Carolina's requirement that a corporation file as a separate entity enables many of these strategies.

Separate entity filing gives corporations with subsidiaries in multiple states the ability to devise ways to shift income from a high effective tax rate state to a low effective tax rate state, often through the use of passive investment companies and inter-company transactions. Over the past several years, the General Assembly has enacted changes to the State's corporate income tax laws to address the shifting of income between states by multistate corporations. Despite the efforts, the problem of income shifting between multistate corporations continues to be an issue.

The Department of Revenue has aggressively used the tools available to it to require a corporation to file a consolidated return when the Department believes the corporation's net income attributable to this State is not accurately reflected on its separate entity filing return. This action by the Department is referred to as 'forced combinations'. The Department has used forced combinations for a number of years and it has collected more than $200 million in taxes from forced combinations.

Taxpayers, seeking clarity on the law, have filed lawsuits contesting the Department's authority to force combinations. G.S. 105-130.6 provides the authority the Department uses to force combinations. Taxpayers express concern that the statute is vague and there are no administrative rules or directives to provide guidance or certainty to taxpayers as to when a combined reporting is required, who is required to be included in the combined report, or how the combination is to be accomplished.

[5] The General Assembly chooses whether or not to conform to the federal tax law changes each year when it considers legislation updating the date of reference to the Internal Revenue Code.

Taxpayers believe the statute does not provide any meaningful taxpayer remedies because it says: "The findings and conclusions of the Secretary shall be presumed to be correct and shall not be set aside unless shown to be plainly wrong."

In its deliberations of this issue, the Committee recognized the following principles of taxation:

- Equity. - The tax laws should treat similarly situated taxpayers the same and it should treat similar transactions the same.
- Simplicity. - The tax laws should be as administratively simple as possible to reduce compliance burdens on taxpayers and administrative burdens on government.
- Sufficiency. - The tax laws should provide sufficiency and predictability of revenue.
- Efficiency. - The tax laws should not impede or reduce the productive capacity of the economy.
- Competitiveness. The tax laws should promote long-term, sustainable economic development, job creation, and growth.

Based upon those principles, it desired a bill that would meet the following goals:

- Provide a comprehensive way to nullify income shifting strategies.
- Modernize the State's tax laws to adapt to the growth of multi-state corporations.
- Broaden the corporate tax base.
- Reduce uncertainty about when corporations need to file combined returns, who is required to be included in it, and how it is to be accomplished.
- Provide a more level playing field for all businesses, both those that operate only in North Carolina and those that operate in multiple states.

The Committee continues to believe that a more comprehensive way to

address the issue of income shifting between affiliated corporations, and to meet its desired goals, is through the use of combined reporting. The Committee's recommendation that the State consider moving from single entity reporting to combined reporting is not new. The Governor's Commission to Modernize State Finances recommended this change in 2001; the Income Tax Subcommittee of State and Local Fiscal Modernization Study Commission recommended the change in 2007; and Governor Easley included combined reporting in his 2007 budget recommendations. The Multistate Tax Commission adopted a model uniform statute for combined reporting in 2006. Since 2004, six states have adopted combined reporting6; today, 22 states require combined reporting.7

Legislative Proposal 2, *Modernize Corporate Income Tax Filing*, sets forth the basic structure for combined reporting:

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

[6] Massachusetts, Michigan, New York, Texas, West Virginia, and Vermont.
[7] Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kentucky, Maine, Minnesota, Montana, Nebraska, New Hampshire, North Dakota, Oregon, and Utah. (In addition to the six states listed in the preceding footnote.)

group member that is a non-US corporation. However, the proposal gives the combined group the option to exclude a group member whose business activity outside the United States is 80% or more of its total business activity. This election is commonly referred to as a 'water's edge election'.

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

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

- The percentage reduction by which the corporate income tax rate could be reduced to render the proposal revenue-neutral. The Committee anticipates that broadening the corporate tax base, as this proposal recommends, would generate additional corporate income tax revenue.
- The relationship between combined reporting and the franchise tax statutes.
- Transitional issues.
- Administrative issues.
- A determination as to what corporations, if any, would be excluded from combined reporting.

- How the income of corporations with special apportionment formulas under the current law would be apportioned under combined reporting.

SALES AND USE TAX

Modernize Sales Tax Statutes/Digital Products

One of the primary objectives of the Revenue Laws Study Committee is to regularly review the tax laws to determine whether they need updating and whether they meet principles of simplicity, fairness, and ease of administration. In 2007, the Streamlined Sales and Use Tax Project (SSUTP) examined the issue of digital products and, after lengthy consideration, adopted definitions and issued rules to guide member states that choose to consider the tax treatment of these items. In light of the Committee's overarching mission and its ongoing participation in the SSTUP, the Committee undertook to study the issue of taxing digital products.

The primary themes that emerged from its study were a recognition that the sales and use tax statutes are outdated as they relate to today's modern retail economy, that they do not apply evenhandedly to sales of equivalent items where the only distinction is the method of delivery, and the State will lose sales tax revenue as the transition from purchases of tangible media to purchases of digital media continues and grows. With these principles in mind, the Committee recommended Legislative Proposal #5, *Modernize Sales Tax Statutes/Digital Products*. The Proposal does three things:

- It applies the general rate of State and local sales tax to certain digital goods when the tangible equivalent of the good would be subject to sales tax.
- It eliminates the sales and use tax exemption on prewritten computer software delivered electronically or via load and leave.
- It revises the "mail order sale" provision by modernizing the terminology and by providing that a retailer is presumed to be soliciting business in this State when it

enters into certain commission agreements with in-State residents and the contractual arrangement generates in excess of $10,000 in sales to the retailer.

The first two items relate to modernizing the sales tax statutes to more accurately reflect the current retail economy. The third item, however, relates to a recent court decision that was discussed at the Committee's last meeting. At issue in that case was a recent amendment to the New York sales tax statutes providing that a retailer is presumed to be soliciting business through an independent contractor or other representative in that State and, therefore, required to collect sales tax if all of the following conditions are met:

1. The retailer has entered into an agreement with a resident of that State.
2. Under the agreement, the resident receives a commission or other consideration in exchange for directly or indirectly referring potential customers, whether by a link on an Internet website or otherwise, to the retailer.
3. The cumulative gross receipts from sales by the retailer to purchasers in that State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of $10,000 during the preceding four quarterly periods.

The presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution.

Amazon brought a lawsuit challenging the constitutionality of this provision arguing that it violates the Commerce Clause of the United States Constitution as well as both the Federal and State Constitutions' Due Process and Equal Protection Clauses. On January 12, 2009, the New York Supreme Court[8] dismissed the complaint for failure to state a cause of action. The court disagreed with Amazon's assertion that the

[8] The New York Supreme Court is a trial-level court.

commissioned agents were mere advertisers concluding that the provision requires tax collection only when an out-of-state seller avails itself of the benefit of in-state contractors who are compensated for referrals and who generate actual business for the seller. Moreover, the court reaffirmed principles set out in the Scripto v. Carson case where sufficient nexus existed to subject an out-of-state company to tax collection obligation by virtue of having 10 in-state independent contractors who solicited orders for products on behalf of that company.

This proposal revises the current "mail order" provisions by modernizing the terminology and by specifically adding language identical to the New York provision for purposes of clarifying certain circumstances under which a remote retailer is considered to be soliciting or transacting business within this State.

Streamlined Sales and Use Tax Project Update

The Revenue Laws Study Committee has spent a considerable amount of time over the past several years on the Streamlined Sales and Use Tax Project (Project), which began in March 2000. The adoption of the Streamlined Sales and Use Tax Agreement (Agreement) in 2002 provided the framework for participating states to achieve the uniformity and simplification measures initially established by a coalition of states, local governments, and businesses. The goal of the Project is to achieve sufficient simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in those states that have adopted the uniform provisions of the Agreement. Based on decisions by the United States Supreme Court, states cannot require remote sellers that do not have a physical presence in the state to collect and remit its use tax.

Andy Sabol, the director of the Sales and Use Tax Division of the Department of Revenue, updated the Revenue Laws Study Committee on the activities of the Streamlined Sales Tax Governing Board (Governing Board). North Carolina is one of twenty-two states represented on the Governing Board. The Governing Board

established a central registration system in October 2005 that allows sellers to register for sales and use tax purposes in all member states. Over 1,000 sellers have registered since the system's inception.

Since October 2005, North Carolina has collected approximately $36 million in use tax revenue from remote sellers. The State has received $7.9 million during the 2008-2009 fiscal year to date. The amounts collected voluntarily are far less than the estimated amounts the state is not collecting in use tax revenue from sales by remote sellers. A University of Tennessee study, commissioned a few years ago, estimated a revenue loss to state and local governments of more than $30 billion a year from uncollected use taxes on remote sales. The Governing Board has recently commissioned a study to provide an update on this estimate.

The United States Supreme Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote sellers. Sen. Mike Enzi (R-WY) and Rep. William Delahunt (D-MA) introduced a bipartisan bill in the 110th Congress to provide the necessary authorization to those states that had adopted the simplification and uniformity measures established in the Agreement. Although Congress did not enact the legislation last biennium, the Governing Board believes that the 111th Congress may represent the best opportunity for action on the Streamlined-related legislation, known as the Sales Tax Fairness and Simplification Act (STFSA). The National Conference of State Legislatures has recommended that Congress include the provisions of the STFSA as part of the economic stimulus legislation it is working to develop. The provisions of the STFSA would provide tens of billions of dollars in funding to states and local governments at a minimal or no cost to the federal government.

Legislative Proposal #3, *Streamlined Sales and Use Tax Update*, does two things:

- It encourages the 111th Congress to enact the provisions of the STFSA.

- It updates the statutory reference to the Agreement by changing the date from June 23, 2007, to September 5, 2008. North Carolina does not need to amend its sales and use tax laws to conform to any of the changes made in the Agreement since June 23, 2007.

Taxation of Food

Section 28.16(h) of S.L. 2008-107 directed the Revenue Laws Study Committee to study the distinction between food and prepared food under the sales and use tax laws and determine whether the distinction should be eliminated by applying a uniform, revenue-neutral rate to all food.

The Committee began its discussion by reviewing the legislative history of the sales tax on food and prepared food:

- 1933: Food for human consumption exempt from sales tax.[9]
- 1961: Food exemption repealed. Food subject to sales tax.
- 1998: State sales tax rate on food phased out. Food remains subject to a 2% local sales tax rate. Prepared food remains subject to the combined rate of State and local sales tax.
- 2000: Definitions of 'food' and 'prepared food' modified to conform to the Streamlined Sales and Use Tax Agreement. Food remains exempt from State sales tax; prepared food remains subject to the combined State and local sales tax. However, some foods once defined as 'food' and exempt from State tax become defined as 'prepared food' and become subject to the combined State and local tax rate.
- 2007: Bread, rolls, and buns sold at a bakery thrift store exempt from State sales tax; they remain subject to local sales tax.

[9] Except from 1935-1937.

- 2008: Bakery items defined as a special class of prepared food. Bakery items exempt from State sales tax; remain subject to local sales tax.

The distinction between food and prepared food often becomes complex. Prepared food is food that meets one or more of the following conditions: the retailer made the food item by mixing or combining two or more foods for sale as a single item or the retailer provides eating utensils to customers to use in consuming the food. Any food item prepared by a retailer and sold by the retailer to a consumer is a prepared food and is subject to the State and local sales tax rates. A similar product produced by someone else, but sold by the same retailer, is food and is exempt from State sales tax. For example, slaw prepared by Harris Teeter and sold in its deli section is prepared food. Slaw produced by someone else and sold at Harris Teeter is food. Likewise, the same product may be taxed differently depending upon where it is purchased. For example, a donut purchased at the place where it is made is prepared food. The same donut purchased at a grocery store is food.

How food is defined determines its tax rate. In North Carolina, there is a local sales tax of 2% on food while prepared food is subject to the general State sales tax rate of 4.25% as well as the applicable local rate, which ranges from 2.5% to 2.75%. The General Assembly directed the Committee to consider whether the distinction between food and prepared food should be eliminated by taxing all food at a uniform, revenue-neutral rate. The Committee learned that the revenue-neutral rate that would need to apply to all food would be 5.1%. That would mean that the tax rate on prepared food would decrease from 6.75% to 5.1%; but the tax rate on food would increase from 2% to 6.75%. The Committee did not move forward with a legislative proposal on this issue.

PROPERTY TAX

Advancement of Reappraisal Schedule

The Revenue Laws Study Committee recommended legislation to the 2008 Session of the 2007 General Assembly that would have advanced the octennial schedule for general appraisals of property tax to a quadrennial schedule. The purpose of this proposal was to reduce the discrepancy between the property tax value of property and its market value, since the law requires that property be appraised at its true or market value for property tax purposes. During the 2008 Session, several smaller rural counties voiced concerns about their lack of manpower and the expense of conducting more frequent appraisals. As a result, the version of the Committee's proposal enacted during the 2008 Session only requires an advanced reappraisal schedule when a county has a population of 75,000 or greater and the county's sales assessment ratio shows that the assessed value of the property differs from the sales price of the property by more than 15%. (S.L. 2008-146). Currently only ten counties are affected by the 2008 legislation.

Legislative proposal 4, *Real Property Sales Information,* is an attempt to assist the counties in satisfying the statutory requirement of appraising property at its true value without requiring more frequent appraisals. The proposal would require that certain information be reported to the county assessor each time property is transferred in the county. This information would be provided to the assessor on a form developed by the Department of Revenue, and the deed transferring the property would not be accepted by the county register of deeds until the tax assessor certifies that the form was filed.

The Committee recommended Proposal 4 after reviewing the current law on appraising real property and studying recommendations from tax assessors on how to assist them in conducting general reappraisals. These recommendations were elicited during field trips in which staff of the Committee and the Department's Property Tax Division met with tax assessors from large urban counties and smaller rural counties.[10] The assessors recognized the advantages of advancing the schedule; however, assessors

[10] Staff met in Charlotte with tax assessors from Mecklenburg County and surrounding counties and in Edenton with assessors from Chowan County and surrounding counties.

from the smaller more rural counties pointed out that revaluations are expensive and that they do not have the manpower or revenue to conduct them. The three main recommendations made by the tax assessors were:

1. Require statewide sales information forms.
2. Provide funding for staff at the State level to assist smaller counties with revaluations.
3. Update the schedules of values in the fourth year of a general reappraisal cycle in lieu of conducting a full reappraisal.

The Committee felt that a proposal requiring parties to a land transfer to file a sales information report with the county tax assessor would be the most helpful and cost efficient way to assist the counties in achieving the statutory requirement of appraising property at its true value for tax purposes. The Committee was informed that approximately one-half of the counties are currently requesting confirmation letters regarding transfers of property while only five counties require information affidavits. This proposal would require information reports in all counties before the deed transferring the property could be accepted for recording.

Tax Exemptions for Nonprofits

At its October meeting, the Committee heard two staff presentations on this topic: the first provided an overview of the tax treatment of nonprofits generally, and the second presentation focused specifically on hospital charity care, spotlighting ongoing measures at the federal level both in Congress and within the Internal Revenue Service. These presentations were followed by remarks from a guest speaker, Stan Jenkins, a county tax assessor from Illinois, who discussed one of the nation's leading ongoing cases involving the denial of a property tax exemption for a nonprofit hospital.

Nonprofit entities benefit from a number of both federal and state tax exemptions. One rationale for the exemptions is that nonprofits provide services and benefits that the government would otherwise have to provide with tax dollars. The Committee is aware that challenges to these exemptions are not new, but in recent years

there has been even more attention to these exemptions. Factors contributing to this increased examination include the rapid and significant growth of nonprofits, the increase in their "commercial" activities, and the number and extent of states experiencing fiscal crisis. The Committee heard examples that illustrate the trend of local governments toward denying property tax exemptions for nonprofits, especially for hospitals based on their failure to meet statutory thresholds of providing charity care.

The Committee concluded its review of this issue by contemplating what the actual goal of the property tax exemption is as it relates to charitable nonprofits, whether the law is clear, and whether the current law fulfills its public purpose. The Committee declined to move forward with any proposals on this issue. However, present at the meeting was Hugh Tilson of the North Carolina Hospital Association who informed the Committee that the Association was in the process of compiling information from its members related to the level of community benefit and charity care provided by its members using the revised IRS Guidelines. Mr. Tilson indicated that the Association's goal was to have this information available on its website by the end of the year. As a follow up to this, the Committee heard from Hugh Tilson at its final meeting who summarized the data collected to date. I

TECHNICAL, ADMINISTRATIVE, AND CLARIFYING CHANGES

The Revenue Laws Study Committee recommends Legislative Proposal 6, *Revenue Laws Technical, Administrative, and Clarifying Changes.* This proposal makes several technical and clarifying changes to the revenue laws and related statutes, including changes to the motor fuel tax and property tax laws. Many of the changes were recommendations of the Department of Revenue.

PRIVILEGE LICENSE TAX

Local Privilege License Taxes

For the second time in four years, the Revenue Laws Study Committee considered the issue of reforming the privilege license tax system. The catalyst for revisiting this subject was the passage of House Bill 2558, the Home Inspector Privilege License Act. With the passage of this act, the General Assembly experienced for the first time since the repeal in 1996, a single industry seeking the imposition of a State privilege tax in order to shield itself from local privilege license taxes. The home inspectors sought the change, in part, because of the way in which the local tax was being applied to businesses operating in multiple cities. Specifically, the home inspectors reported being double-taxed.

At its November 19 meeting, Christopher McLaughlin, Assistant Professor of Public Law and Government at the UNC School of Government, provided the Committee with an overview of the system and an analysis of its deficiencies. Mr. McLaughlin reported that this system of taxation has long been considered outmoded, inefficient, and arbitrary. It has also been a source of confusion for local governments and taxpayers alike. One of the reasons for this confusion is that in order to determine the scope of a county's or city's authority to levy a privilege license tax, one must refer to the law as it existed in 1995 before the repeal of the majority of the State-level privilege license taxes. The Committee also discussed equity concerns including the arbitrary distinctions between businesses, the inconsistent application of the law across the State, and instances of double taxation of some businesses.

At its December meeting, the Committee heard remarks from Karl Knapp with the League of Municipalities and Jim Blackburn with the Association of County Commissioners. At its January 7, 2009 meeting, the Committee heard from Andy Ellen with the Retail Merchants Association and Mark Prak, a Raleigh attorney who has experience in this area.

Although the Committee was presented with five broad options for modifying the system, it was unable to reach consensus on an approach that would balance the

cities' concern about preserving this source of local revenue while addressing the business community's goal of modernization and uniformity.

Resale of Tickets on the Internet

The Revenue Laws Study Committee reviewed the legislation enacted by the 2008 General Assembly. In its review, it considered the sunset placed on S.L. 2008-158. This legislation, *Resale of Tickets via Internet*, allows admission tickets to be resold on the Internet at a price that exceeds the price printed on the ticket. Under prior law, this sale would be a criminal offense. Reselling tickets online is a new and growing business; the legislation recognized this reality and amended the law to remove the criminal offense and to provide safeguards for the venue and the customer.

The issue left unresolved by the legislation is the application of the State privilege license to the resell of the tickets. Under current law, the State imposes a privilege tax on a person engaged in the business of giving, offering, or managing a form of amusement or entertainment. Unlike the sales tax, the privilege tax is a tax on the person, not the transaction. The current law does not impose the privilege tax on a person engaged in the business of reselling tickets to an entertainment event. The tax rate is 3% of the gross receipts derived by the sale.

Under the Senate version of the bill, the privilege tax would have been expanded to include a person engaged in the business of reselling tickets. The tax would have applied to the difference between the price of the ticket sold and the face price of the ticket. The House deleted this provision from the bill. The final bill, crafted by a conference committee, placed a sunset on the bill of June 30, 2009.[11] The sunset necessitates the General Assembly revisiting the issue in 2009.

The Revenue Laws Study Committee did not recommend any legislation on this topic. It did recognize that the 2009 General Assembly has several choices:

[11] The final version of the bill contained a monthly reporting requirement. The Department of Revenue reported that only four reports have been filed. The reports, filed by different filers, showed less than 100 tickets resold and less than $5,000 of net proceeds.

- It could do nothing. In this event, the Act will sunset and the activity of reselling tickets will once again be illegal.
- It could extend the sunset.
- It could resolve the tax issue in one of three ways:
  - It could remove the sunset, thereby maintaining the status quo - no taxation on the resell of tickets.
  - It could impose the privilege license tax on a person engaged in the business of reselling tickets via Internet.
  - It could change the taxation of amusements by repealing the State privilege license tax on amusements and, in its place, imposing a State and local sales tax on the price of the tickets.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee makes the following six recommendations to the 2009 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. Modernize Corporate Income Tax Filings
3. Streamlined Sales and Use Tax Update
4. Real Property Sales Information
5. Modernize Sales Tax Statutes/Digital Products
6. Revenue Laws Technical, Administrative, & Clarifying Changes

2007-2008
REVENUE LAWS STUDY COMMITTEE



REPORT TO THE 2009 GENERAL ASSEMBLY OF NORTH CAROLINA 2009 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 AVAILABLE ON-LINE:
http://www.ncleg.net/LegLibrary/

THE REPORT AND ALL MEETING MATERIALS ARE ALSO AVAILABLE ON-LINE
AT THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

TABLE OF CONTENTS

Letter of Transmittal i

Revenue Laws Study Committee Membership ii

Preface 1

Committee Proceedings 3

Committee Recommendations and Legislative Proposals 29

1. AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS 30

2. AN ACT TO CHANGE THE CORPORATE INCOME TAX 46

3. AN ACT TO URGE THE 111TH CONGRESS TO GRANT STATES THE ABILITY TO REQUIRE COLLECTION OF SALES AND USE TAX BY REMOTE RETAILERS AND TO UPDATE THE REFERENCE TO THE STREAMLINED SALES AND USE TAX AGREEMENT 51

4. AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED 57

5. AN ACT TO MODERNIZE THE SALES AND USE TAX STATUTES BY TREATING MUSIC, MOVIES, COMPUTER SOFTWARE, AND BOOKS THAT ARE DELIVERED ELECTRONICALLY THE SAME AS THOSE THAT ARE PURCHASED IN A TANGIBLE MEDIUM AND BY REVISING THE "MAIL ORDER" SALES TAX PROVISIONS TO INCLUDE SPECIFIC REFERENCES TO INTERNET SALES 63

6. AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS 76

Appendices*

A. Authorizing Legislation, Article 12L of Chapter 120 of the General Statutes
B. Meeting Agendas
C. Disposition of Committee's Recommendations to the 2008 Session
D. Remarks Concerning Sales Taxation of Digital Products from Brooks Raiford, President & CEO, North Carolina Technology Association
E. List of Counties Impacted by 2008 Legislation Advancing Reappraisal Schedule
F. List of Counties that Obtain Sales Information on Real Property Transfers
G. Examples of Real Property Sales Information Forms
H. North Carolina Hospital Association Report on Charity Care and Community Benefit Data
I. North Carolina Department of Revenue Report on Revenue Generated from Captive REIT Provision
J. Department of Revenue Report on Customer Service Initiatives dated January 27, 2009

*All of the meeting handouts, including Power Point presentations, may be accessed online at the Revenue Laws Study Committee website: http://www.ncleg.net/committees/

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

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

February 10, 2009

TO THE MEMBERS OF THE 2009 GENERAL ASSEMBLY:

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

Respectfully Submitted,

Rep. Paul Luebke, Co-Chair

Sen. John Kerr, Co-Chair

2007-2008

REVENUE LAWS STUDY COMMITTEE

MEMBERSHIP

Senator John H. Kerr, III, Cochair

Senator Peter Samuel Brunstetter
Senator Daniel Gray Clodfelter
Senator Walter H. Dalton
Senator Fletcher Lee Hartsell, Jr.
Senator David W. Hoyle
Mr. Leonard W. Jones
Mr. J. Micah Pate, III

Representative Paul Luebke, Cochair

Rep. Harold J. Brubaker
Rep. Becky Carney (Advisory)
Rep. Pryor Gibson
Rep. Dewey Lewis Hill
Rep. Daniel Francis McComas
Rep. William C. McGee
Rep. William L. Wainwright
Rep. Jennifer Weiss

Staff:

DeAnne Mangum, Committee Assistant
Cindy Avrette, Staff Attorney
Rodney Bizzell, Fiscal Analyst
Barry Boardman, Fiscal Analyst
Judy Collier, Research Assistant
Dan Ettefagh, Staff Attorney
Heather Fennell, Staff Attorney
Trina Griffin, Staff Attorney
Sandra Johnson, Fiscal Analyst
Brian Slivka, Fiscal Analyst
Martha Walston, Staff Attorney

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. Before it was created as a permanent legislative commission in 1997, the Revenue Laws Study Committee was a subcommittee of the Legislative Research Commission. It has studied the revenue laws every year since 1977. The Committee consists of sixteen members, eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. Committee members may be legislators or citizens. The co-chairs for 2007-2008 are Senator John Kerr and Representative Paul Luebke.

In its study of the revenue laws, G.S. 120-70.106 gives the Committee 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 and may also be accessed online at the Committee's website: http://www.ncleg.net/committees/

In 2002, the General Assembly established a permanent subcommittee under the Revenue Laws Study Committee to study and examine the property tax system.[1] The subcommittee consists of eight members, four appointed by the Senate chair of the Revenue Laws Study Committee and four appointed by the House chair of the

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

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. Although the Property Tax Subcommittee did not meet during the 2008-2009 interim and has not met since 2004, staff met with representatives from the North Carolina Department of Revenue and groups of tax assessors and collectors throughout the State to discuss ways to improve the implementation of property tax changes that had been recommended by the Revenue Laws Study Committee and enacted during the 2007-2008 biennium.

COMMITTEE PROCEEDINGS

The Revenue Laws Study Committee met five times after the adjournment of the 2008 Regular Session of the 2007 General Assembly on July 18, 2008. Appendix B contains a copy of the Committee's agenda for each meeting. All of the materials distributed at the meetings may be viewed on the Committee's website: http://www.ncleg.net/committees/. The Committee received numerous requests from legislators, taxpayers, the Department of Revenue, and interest groups to study various issues of tax policy and tax administration. The Committee considered many issues but was unable to take up all of the issues suggested to it. The Committee considered all proposed tax changes in light of general principles of tax policy and as part of an examination of the existing tax structure as a whole.

REVIEW OF THE RECOMMENDATIONS MADE TO THE 2008 GENERAL ASSEMBLY

The 2008 General Assembly enacted 13 of the Revenue Laws Study Committee's 14 legislative proposals in whole or in part. Appendix C lists the Committee's recommendations and the action taken on them in 2008. A document entitled "**2008 Finance Law Changes**" summarizes all of the tax legislation enacted in 2008. It is available in the Legislative Library located in the Legislative Office Building. It may also be viewed on the Legislative Library's website: http://www.ncleg.net/LegLibrary under 'Studies and Reports,' 'Tax Law Changes (1996 - 2008)'.

IRC UPDATE

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[2] The General Assembly determines each year whether to update its reference to the Code.[3] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The current reference to the Code is May 1, 2008. Since that date, Congress has enacted five pieces of legislation that made changes to the Code. This federal legislation includes the Heartland, Habitat, Harvest, and Horticulture Act of 2008, signed into law May 22, 2008 (P.L. 110-234); the Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245); the Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289); the Emergency Economic Stabilization Act of 2008 signed into law October 3, 2008 (P.L. 110-343); and the Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458) signed into law December 23, 2008. In addition to the preceding acts, an action by the Treasury Department may affect State revenue. On September 30, 2008 the IRS issued Notice 2008-84. This notice provides a potential tax break to purchasers of banks with outstanding bad debt.

The Committee began its discussion of conformity with an overview of the five federal acts. Specific attention was given to the Housing Assistance Tax Act (HATA) and the Emergency Economic Stabilization Act (EESA) in light of the substantial fiscal

---

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

[3] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

impact conformity would have on State revenues. The HATA includes a provision that allows an additional standard deduction to be taken by non-itemizers for State and local real property taxes paid. The EESA provides compensation limits for executives of financial institutions participating in the Troubled Asset Relief Program, extends various deductions for both individuals and businesses, and provides disaster relief for victims of federally declared disasters occurring in 2008 and 2009.

The fiscal impact on the State's General Fund of fully conforming to all five acts would be a combined loss of approximately $191 million for the 2009-10 and 2010-11 fiscal years. Of this loss to the General Fund, $13 million is associated with the additional standard deduction for real property taxes provision. The additional standard deduction would reduce the State's General Fund by approximately $3 million for the 2008-09 fiscal year and $10 for the 2009-10 fiscal year.

In deciding whether to conform to the federal changes, the Committee balanced the benefits of conformity, which include improved compliance, tax simplicity, and ease of administration, against the General Assembly's responsibility to provide the necessary revenues to support the State's budget. In light of the cost of conformity, the unknowns associated with the budget outlook, and the possibility of further substantial federal legislative changes to the Code, the Committee recommended Legislative Proposal 1, *IRC Update*. The proposal updates the Code reference to January 1, 2009, and conforms to all of the federal changes, with the exception of the additional standard deduction for real property taxes provision in HATA and extended by the EESA. Under this proposal taxpayers would be required to add back the additional standard deduction for real property taxes to federal taxable income for the purposes of determining State net income.

CHANGE CORPORATE INCOME TAX

The Revenue Laws Study Committee recommended to the 2007 Session of the General Assembly that the State consider changing how a corporation determines its net income for corporate income tax purposes. Under current law, a corporation files as a separate entity, meaning it must determine its State net income as if a separate return had been filed for federal income tax purposes. Under the proposal recommended by the Committee to the 2007 General Assembly, a corporation that is part of an affiliated group engaged in a single trade or business would file a combined report.[4] The General Assembly did not enact the legislation last biennium because many of the outstanding issues that needed to be addressed by the proposal were left unresolved. The Committee continued its study of business taxation this interim.

The Committee first began its study of the issue of business taxation with a directive from the General Assembly to review the authority of the Secretary of Revenue to require taxpayers to file consolidated returns and to consider whether the State should require corporations to file consolidated returns.[5] The Committee considered the issue at five meetings prior to the convening of the 2007 Session of the General Assembly: September 5, 2006, November 16, 2006, December 12, 2006, January 16, 2007, and January 23, 2007. The Committee considered the issue at four meetings prior to the convening of the 2009 General Assembly: November 19, 2008, December 15, 2008, January 7, 2009, and January 28, 2009. Over the course of the past three years, the Committee heard from its staff, the Department of Revenue, and taxpayers. The Committee also sought the insight and knowledge of other states that have recently enacted legislation in this area, namely West Virginia and Texas.

---

[4] Senate Bill 244 and House Bill 462.

[5] S.L. 2006-196.

The Committee learned that North Carolina's corporate income tax has been declining as a percentage of tax revenues for decades. The reason for the decline is twofold: tax policy decisions enacted by the General Assembly and tax shifting strategies of corporate taxpayers. North Carolina begins its calculation of corporate income tax with federal taxable income. In addition to policy decisions made at the federal level that decrease federal taxable income[6], such as accelerated depreciation, the General Assembly has amended the North Carolina tax laws to provide various corporate tax credits that reduce the amount of corporate tax payable to the State, such as the Article 3J tax credits. Business tax planning strategies also account for part of the decline in corporate tax revenues as a percentage of overall tax revenues. North Carolina's requirement that a corporation file as a separate entity enables many of these strategies.

Separate entity filing gives corporations with subsidiaries in multiple states the ability to devise ways to shift income from a high effective tax rate state to a low effective tax rate state, often through the use of passive investment companies and inter-company transactions. Over the past several years, the General Assembly has enacted changes to the State's corporate income tax laws to address the shifting of income between states by multistate corporations. Despite these efforts, the problem of income shifting between multistate corporations continues to be an issue.

The Department of Revenue has aggressively used the tools available to it to require a corporation to file a consolidated return when the Department believes the corporation's net income attributable to this State is not accurately reflected on its separate entity filing return. This action by the Department is referred to as "forced

---

[6] The General Assembly chooses whether or not to conform to the federal tax law changes each year when it considers legislation updating the date of reference to the Internal Revenue Code.

combination." The Department has used forced combinations for a number of years and it has collected more than $200 million in taxes from forced combinations.

Taxpayers, seeking clarity on the law, have filed lawsuits contesting the Department's authority to force combinations. G.S. 105-130.6 provides the authority the Department uses to force combinations. Taxpayers express concern that the statute is vague and there are no administrative rules or directives to provide guidance or certainty to taxpayers as to when a combined reporting is required, who is required to be included in the combined report, or how the combination is to be accomplished. Taxpayers believe the statute does not provide any meaningful taxpayer remedies because it says: "*The findings and conclusions of the Secretary shall be presumed to be correct and shall not be set aside unless shown to be plainly wrong.*"

The adoption of mandatory combined reporting would address both the issue of income shifting and the issue of the lack of clarity in the law concerning forced combinations. Several prior studies have recommended that North Carolina require combined reporting. The Governor's Commission to Modernize State Finances recommended moving from single entity reporting to combined reporting as long ago as 2001. In 2007, this Committee, the Income Tax Subcommittee of the State and Local Fiscal Modernization Study Commission, and Governor Easley[7] all recommended this change. The Multistate Tax Commission adopted a model uniform statute for combined reporting in 2006. Twenty-two states[8] require combined reporting; six of those states have adopted combined reporting since 2004.[9]

---

[7] Governor Easley included the tax law change in his budget recommendation to the 2007 General Assembly, see HB 706, 707, and 708.

[8] Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kentucky, Maine, Minnesota, Montana, Nebraska, New Hampshire, Massachusetts, Michigan, New York, North Dakota, Oregon, Texas, Utah, West Virginia, and Vermont.

[9] Massachusetts, Michigan, New York, Texas, West Virginia, and Vermont.

The Committee acknowledges that its recommendation to the 2007 General Assembly did not resolve several key issues that would need to be addressed before the State could adopt combined reporting. Those issues include the following:

- The percentage reduction by which the corporate income tax rate could be reduced to render the proposal revenue-neutral. The Committee anticipates that broadening the corporate tax base, which combined reporting would do, would generate additional corporate income tax revenue. It continues to be the Committee's desire that any change to the corporate income tax structure be revenue-neutral.
- The relationship between combined reporting and the franchise tax statutes.
- A determination as to what corporations, if any, would be excluded from combined reporting.
- How the income of corporations with special apportionment formulas under the current law would be apportioned under combined reporting.
- Various transitional and administrative issues.

The Committee did not want to recommend a proposal to the 2009 General Assembly that did not address the unresolved issues from 2007. However, the Committee remains supportive of legislation that would further the following tax policy goals:

- Provide a more level playing field for all businesses, both those that operate only in North Carolina and those that operate in multiple states.
- Provide a comprehensive structure to nullify income shifting strategies.
- Modernize the tax laws to adapt to the growth of multi-state corporations.

- Reduce uncertainty about when a corporation needs to file a combined return, who the corporation includes in it, and how the combination is to be accomplished.
- Broaden the corporate income tax base and adjust the tax rate to make the changes revenue-neutral.

The Committee believes that, through its members, much work may be accomplished during the 2009 session on the issue of business taxation. Legislative Proposal #2, *Change Corporate Income Tax*, states the intent of the General Assembly to change the corporate income tax laws to accomplish the goals established by the Committee.

SALES AND USE TAX

Modernize Sales Tax Statutes/Digital Products

One of the primary objectives of the Revenue Laws Study Committee is to regularly review the tax laws to determine whether they need updating and whether they meet principles of simplicity, fairness, and ease of administration. In 2007, the Streamlined Sales and Use Tax Project (SSUTP) examined the issue of digital products and, after lengthy consideration, adopted definitions and issued rules to guide member states that choose to tax these items. In light of the Committee's mission and its ongoing participation in the SSUTP, the Committee undertook a study of taxing digital products.

Three findings emerged from its study of this issue. First, the Committee recognized that the sales and use tax statutes are outdated in relation to today's modern retail economy. The sales and use tax statutes were originally enacted in the 1930s and were drafted to apply to sales of tangible personal property because those items constituted the bulk of consumer purchases at that time. Technology and the

prevalence of the Internet have transformed society in a number of ways, including the way in which consumers make purchases. Over the last 10 years, more and more consumers shop online and download or stream media in digital format. When the sales tax statutes were enacted, intangible digital goods were not in existence and therefore not contemplated under the tax code. Because purchases of media in digital format are quickly becoming the norm, a number of State legislatures are revisiting their sales tax statutes and considering changes that would bring those statutes into the 21st Century.

Second, the Committee found that the sales and use statutes are inequitable to the extent that similar, if not identical, items are treated differently based upon the method of delivery or the point of purchase. This unequal treatment impacts consumers as well as retailers. For example, a consumer who purchases a CD in a "brick and mortar" retail establishment, such as Walmart, pays sales tax on that item. Likewise, a consumer who orders the CD from the Walmart website pays sales tax on that item. However, a consumer who downloads the exact same CD in MP3 format from the Walmart website does not pay any sales tax on the item. In these examples, the consumer purchases the same item, but the tax treatment differs. This differing tax treatment discriminates against consumers who either choose to purchase a tangible format or who do not have the technological capability to download or stream in digital format because they do not have a computer or high-speed Internet access. Moreover, the tax code should not drive consumer choice; it should be neutral as to industry, content, and delivery method. This unequal tax treatment also places brick and mortar retailers, or at least those without an Internet presence, at a competitive disadvantage with Internet retailers. A sound tax structure is one that is fair and neutral. Taxing digital goods in the same manner as their tangible counterparts would promote these

principles.

Third, the Committee recognized that the State will lose sales tax revenue that it is currently collecting as consumers continue to transition from purchases of tangible media to purchases of digital media. With these findings in mind, the Committee recommended Legislative Proposal #5, *Modernize Sales Tax Statutes/Digital Products.* The Proposal does three things:

- It applies the general rate of State and local sales tax to certain digital goods when the tangible equivalent of the good would be subject to sales tax.
- It eliminates the sales and use tax exemption on prewritten computer software delivered electronically or via load and leave.
- It revises the "mail order sale" provision by modernizing the terminology and by providing that a retailer is presumed to be soliciting business in this State when it enters into certain commission agreements with in-State residents and the contractual arrangement generates in excess of $10,000 in sales to the retailer.

These three items relate to modernizing the sales tax statutes to more accurately reflect the current retail economy. The first two address items that are received in a digital format. The third item addresses the modern methods by which retailers sell their products. At its last meeting, the Committee discussed North Carolina's current "mail order" provisions and a recent New York trial court decision.

The current mail order provision, G.S. 105-164.8(b), sets out the circumstances under which a remote retailer is engaged in business in this State and, therefore, is required to collect sales tax. The circumstances listed in that statute include when a retailer has representatives in this State who solicit or transact business on behalf of the

retailer regardless of whether the sales subject to tax result from the solicitation. This specific statutory statement of when a retailer is engaged in business reflects the nexus principles established in the 1960 United States Supreme Court case of *Scripto v. Carson.* In that case, the Supreme Court held that sufficient nexus existed to subject an out-of-state company to tax collection by virtue of having 10 in-state independent contractors who solicited orders for products on behalf of that company.

New York recently amended its sales tax statutes to provide that a retailer is presumed to be soliciting business through an independent contractor or other representative in that State and, therefore, required to collect sales tax if all of the following conditions are met:

1. The retailer has entered into an agreement with a resident of that State.
2. Under the agreement, the resident receives a commission or other consideration in exchange for directly or indirectly referring potential customers, whether by a link on an Internet website or otherwise, to the retailer.
3. The cumulative gross receipts from sales by the retailer to purchasers in that State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of $10,000 during the preceding four quarterly periods.

The presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution.

Amazon brought a lawsuit challenging the constitutionality of this provision arguing that it violates the Commerce Clause of the United States Constitution as well as both the Federal and State Constitutions' Due Process and Equal Protection Clauses.

On January 12, 2009, the New York Supreme Court[10] dismissed the complaint for failure to state a cause of action. The court disagreed with Amazon's assertion that the commissioned agents were mere advertisers concluding out that the provision requires tax collection only when an out-of-state seller avails itself of the benefit of in-state contractors who are compensated for referrals and who generate actual business for the seller. Proposal #5 revises North Carolina's mail order provision by specifically adding language identical to the New York provision and by modernizing the terminology from "mail order" to "remote" to more accurately reflect the prevalence of Internet sales. The addition of the New York language continues to reflect the nexus principles established in the *Scripto* case.

After the presentation of the proposal, there was some Committee discussion with regard to the scope of the tax on digital goods under the proposal and the extent to which other states were already taxing these items. There was no discussion of the *Amazon* case. Brooks Raiford, President and CEO of the North Carolina Technology Association gave some remarks after the presentation of the proposal, which can be found in Appendix D. The Committee voted to include the proposal in its final report.

Streamlined Sales and Use Tax Project Update

The Revenue Laws Study Committee has spent a considerable amount of time over the past several years on the Streamlined Sales and Use Tax Project (SSUTP), which began in March 2000. The adoption of the Streamlined Sales and Use Tax Agreement (Agreement) in 2002 provided the framework for participating states to achieve the uniformity and simplification measures initially established by a coalition of states, local governments, and businesses. The goal of the SSUTP is to achieve sufficient

[10] The New York Supreme Court is a trial-level court.

simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in those states that have adopted the uniform provisions of the Agreement. Based on decisions by the United States Supreme Court, states cannot require remote sellers that do not have a physical presence in the state to collect and remit its use tax.

Andy Sabol, the director of the Sales and Use Tax Division of the Department of Revenue, updated the Committee on the activities of the Streamlined Sales Tax Governing Board (Governing Board). North Carolina is one of twenty-two states represented on the Governing Board. The Governing Board established a central registration system in October 2005 that allows sellers to register for sales and use tax purposes in all member states. Over 1,000 sellers have registered since the system's inception.

Since October 2005, North Carolina has collected approximately $36 million in use tax revenue from remote sellers. The State has received $7.9 million during the 2008-2009 fiscal year to date. The amounts collected voluntarily are far less than the estimated amounts the State is not collecting in use tax revenue from sales by remote sellers. A University of Tennessee study, commissioned a few years ago, estimated a revenue loss to state and local governments of more than $30 billion a year from uncollected use taxes on remote sales. The Governing Board has recently commissioned a study to provide an update on this estimate.

The United States Supreme Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote sellers. Sen. Mike Enzi (R-WY) and Rep. William Delahunt (D-MA) introduced a bipartisan bill in the 110th Congress to provide the necessary authorization to those states that had adopted the simplification and uniformity measures established in the

Agreement. Although Congress did not enact the legislation last biennium, the Governing Board believes that the 111th Congress may represent the best opportunity for action on the Streamlined-related legislation, known as the Sales Tax Fairness and Simplification Act (STFSA). The National Conference of State Legislatures has recommended that Congress include the provisions of the STFSA as part of the economic stimulus legislation it is working to develop. The provisions of the STFSA would provide tens of billions of dollars in funding to states and local governments at a minimal or no cost to the federal government.

Legislative Proposal #3, *Streamlined Sales and Use Tax Update*, does two things:

- It encourages the 111th Congress to enact the provisions of the STFSA.
- It updates the statutory reference to the Agreement by changing the date from June 23, 2007, to September 5, 2008. North Carolina does not need to amend its sales and use tax laws to conform to any of the changes made in the Agreement since June 23, 2007.

Taxation of Food

Section 28.16(h) of S.L. 2008-107 directed the Revenue Laws Study Committee to study the distinction between food for home consumption and prepared food under the sales and use tax laws and determine whether the distinction should be eliminated by applying a uniform, revenue-neutral rate to all food.

The Committee began its discussion by reviewing the legislative history of the sales tax on food for home consumption and prepared food:

- **1933:** Food for human consumption exempt from sales tax.[11]
- **1961:** Food exemption repealed. Food for home consumption subject to

[11] Except from 1935-1937.

sales tax.

- **1998:** State sales tax rate on food for home consumption phased out. Food remains subject to a 2% local sales tax rate. Prepared food remains subject to the combined rate of State and local sales tax.
- 2000: Definitions of "food" and "prepared food" modified to conform to the Streamlined Sales and Use Tax Agreement. Food for home consumption remains exempt from State sales tax and subject to local sales tax; prepared food remains subject to the combined State and local sales tax. However, some foods once defined as "food" and exempt from State tax become defined as "prepared food" and become subject to the combined State and local tax rate.
- 2007: Bread, rolls, and buns sold at a bakery thrift store exempt from State sales tax; they remain subject to local sales tax.
- 2008: Bakery items defined as a special class of prepared food. Bakery items exempt from State sales tax; remain subject to local sales tax.

The distinction between food for home consumption and prepared food often becomes complex. Prepared food is food that meets one or more of the following conditions: the retailer made the food item by mixing or combining two or more foods for sale as a single item or the retailer provides eating utensils to customers to use in consuming the food. Any food item prepared by a retailer and sold by the retailer to a consumer is a prepared food. A similar product produced by someone else, but sold by the same retailer, is food for home consumption. For example, slaw prepared by Harris Teeter and sold in its deli section is prepared food. Slaw produced by someone else and sold at Harris Teeter is food. Likewise, the same product may be defined differently

depending upon where it is purchased. For example, a donut purchased at the place where it is made is prepared food. The same donut purchased at a grocery store is food.

How food is defined determines its tax rate. In North Carolina, there is a local sales tax rate of 2% on food for home consumption while prepared food is subject to the general State sales tax rate of 4.25% as well as the applicable local rate, which ranges from 2.5% to 2.75%. The General Assembly directed the Committee to consider whether the distinction between food for home consumption and prepared food should be eliminated by taxing all food at a uniform, revenue-neutral rate. The Committee learned that the revenue-neutral rate that would need to apply to all food would be 5.1%. That would mean that the tax rate on prepared food would decrease from 6.75% to 5.1%; but the tax rate on food for home consumption would increase from 2% to 5.1%. The Committee did not move forward with a legislative proposal on this issue.

PROPERTY TAX

Advancement of Reappraisal Schedule

The Revenue Laws Study Committee recommended legislation to the 2008 Session of the 2007 General Assembly that would have advanced the octennial schedule for general appraisals of property tax to a quadrennial schedule. The purpose of this proposal was to reduce the discrepancy between the property tax value of property and its market value, since the law requires that property be appraised at its true or market value for property tax purposes. During the 2008 Session, several small, rural counties voiced concerns about their lack of manpower and the expense of conducting more frequent appraisals. As a result, the version of the Committee's proposal enacted during the 2008 Session requires an advanced reappraisal schedule only when a county has a population of 75,000 or greater and the county's sales assessment ratio shows that

the assessed value of the property differs from the sales price of the property by more than 15% (S.L. 2008-146). Currently, only ten counties are affected by the 2008 legislation, which are listed in the chart in Appendix E.

Legislative Proposal 4, *Real Property Sales Information,* is an attempt to assist the counties in satisfying the statutory requirement of appraising property at its true value without requiring more frequent appraisals. The proposal would require that certain information be reported to the county assessor each time property is transferred in the county. This information would be provided to the assessor on a form developed by the Department of Revenue, and the deed transferring the property would not be accepted by the county register of deeds until the tax assessor certifies that the form was filed. A list of counties that currently require this information to be provided and examples of their forms can be found in Appendix F and Appendix G, respectively.

The Committee recommended Proposal 4 after reviewing the current law on appraising real property and studying recommendations from tax assessors on how to assist them in conducting general reappraisals. These recommendations were elicited during field trips in which staff of the Committee and the Department's Property Tax Division met with tax assessors from large urban counties and small rural counties.[12] The assessors recognized the advantages of advancing the schedule; however, assessors from the smaller more rural counties pointed out that revaluations are expensive and that they do not have the manpower or revenue to conduct them. The three main recommendations made by the tax assessors were:

- Require statewide sales information forms.

[12] Staff met in Charlotte with tax assessors from Mecklenburg County and surrounding counties and in Edenton with assessors from Chowan County and surrounding counties.

- Provide funding for staff at the State level to assist smaller counties with revaluations.
- Update the schedules of values in the fourth year of a general reappraisal cycle in lieu of conducting a full reappraisal.

The Committee felt that a proposal requiring parties to a land transfer to file a sales information report with the county tax assessor would be the most helpful and cost-efficient way to assist the counties in achieving the statutory requirement of appraising property at its true value for tax purposes. The Committee was informed that approximately one-half of the counties are currently requesting confirmation letters regarding transfers of property while only five counties require information affidavits. A list of these counties is found in Appendix E, and examples of sales information disclosure forms used by some of these counties are in Appendix F. This proposal would require information reports in all counties before the deed transferring the property could be accepted for recording.

Tax Exemptions for Nonprofits

At its October 22, 2008, meeting, the Revenue Laws Study Committee heard two staff presentations regarding the tax treatment of nonprofits. The first presentation provided a general overview, and the second presentation focused specifically on hospital charity care, spotlighting ongoing measures at the federal level, both in Congress and within the Internal Revenue Service. These presentations were followed by remarks from a guest speaker, Stan Jenkins, a county tax assessor from Illinois, who discussed one of the nation's leading, ongoing cases involving the denial of a property tax exemption for a nonprofit hospital.

Nonprofit entities benefit from a number of both federal and state tax exemptions. One rationale for the exemptions is that nonprofits provide services and benefits that the government would otherwise have to provide with tax dollars. While nonprofits are subject to some federal taxes, such as FICA and telephone and gasoline excise taxes, they are not subject to income tax. At the State level, nonprofits are afforded the following tax benefits:

- Exemption from State income tax.
- Eligibility for a semiannual sales tax refund.
- Exemption from property tax.
- Deductibility for donors of charitable contributions.

Of the nonprofit entities, hospitals in particular have come under frequent scrutiny at the national, state, and local levels. Unfavorable newspaper articles have reported that many nonprofit hospital systems are more profitable than for-profit hospitals and cite examples of hospitals reinvesting most of the profits into rich executive pay and high-end capital improvements rather than focusing on the level of charity care being provided. In 2004, there were 40 class action lawsuits against nonprofit hospitals and legislation introduced in 12 states in an attempt to reign in their aggressive collection practices directed at uninsured patients. From 2005 to 2008, both the Government Accountability Office and the IRS conducted studies of the charity care issue resulting in consistent findings. Specifically, the IRS found:

- There is a wide variation in eligibility for charity care.
- There is a wide variation in publicizing opportunity for charity care.
- 45% of hospitals spent 3% or less on charity care.
- Nearly 25% spent 1% or less on charity care.

As a result of the study, the IRS modified the form on which nonprofits report their community activities as a means to justify their tax-exempt status. Areas of significant change included governance and compensation of officers, directors, trustees, key employees, and highest compensated employees as well as the method for determining public charity status. One of the goals of the new form is to standardize the definition and calculation of charity care and community benefits.

In addition to getting a national perspective, the Committee also looked at the relevant North Carolina statutes and found that for the different exemptions, there are different thresholds or standards that must be met in order to obtain the exemptions. Nonprofit hospitals, for example, may apply for a sales tax refund for purchases of tangible personal property[13] used in carrying on the work of the nonprofit. The refund is essentially automatic. However, in order to obtain a property tax exemption, the statute requires that the property owned and operated by a nonprofit hospital be "actually and exclusively used for charitable hospital purposes." A charitable hospital purpose is defined as "a hospital purpose that has humane and philanthropic objectives; it is a hospital activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward." Most states have similar language in their statutes, and nonprofits have increasingly come under fire for not meeting their statutory obligation of "actually and exclusively" or "wholly and exclusively" providing charity care, as those terms have been interpreted by the courts.

The Committee also heard examples of a growing trend among local governments to deny property tax exemptions for nonprofits, especially for hospitals, based on their failure to meet statutory thresholds of providing charity care. Mr.

[13] Other than electricity, telecommunications service, and ancillary service.

Jenkins spoke to the Committee about one such example based on his experience as a county tax assessor involved in the *Provena Covenant Medical Center* case. His comments reflected themes similar to those found in the GAO and IRS studies as well as the newspaper articles regarding low levels of charity care and mistreatment of uninsured patients through overcharging and aggressive collection practices.

Also present at the meeting was Hugh Tilson of the North Carolina Hospital Association who informed the Committee that the Association was in the process of compiling information from its members related to the level of community benefit and charity care provided by its members using the revised IRS Guidelines. Mr. Tilson indicated that the Association planned to have this information available on its website by the end of the year. As a follow up, the Committee heard from Hugh Tilson at its final meeting who summarized the data collected to date, a copy of which is attached as Appendix H and for which more detail can be found on the Association's website: http://www.ncha.org.

Challenges to these exemptions are not new, but in recent years there has been a surge in the attention given to them. Factors contributing to this increased examination include the rapid and significant growth of nonprofits, the increase in their "commercial" activities, and the number and extent of states experiencing fiscal crisis. The Committee concluded its review of this issue by contemplating whether there is a clear rationale for the various tax exemptions for charitable nonprofits, whether the law is clear and consistent, and whether the current law fulfills its public purpose. The Committee, however, declined to move forward with any proposals on this issue.

PRIVILEGE LICENSE TAX

Local Privilege License Taxes

For the second time in four years, the Revenue Laws Study Committee considered the issue of reforming the privilege license tax system. The catalyst for revisiting this subject was the passage of House Bill 2558, *the Home Inspector Privilege License Act*. With the passage of this act, the General Assembly experienced for the first time since the repeal of most State-level privilege license taxes in 1996, a single industry seeking the imposition of a State privilege tax to shield it from local privilege license taxes. The home inspectors sought the change, in part, because of the way in which the local tax was being applied to businesses operating in multiple cities. Specifically, the home inspectors reported being double-taxed.

At its November 19, 2008, meeting, Christopher McLaughlin, Assistant Professor of Public Law and Government at the UNC School of Government, provided the Committee with an overview of the local privilege license tax system and an analysis of its deficiencies. Mr. McLaughlin characterized the system as archaic, inconsistent, and arbitrary. The system is archaic because it is based on references to repealed statutes, which are essentially "trapped in time" and cannot be changed. Specifically, the repealed statutes refer to monetary caps that have never been adjusted for inflation and to businesses that sell items like record players, tape cartridges, and bagatelle tables. The Committee heard that the law is often applied inconsistently because local business license officers have different, yet valid, interpretations of how to apply the repealed statutes. The system is arbitrary because there is no rationale for exempting some businesses altogether, subjecting some to caps, and subjecting others to an unlimited amount of tax. Given these characteristics, the administration of privilege license taxes frequently proves to be a source of confusion for local governments and taxpayers alike.

The Committee also heard testimony about instances of double taxation. If a city chooses to levy a privilege tax based on a business' total gross receipts while another city levies a tax only on the gross receipts derived from transacting business in that city, then a business that operates in both cities will pay tax twice on some portion of its gross receipts.

At its December 15, 2008, meeting, the Committee heard remarks from Karl Knapp with the North Carolina League of Municipalities and Jim Blackburn with the North Carolina Association of County Commissioners. Mr. Knapp informed the Committee that there was a meeting of business license officers in early December to discuss the issues raised about the privilege license system. He expressed the view of the group that while the system should be updated to eliminate references to repealed statutes and the various caps and exemptions, the system should not be repealed entirely because it is a significant source of income for cities. He also indicated that the group did not believe there were widespread instances of double taxation and that most cities allowed businesses to apportion their gross receipts. Mr. Blackburn was in general agreement with Mr. Knapp's statements and offered the assistance of the Association in helping to draft clarifying language, if the Committee so desired.

At its January 7, 2009, meeting, the Committee heard from Andy Ellen with the Retail Merchants Association and Mark Prak, a Raleigh attorney. Mr. Ellen emphasized the concerns illustrated in Mr. McLaughlin's November presentation. He gave the Committee two specific examples to illustrate the system's inequities. The first example was a grocery store subject to a gross receipts tax because the gross receipts method of taxation will disproportionately impact a business operating on a low gross margin. The second example was a pharmacy that collects copays from customers, which count toward gross receipts but are a pass-through cost that the pharmacy does not get to

keep in terms of profit. Mr. Prak echoed the concerns expressed by Mr. Ellen, stating that privilege license taxes are confusing and unequally applied. He also indicated that, in his law practice, he has been involved in cases where local governments were not apportioning gross receipts for purposes of applying the privilege license tax resulting in the double taxation of certain businesses.

Although the Committee was in general agreement that changes are needed to address the problems with the privilege license taxes, it did not reach a conclusion about specific changes. The Committee was presented with five broad options for modifying the system, but was unable to reach consensus on an approach that would balance the cities' concern about preserving this source of local revenue while addressing the business community's goal of modernization and uniformity.

Resale of Tickets on the Internet

The Revenue Laws Study Committee reviewed the legislation enacted by the 2008 General Assembly. In its review, it considered the sunset placed on S.L. 2008-158. This legislation, *Resale of Tickets via Internet*, allows admission tickets to be resold on the Internet at a price that exceeds the price printed on the ticket. Under prior law, this sale would be a criminal offense. Reselling tickets online is a new and growing business; the legislation recognized this reality and amended the law to remove the criminal offense and to provide safeguards for the venue and the customer.

The issue left unresolved by the legislation is the application of the State privilege license to the resell of the tickets. Under current law, the State imposes a privilege tax on a person engaged in the business of giving, offering, or managing a form of amusement or entertainment.[14] The tax rate is 3% of the gross receipts derived

[14] G.S. 105-37.1.

by the sale. Unlike the sales tax, the privilege tax is a tax on the person, not the transaction. The current law does not impose the privilege tax on a person engaged in the business of reselling tickets to an entertainment event and an entertainment event is not subject to sales tax.

Under the Senate version of the bill, the privilege tax would have been expanded to include a person engaged in the business of reselling tickets. The tax would have applied to the difference between the price of the ticket sold and the face price of the ticket. The House deleted this provision from the bill. The final bill, crafted by a conference committee, placed a sunset on the bill of June 30, 2009.[15] The sunset necessitates the General Assembly revisiting the issue in 2009.

The Revenue Laws Study Committee did not recommend any legislation on this topic. It did recognize that the 2009 General Assembly has several choices:

- It could do nothing. In this event, the Act will sunset and the activity of reselling tickets will once again be illegal.
- It could extend the sunset.
- It could resolve the tax issue in one of three ways:
  - It could remove the sunset, thereby maintaining the status quo - no taxation on the resell of tickets.
  - It could impose the privilege license tax on a person engaged in the business of reselling tickets via Internet.
  - It could change the taxation of amusements by repealing the State privilege license tax on amusements and, in its place, imposing a State and local sales tax on the price of the tickets.

[15] The final version of the bill contained a monthly reporting requirement. The Department of Revenue reported that only four reports have been filed. The reports, filed by different filers, showed less than 100 tickets resold and less than $5,000 of net proceeds.

TECHNICAL, ADMINISTRATIVE, AND CLARIFYING CHANGES

The Revenue Laws Study Committee recommends Legislative Proposal 6, *Revenue Laws Technical, Administrative, and Clarifying Changes.* This proposal makes several technical and clarifying changes to the revenue laws and related statutes, including changes to the motor fuel tax and property tax laws. Many of the changes were recommendations of the Department of Revenue.

REPORTS TO REVENUE LAWS

At the last meeting, the Department of Revenue made two reports to the Committee. Section 31.18(d) of S.L. 2007-323 directed the Department to report the amount of corporate income tax revenue generated in the 2007 taxable year resulting from the new requirement that corporations are required to add back to taxable income dividends paid by captive real estate investment trusts (REITS). The Department reported that there were 12 entities who reported add-backs generating $12,805,806 in revenue. A copy of this report is found in Appendix I.

The Small Business Protection Act (Section 28.16(i) of S.L. 2008-107) resulted from concerns raised by small businesses related to advice received by the Department, primarily concerning sales tax obligations. Part of this act required the Department to report to the Revenue Laws Study Committee prior to the convening of the 2009 Session on its customer service initiatives. Linda Millsaps, Chief Operating Officer of the Department of Revenue, presented this report to the Committee, which is attached as Appendix J.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee makes the following six recommendations to the 2009 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. Change Corporate Income Tax
3. Streamlined Sales and Use Tax Update
4. Real Property Sales Information
5. Modernize Sales Tax Statutes/Digital Products
6. Revenue Laws Technical, Administrative, and Clarifying Changes

LEGISLATIVE PROPOSAL #1

IRC UPDATE

LEGISLATIVE PROPOSAL #1

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

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

SHORT TITLE: IRC Update.

SPONSORS:

BRIEF OVERVIEW: This proposal would update from May 1, 2008 to January 1, 2009, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. By doing so, North Carolina would conform to changes made by five federal acts, except the bill would not conform to the new additional standard deduction for real property taxes authorized by the Housing Assistance Tax Act. The five federal acts are as follows:

1) Heartland, Habitat, Harvest, and Horticulture Act of 2008.
2) Heroes Earnings Assistance and Relief Tax Act of 2008.
3) Housing Assistance Tax Act of 2008.
4) Emergency Economic Stabilization Act of 2008.
5) Worker, Retiree, and Employer Recovery Act of 2008.

FISCAL IMPACT: Based on the analysis of the Joint Committee on Taxation, the bill is expected to have an impact on the State's General Fund. The fiscal impact on the State's General Fund of conforming to all five acts except the new additional standard deduction for real property taxes would be a combined loss of approximately $177.7 million for the 2009-10 and 2010-11 fiscal years. The methodology used begins with the Joint Tax Committee estimates of the nationwide federal impact by federal fiscal year (Federal fiscal years run from October through September). Fiscal Research adjusted these numbers back to an approximate calendar year tax impact. The next step was to

prorate the national numbers to the state impact. The Department of Revenue undertook this process using taxpayer data and North Carolina economic data.

After calculating the estimated State tax year impacts, the numbers were converted to state fiscal year by assuming that the traditional FRD method of putting 45% of a calendar year tax liability in the January-June period that finishes up one fiscal year and the allocating the remainder to the following fiscal year. There were not adjustments made to the JCT's estimates based on level of taxpayer compliance. Therefore, the fiscal estimates assume 100% taxpayer compliance with the tax law changes.

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

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

BILL DRAFT 2009-TDx-3 [v.5] (01/21)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
2/2/2009 8:59:23 AM

Short Title: IRC Update. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

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

The General Assembly of North Carolina enacts:

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

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

...

(1b) Code. – The Internal Revenue Code as enacted as of ~~May 1, 2008,~~January 1, 2009 including any provisions enacted as of that date which become effective either before or after that date."

SECTION 2. Notwithstanding Section 1 of this act, any amendments to the Internal Revenue Code enacted after May 1, 2008, that increase North Carolina taxable income for the 2008 taxable year become effective for taxable years beginning on or after January 1, 2009.

SECTION 3. G.S. 105-134.6(c) reads as rewritten:

"(c) Additions. – The following additions to taxable income shall be made in calculating North Carolina taxable income, to the extent each item is not included in taxable income:

...

(11) The amount of the taxpayer's additional standard deduction for real property taxes under section 63(c)(1)(C) of the Code."

SECTION 4. This act is effective when it becomes law.

Draft 2009-TDx-3: IRC Update

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Heather Fennell Committee Counsel
Version:			

SUMMARY: ***This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2008 to January 1, 2009. By doing so, North Carolina would conform to the changes made by five federal acts, except the bill would not conform to the new additional standard deduction for real property taxes. This bill would become effective when it became law.***

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

BILL ANALYSIS:

This bill would change the reference date to January 1, 2009, effective when the bill becomes law. Changing the reference date to January 1, 2009 would incorporate the changes made in the following acts:

- The Heartland, Habitat, Harvest, and Horticulture Act of 2008, signed into law May 22, 2008 (P.L. 110-234).
- The Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245);
- The Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289);
- The Emergency Economic Stabilization Act of 2008 signed into law October 3, 2008
- (P.L. 110-343);
- The Worker, Retiree, and Employer Recovery Act of 2008 (P.L. 110-458) signed into law December 23, 2008.

In addition to the preceding acts, an action by the Treasury Department may affect State revenue. On September 30, 2008 the IRS issued Notice 2008-84. This notice provides a potential tax break to purchasers of banks with outstanding bad debt.

---

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

[2] The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would ... be invalidated as an unconstitutional delegation of legislative power."

Heartland, Habitat, Harvest, and Horticulture Act of 2008

Endangered species recovery expense. – The act creates a new deduction for endangered species recovery expenditures for expenses incurred after December 31, 2008. Farmers may currently claim a deduction for qualifying soil and water conservation expenditures and land erosion prevention expenditures. The deduction is limited to 25% of gross income derived from farming during the tax year but can be carried forward indefinitely. This act adds endangered species recovery expenditures to the category of expenditures that qualify for the deduction. The expenditures must be paid or incurred by a farmer after December 31, 2008 for the purpose of site-specific management actions recommended in recovery plans approved pursuant to the Endangered Species Act of 1973. Depreciable structures, appliances, or facilities do not qualify for the deduction.

Charitable Contributions of Real Property for Conservation Purposes. – The act extends the increased deduction for charitable contributions of real property for conservation purposes for tax years beginning before January 1, 2009. The deduction for capital gain appreciated real property is generally limited to 30% of the donor's adjusted gross income if the donor uses the fair market value of the donated property. If the donor's basis is used as the value of the property, and the property is donated to a "maximum deduction" organization, the deduction is limited to 50% of the donor's adjusted gross income.[3] Deductions for donations to non-maximum donation organizations are limited to 20% of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years. The Pension Protection Act of 2006 increased the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50% of adjusted gross income, with a 15-year carryforward for any excess. A "qualified farmer or rancher" may deduct the value of the gift up to 100% of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming is greater than 50% of the taxpayer's gross income for the tax year. The land donated by a farmer or rancher also must "be available" for agricultural use, but it need not be used for that purpose. This act extends these provisions through December 31, 2009.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Heroes Earnings Assistance and Relief Tax Act of 2008

State or Local Bonuses for Combat Veterans. – The act excludes state or local bonuses for combat veterans from gross income for income tax purposes. Generally all income is included in gross income unless the income is explicitly excluded. "Qualified military benefits" are excluded from gross income. These benefits generally include allowances or in-kind benefits provided to family members and former members of the armed services, or their dependents by reason of the member's service, including housing, moving, and travel allowances. This act expands the definition of "qualified military benefits" to include bonus payments by a state or local government to a member or former member of the armed services, or to a dependent of a member. To qualify for the exclusion, the payment must have been made for the member's service in a combat zone.[4]

---

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

[4] A combat zone is defined as any area the president has by executive order designated an area in which the Armed Forces are or have engaged in combat.

Contributions of Military Death Gratuities to Roth IRAs and Coverdell ESAs. – The act allows military death gratuities to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs. Upon notification of the death of military personnel on active duty or on inactive duty training, a death gratuity is paid to or for the person's survivor. The death gratuity is a qualified military benefit and excluded from income. Roth IRAs are subject to annual contribution limits equal to the lesser of the statutory dollar amount or 100% of taxable income. For 2008, the annual limit on contributions is $5,000 for individuals, with an additional catch up contribution of $1,000 allowed for individuals over age 50. Sums may be rolled-over from eligible retirement plans to Roth IRAs, subject to income-phase out limitations. For 2008, rollovers are allowed for individuals whose gross adjusted income does not exceed $100,000. A Coverdell Education Savings Account is a tax-exempt trust created for paying the education expenses of the trust's designated beneficiary. Annual contributions to Coverdell ESAs may not exceed $2,000. This act allows the gratuity to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Housing Assistance Tax Act of 2008

Real Property Tax Deduction for Non-itemizers. – The act creates a deduction for real property taxes paid by non-itemizers for any tax year beginning in 2008. Taxpayers can take either the basic standard deduction, or itemize deductions, but not both. Taxpayers who itemize deductions may deduct state and local taxes paid, including individual income taxes, real property taxes, and personal property taxes. This act allows taxpayers who take the standard deduction to claim an additional deduction for state and local real property taxes for any tax year beginning in 2008. The deduction is the lesser of (1) the amount allowable as a deduction for state and local taxes if the taxpayer claimed itemized deductions, or (2) $500 for individuals, $1000 for joint returns.

► ***BILL ANALYSIS:*** The bill does not conform to the provision of this act providing an additional standard deduction for state and local real property taxes.

Emergency Economic Stabilization Act of 2008

Executive Compensation Limits for Financial Institutions Participating in Troubled Asset Relief Program (TARP). – The act restricts certain financial institutions that sell troubled assets to the Treasury Department by means of a public action from deducting more than $500,000 for executive compensation and prohibits the firms from contracting for new golden parachute payments. Firms that sell troubled assets directly to the government must exclude incentives for executive officers to take unnecessary risks; must recover bonuses to senior executives based on materially inaccurate information; and may not make any golden parachute[5] payments to senior executives while the government holds an equity or debt position in the firm.

Previously, there were three limits in the IRC for executive compensation:

(1) A publicly held corporation cannot deduct applicable employee remuneration that exceeds $1 million per tax year.

(2) A corporation cannot deduct excess golden parachute payments paid to a disqualified individual that were triggered by a change in ownership or control.

(3) Excess payments are subject to a 20% excise tax paid by the recipient.

[5] A parachute payment is any payment in the nature of compensation paid to a disqualified individual that either is contingent upon a change in ownership of the corporation and equals or exceeds 3 times the individual's base pay, or is made under an agreement that violates securities laws or regulation.

This act imposes new restrictions on executive compensation for financial institutions that sell troubled assets as part of TARP.

Limits when financial institutions sell troubled assets through a public auction. – If a firm sells troubled assets through a TARP managed public auction to the Treasury, and has assets in excess of $300 million, the firm must adhere to the following limits on executive compensation.

(1) $500,000 limit on the deductibility of executive compensation, including incentive and commission pay.

(2) No deduction for excess golden parachute payments; excess payments are also subject to a 20% excise tax paid by the recipient.

(3) Prohibition from entering into a new employment contract that provides a golden parachute in the event of an involuntary termination, bankruptcy filing, insolvency, or receivership.

Limits when sales made directly to the Treasury: If a firm sells troubled assets directly to the Treasury, the firm must adhere to the following standards for compensation and benefits paid to senior executive officers for the duration of time the government holds the assets:[6]

(1) Limits on compensation that exclude incentives for executives to take unnecessary and excessive risks that threaten the value of the firm.

(2) Recovery of any bonus or incentive compensation paid to an executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate.

(3) Prohibition on golden parachutes.

Extension of Income Exclusion for Discharged Indebtedness on Principal Residence. – The act extends the exclusion from income for discharged indebtedness on principal residences for discharges occurring before January 1, 2013. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the unpaid mortgage debt, the canceled debt is considered income under the Code. There is no income limitation but no more than $2 million in mortgage debt is eligible for exclusion. The exclusion from income for discharged indebtedness related to a principal residence is for the three-year period beginning January 1, 2007 and ending December 31, 2009. This act extends the exclusions for discharged indebtedness related to a principal residence for the period beginning January 1, 2007 and ending on December 31, 2012.

Qualified Charitable Distribution from IRAs. – The act extends the favorable treatment of qualified charitable distributions from IRAs for two years, for distributions made in 2008 and 2009. Generally, to make a charitable donation from an IRA, a distribution must be taken and the applicable rules regarding taxable income apply. The distribution is included in taxable income to the extent the distributions are not attributable to a return of nondeductible contributions. The standard charitable deduction rules then apply to the donation. The Pension Protection Act of 2006 provided that individuals 70 ½ or older could distribute up to $100,000 per taxable year from their IRAs to charitable institutions without recognizing the income. The distribution must be made directly to the charitable organization from the trustee. This distribution counts towards the required minimum distribution. This is extended by the act for distributions in 2008 and 2009.

Transportation Fringe Benefit for Bicycle Commuters. – The act allows a new transportation fringe benefit for bicycle commuters. In general, commuting expenses to and from a place of business are not deductible. Transportation fringe benefits can defray some of an employee's commuting expenses with either pre-tax dollars that reduce otherwise taxable compensation, or with direct, employer-subsidized amounts that are considered tax free. This act adds qualified bike commuting reimbursements to the

[6] A senior executive officer is an individual who is one of the top five highly paid executives of a public company whose compensation is required to be disclosed pursuant to the Securities Exchange Act of 1394.

type of qualified transportation fringe benefits that an employer may provide to an employee who commutes to work using a bike.

***Extension of certain deductions.* –**

Deduction for Qualified Tuition and Related Expenses. – The act extends the deduction for qualified tuition and related expenses for tax years beginning before January 1, 2010. The expenses eligible for the deduction include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or dependent at an eligible institution of higher education. The maximum deduction is $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 for joint filers) and $2,000 for taxpayers whose AGI does not exceed $80,000 ($160,000 for joint filers).

Above-the-Line Deduction for Certain Expenses of School Teachers. – The act extends the above-the-line deduction for eligible educators for tax years beginning in 2008 and 2009. The $250 deduction is allowed for books, supplies, and computer equipment purchased by an eligible educator for use in the classroom.

Enhanced Deduction for Charitable Contributions of Computers. – The act extends the enhanced deduction for charitable contributions of computers for tax years beginning in 2008 and 2009. C corporations that make qualified contributions of computer technology and equipment may claim and enhanced deduction equal to the corporation's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. The enhanced deduction may not exceed twice the corporation's basis in the property.

Enhanced Deduction for Charitable Contributions of Food Inventory. – The act extends the enhanced deduction for charitable contributions of food inventory for tax years beginning in 2008 and 2009. Taxpayers may take a deduction for donated food inventory equal to the lesser of (1) the donated item's basis plus one-half of the amount of gain that would be realized if the donated food item was sold at fair market value, or (2) two times the donated item's basis. The deduction is limited to 10% of the taxpayer's net income, however, the 10% limitation is suspended for contributions made by farmers or ranchers between October 3, 2008 and January 1, 2009.

Enhanced Deduction for Charitable Contributions of Book Donations. – The act extends the enhanced deduction for charitable contributions of book donations for tax years beginning in 2008 or 2009. Any corporation, other than an S corporation, can take an enhanced deduction for contributions of book inventory equal to the lesser of (1) the donated inventory item's basis plus one-half of the item's appreciation, or (2) two times the donated inventory item's basis.

Deduction for Environmental Remediation Costs. – The act extends the election to deduct environmental remediation costs to cover expenditures paid or incurred in 2008 and 2009. A taxpayer may elect to deduct certain environmental cleanup costs in the tax year paid or incurred, rather than capitalize them. The election only applies to costs that are incurred in connection with the abatement or control of hazardous substances at a "qualified containment site," also called a "brownfield site."

Deduction for Energy Efficient Commercial Buildings. – The act extends the deduction for energy-efficient commercial building property for five years and is available for qualified property placed into service after December 31, 2005 and before January 1, 2014. The deduction applies to "energy efficient commercial building property," which is defined as depreciable property that is installed as part of a building's (1) interior lighting systems, (2) heating, cooling,

ventilation, and hot water systems, or (3) envelope, and is part of a certified plan to reduce the total annual energy and power costs of these systems by at least 50%. The deduction is limited to the product of $1.80 and the total square footage of the building, reduced by the aggregate amount deducted in any prior year.

Gain on Sales or Dispositions to Implement FERC or State Electric Restructuring Policy. – The act extends the special gain recognition rule for qualifying electric transmission transactions that implement FERC or state electric restructuring policy for two years for qualified electric utilities to sales or dispositions prior to January 1, 2010. A qualified electric utility can elect to recognize qualified gain from a qualifying electric transmission transaction over an eight-year period to the extent the amount realized from the sale is used to purchase exempt utility property within an applicable period.

Treatment of RIC Dividends Paid to Foreign Persons. – The act extends the exemption from the 30% tax on regulated investment company (RIC)[7] dividends that are designated as interest-related or short-term capital gains for two years to tax years beginning before January 1, 2010. Generally, US income paid to a nonresident alien or foreign corporation that is not connected with a US trade or business is subject to a flat 30% tax which is collected through withholding. Dividends that are designated as interest-related or short-term capital gains are exempt from the 30% tax.

15-Year MACRS Recovery period for Qualified Leasehold Improvements, Qualified Restaurant Improvements and Buildings, and Qualified Retail Improvement Property. – The act extends the 15-year Modified Adjusted Cost Recovery System (MACRS) recovery period for qualified leasehold improvements and restaurant improvements and buildings for two years and applies to property placed in service before January 1, 2009. The act also creates 15-year a MACRS recovery period for qualified retail improvement property and applies to property placed in service after December 31, 2007 and before January 1, 2009. Before these provisions, the improvements would generally be considered a structural component of the building and would be depreciated over a 39 year period.

Tax Treatment of Certain Payments to Controlling Exempt Organizations. – The act extends the special rules that permit the exclusion of qualifying payments by a controlled entity to a tax-exempt organization from that tax exempt organization's unrelated business income (UBTI) for two years through December 31, 2009. Tax-exempt organizations are taxed on UBTI, including amounts paid by a controlled entity. Only the excess amount of certain qualifying payments of rent, royalties, annuities, or interest income is included. Qualifying payments must be made in connection with a contract that is in effect August 17, 2006. Payments that exceed the amount that would be paid in an arms-length transaction are included in the UBTI.

Basis adjustment to stock of S corporations making charitable contributions of property. – The act extends the provision providing that the amount of a shareholder's basis reduction in the stock of an S corporation by reason of a charitable contribution made by the corporation equals the shareholder's pro rata share of the adjusted basis of the contributed property for two years and applies to tax years beginning before January 1, 2009. This change preserves the intended benefit without causing the shareholder to recognize a gain or reduced loss that is attributable to the appreciation upon the subsequent sale of stock.

[7] A RIC is commonly known as a mutual fund.

Seven-Year Depreciation Period for Motorsports Facilities. – The act extends the 7 year MACRS recovery period for motorsports entertainment complexes to property placed in service in 2008 and 2009. Historically, race tracks and facilities were treated by the IRS the same as theme and amusement parks. The American Jobs Creation Act of 2004 codified this treatment. A "motorsports entertainment complex" is a racing track facility that is permanently situated on land, hosts at least one racing event for cars of any type, trucks, or motorcycles during the 36-month period following the first day of the month in which it is put in service, and is open to the public for an admission fee.

Extend and Modify Treatment of Certain Qualified Film and Television Productions. – The act extends the expensing election related to film and television productions for one year for productions that begin before January 1, 2010, and allows the election to be made, in part, for productions with aggregate costs over the dollar production limit. A taxpayer may deduct the production costs of a qualifying film or television production. To qualify for the election, the aggregate production cost may not exceed $15 million. This act modifies the provision so that the first $15 million of otherwise qualifying film or television productions may be treated as an expense even if the aggregate cost of production exceeds $15 million.

Certain Farming Equipment Business Machinery or Equipment Treated as Five-Year Property. –The act provides that certain machinery or equipment used in a farming business is treated as five-year property for purposes of claiming MACRS depreciation. The equipment does not include grain bins, cotton ginning assets, fences or land improvements. Property that is used in a farming business can be depreciated under the General Depreciation System (GDS) using the 150-percent declining-balance method. Farm machinery and equipment generally has a recovery period of 10 years and has a straight-line recovery method.

Disaster Relief. -

Relief for Midwestern Disaster Areas. – The act modifies and extends many of the tax benefits extended to the victims of Katrina, Wilma, and Rita hurricanes to the victims of storms that hit the Midwest in the summer of 2008. These include the extension of special expensing for qualified property, an enhanced low-income housing credit, and flexible tax-exempt bond financing rules.

Casualty Losses Attributable to Federally Declared Disasters. – The act increases the deduction for casualty losses attributable to federally declared disasters for tax years beginning after December 31, 2007. Personal casualty losses are deductible to the extent the losses exceed $100 per casualty and the sum of the casualty losses exceed 10% of the taxpayer's AGI. For tax years beginning after December 31, 2007, the standard deduction is increased by the amount of any disaster loss amount for casualty losses attributable to a federally declared disaster occurring in 2008 and 2009. The losses are deductible without regard to whether the losses exceed 10% of a taxpayer's adjusted gross income. The deduction for any casualty attributable to a federally declared disaster occurring in 2009 is limited to the amount of the loss that exceeds $500.

Expensing of Qualified Disaster Costs. – The act allows a taxpayer to elect to expense qualified disaster expenses after 2007, rather than capitalizing them. Qualified disaster expenses include any expenditure that is all of the following:

(1) Paid or incurred in connection with a trade, business, or business-related property.
(2) Otherwise chargeable to a capital account.
(3) Made for any of the following:

(a) The abatement or control of hazardous substances that were released on account of a federally declared disaster.

(b) The removal of debris from, or the demolition of structures on, business-related property that is damaged as the result of a federally declared disaster.

(c) The repair of business-related property damaged as a result of a federally declared disaster.

Net Operating Losses Attributable to Federally Declared Disasters. – The act creates a special five-year carryback period for net operating losses (NOLs) has been created for a qualified disaster loss. In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year.

Special Depreciation Allowance for Qualified Disaster Assistance Property. – The act allows an additional 50% depreciation allowance can be claimed for real and personal business property that is purchased to rehabilitate or replace similar property that is destroyed or condemned as a result of a residentially declared disaster for property placed in service after December 31, 2007, with respect to disasters declared after that date and occurring before January 1, 2010.

Increased Expensing for Qualified Disaster Assistance Property. – The act increases the maximum section 179 expense allowance and investment limitation amount for qualified section 179 disaster property placed in service after 2007. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Internal Revenue Code. To be eligible, the property must be tangible personal property which is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take expensing first and claim section 168(k) depreciation on any remaining basis. First year expensing is increased for disaster property:

(1) The section 179 expense deduction ($250,000 for 2008) is increased by the lesser of $100,000 or the cost of the qualified section 170 disaster assistance property placed in service during the tax year.

(2) The amount of the investment limitation ($250,000 for 2008) is increased by the lesser of $600,000 or the cost of qualified section 179 disaster assistance property placed in service during the tax year.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

Worker, Retiree, and Employer Recovery Act of 2008

Required Minimum Distribution. – The act eliminates the required minimum distribution for calendar year 2009 for individual retirement plans and employer-provided qualified retirement plans that are defined contribution plans. Employer-provided qualified retirement plans and individual retirement accounts are subject to minimum distribution rules. Generally, required minimum distributions must begin by April 1 of the year following the calendar year in which the individual reaches 70 ½. The required minimum distribution for each year is determined by a formula that includes the account balance and the individual and individual's designated beneficiary's expected lifetime. Failure to make a required minimum distribution results in a 50% excise tax.

► ***BILL ANALYSIS:*** The bill conforms to the provisions of this act.

IRS Notice 2008-83

The IRS issued Notice 2008-83 on September 30, 2008. The notice suspends a rule that limits the use of built-in losses of banks following a change in ownership of the bank. Section 382 limits a corporation's ability to deduct its net operating losses against taxable income when the corporation undergoes an ownership change. An ownership change is defined as an increase in the percentage of a corporation's stock owned by one or more 5 percent shareholders by more than 50 percentage points within a 3-year period. After an ownership change, the deduction for the amount of losses attributable to the period before the ownership change is limited. The limit is generally equal to the value of the loss corporation at the time of the change multiplied by the applicable federal long-term tax-exempt interest rate. This notice provides that losses on loans or bad debts will not be limited by section 382 for banks that undergo an ownership change.

► ***TECHNICAL CONSIDERATIONS:*** The IRS notice is not a legislative change to the Code, rather it is a technical explanation meant to provide guidance on existing provisions of the Code as explained by the Treasury Department. Some practitioners believe this Notice goes beyond guidance on existing provisions and makes substantial changes to the Code. This bill does not address North Carolina's conformity to the provisions of the Notice.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

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, 2009

TO: Revenue Laws Study Committee

FROM: Barry Boardman
Fiscal Research Division

RE: IRC Update

FISCAL IMPACT

	Yes (X)	No ( )	No Estimate Available ( )		
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
REVENUES:					
Heartland, Habitat, Harvest, and Horticulture Act of 2008	(0.5)	(1.0)	(0.8)	(0.5)	(0.5)
Heroes Earnings Assistance and Relief Tax Act of 2008	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Emergency Economic Stabilization Act of 2008					
Extensions of Certain Deductions	(9.4)	(18.6)	(8.6)	0.0	0.0
MACRS recovery period and other business expensing	(8.5)	(18.2)	(13.6)	(8.3)	(7.4)
Disaster Relief	(7.2)	(16.7)	(15.4)	(5.8)	3.4
Other	(5.7)	(10.8)	(7.4)	(8.5)	(8.4)
EESA TOTAL	(30.9)	(64.3)	(45.0)	(22.7)	(12.5)
Workers, Retiree, and Employer Recovery Act 2008	(36.0)	(44.0)			
TOTAL	**(67.9)**	**(109.8)**	**(46.3)**	**(23.7)**	**(13.5)**
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE: January 1, 2009

BILL SUMMARY: This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2008 to January 1, 2009. By doing so, North Carolina would conform to the changes made by five federal acts, except the bill would not conform to the new additional standard deduction for real property taxes. This bill would become effective when it became law.

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

BILL ANALYSIS: *See the Bill Analysis of the preceding summary.*

ASSUMPTIONS AND METHODOLOGY: The methodology used begins with the Joint Tax Committee estimates of the nationwide federal impact by federal fiscal year (Federal fiscal years run from October through September). Fiscal Research adjusted these numbers back to an approximate calendar year tax impact. The next step was to prorate the national numbers to the state impact. The Department of Revenue undertook this process using taxpayer data and North Carolina economic data.

After calculating the estimated State tax year impacts, the numbers were converted to state fiscal year by assuming that the traditional FRD method of putting 45% of a calendar year tax liability in the January-June period that finishes up one fiscal year and the allocating the remainder to the following fiscal year. There were no adjustments made to the Joint Committee on Taxation's estimates based on the level of taxpayer compliance. Therefore, the fiscal estimates assume 100 percent taxpayer compliance with the tax law changes.

---

* 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.

† 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."

SOURCES OF DATA: US Joint Committee on Taxation, NC Department of Revenue

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #2

CHANGE CORPORATE INCOME TAX

LEGISLATIVE PROPOSAL #2

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO CHANGE THE CORPORATE INCOME TAX

SHORT TITLE: Change Corporate Income Tax.

SPONSORS:

BRIEF OVERVIEW: This proposal states the intent of the General Assembly to enact changes to the corporate income tax laws that further the goals of equity, simplicity, modernization, and broad base/low rate. The proposal would also replace an antiquated term with the correct defined term.

FISCAL IMPACT:

EFFECTIVE DATE: The proposal would become effective when it becomes law.

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-RBxz-9A [v.3] (12/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/30/2009 5:34:20 PM

Short Title: Change Corporate Income Tax. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CHANGE THE CORPORATE INCOME TAX.

The General Assembly of North Carolina enacts:

SECTION 1. The General Assembly intends to enact legislation to provide greater equity and certainty in the tax laws that affect businesses to achieve the following tax policy goals:

(1) Provide a more level playing field for all businesses, both those that operate only in North Carolina and those that operate in multiple states.

(2) Provide a comprehensive structure to nullify income shifting strategies.

(3) Modernize the tax laws to adapt to the growth of multi-state corporations.

(4) Reduce uncertainty about when a corporation needs to file a combined return, who the corporation includes in it, and how the combination is to be accomplished.

(5) Broaden the corporate income tax base and adjust the tax rate to make the changes revenue-neutral.

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

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

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

BILL DRAFT 2009-RBxz-9A: Change Corporate Income Tax

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 28, 2009
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Draft		Committee Staff

SUMMARY: Draft 2009-RBxz-9A states the intent of the General Assembly to enact changes to the corporate income tax laws that further the goals of equity, simplicity, modernization, and broad base/low rate. The proposal would also replace an antiquated term with the correct defined term. The bill becomes effective when it becomes law.

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

Separate entity filing gives corporations with subsidiaries in multiple states the ability to devise ways to shift income from a high effective tax rate state to a low effective tax rate state, often through the use of passive investment companies and inter-company transactions. Over the past several years, the General Assembly has enacted changes to the State's corporate income tax laws to address the shifting of income between states by multistate corporations. Despite the efforts, the problem of income shifting between multistate corporations continues to be an issue.

The Department of Revenue has aggressively used the tools available to it to require a corporation to file a consolidated return when the Department believes the corporation's net income attributable to this State is not accurately reflected on its separate entity filing return. This action by the Department is referred to as 'forced combination'. The Department has used forced combinations for a number of years and it has collected more than $200 million in taxes from forced combinations.

Taxpayers, seeking clarity on the law, have filed lawsuits contesting the Department's authority to force combinations. G.S. 105-130.6 provides the authority the Department uses to force combinations. Taxpayers express concern that the statute is vague and there are no administrative rules or directives to provide guidance or certainty to taxpayers as to when a combined reporting is required, who is required to be included in the combined report, or how the combination is to be accomplished. Taxpayers believe the statute does not provide any meaningful taxpayer remedies because it says: "*The findings and conclusions of the Secretary shall be presumed to be correct and shall not be set aside unless shown to be plainly wrong.*"

BACKGROUND: The adoption of mandatory combined reporting would address both the issue of income shifting and the issue of the lack of clarity in the law concerning 'forced combinations'. The Revenue Laws Study Committee recommended mandatory combined reporting to the 2007 Session of the General Assembly.[1] Under the recommendation, a corporation that is part of an affiliated group engaged in a single trade or business would file a combined report as opposed to a single entity report. Combined reporting is a method of calculating the income of a group of related corporations for tax

[1] Senate Bill 244 and House Bill 462.

purposes. It looks beyond the legal structure of separate incorporations to determine whether two or more related corporations are engaged in a single unitary business.

The General Assembly did not enact the legislation last biennium because many of the outstanding issues that needed to be addressed by the recommendation were left unresolved. Those issues included the following:

- The percentage reduction by which the corporate income tax rate could be reduced to render the proposal revenue-neutral.
- The relationship between combined reporting and the franchise tax statutes.
- A determination as to what corporations, if any, would be excluded from combined reporting.
- How the income of corporations with special apportionment formulas under the current law would be apportioned under combined reporting.
- Various transitional and administrative issues.

Several prior studies have also recommended that North Carolina require combined reporting. The Governor's Commission to Modernize State Finances recommended moving from single entity reporting to combined reporting as long ago as 2001. In 2007, this Committee, the Income Tax Subcommittee of the State and Local Fiscal Modernization Study Commission, and Governor Easley all recommended this change. The Multistate Tax Commission adopted a model uniform statute for combined reporting in 2006. Twenty-two states[2] require combined reporting; six of those states have adopted combined reporting since 2004. [3]

BILL ANALYSIS: The Committee did not want to recommend a proposal to the 2009 General Assembly that did not address the unresolved issues from 2007. However, the Committee remains supportive of legislation that would further the following tax policy goals:

- Provide a more level playing field for all businesses, both those that operate only in North Carolina and those that operate in multiple states.
- Provide a comprehensive structure to nullify income shifting strategies.
- Modernize the tax laws to adapt to the growth of multi-state corporations.
- Reduce uncertainty about when a corporation needs to file a combined return, who the corporation includes in it, and how the combination is to be accomplished.
- Broaden the corporate income tax base and adjust the tax rate to make the changes revenue-neutral.

Section 1 of the proposal states the intent of the General Assembly to enact changes to the corporate income tax laws that further the goals of equity, simplicity, modernization, and broad base/low rate. Section 2 of the proposal would replace an antiquated term with the correct defined term.

The proposal would become effective when it becomes law.

---

[2] Alaska, Arizona, California, Colorado, Hawaii, Idaho, Illinois, Kentucky, Maine, Minnesota, Montana, Nebraska, New Hampshire, Massachusetts, Michigan, New York, North Dakota, Oregon, Texas, Utah, West Virginia, and Vermont.

[3] Massachusetts, Michigan, New York, Texas, West Virginia, and Vermont.

LEGISLATIVE PROPOSAL #3

STREAMLINED SALES AND USE TAX UPDATE

LEGISLATIVE PROPOSAL #3

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO URGE THE 111TH CONGRESS TO GRANT STATES THE ABILITY TO REQUIRE COLLECTION OF SALES AND USE TAX BY REMOTE RETAILERS AND TO UPDATE THE REFERENCE TO THE STREAMLINED SALES AND USE TAX AGREEMENT

SHORT TITLE: Streamlined Sales and Use Tax Update.

SPONSORS:

BRIEF OVERVIEW: The proposal would do two things:

- It would encourage the 111th Congress to enact the provisions of the Sales Tax Fairness and Simplification Act (STFSA), which would give states that have adopted the uniformity and simplification measures of the Streamlined Sales and Use Tax Agreement (Agreement) the ability to require collection of use tax by remote sellers.
- It would update the statutory reference to the Agreement by changing the date from June 23, 2007, to September 5, 2008. North Carolina does not need to amend its sales and use tax laws to conform to any of the changes made in the Agreement since June 23, 2007.

FISCAL IMPACT: No impact.

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

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-RBz-5 [v.6] (01/07)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/26/2009 3:01:20 PM

Short Title: Streamlined Sales and Use Tax Update. (Public)

Sponsors:

Referred to:

A BILL TO BE ENTITLED

AN ACT TO URGE THE 111TH CONGRESS TO GRANT STATES THE ABILITY TO REQUIRE COLLECTION OF SALES AND USE TAX BY REMOTE RETAILERS AND TO UPDATE THE REFERENCE TO THE STREAMLINED SALES AND USE TAX AGREEMENT.

The General Assembly of North Carolina enacts:

SECTION 1. The General Assembly strongly encourages Congress to grant states the ability to require collection of sales and use tax by remote retailers by enacting the provisions of the Sales Tax Fairness and Simplification Act, a bipartisan bill introduced in the 110th Congress as H.R. 3396 by Rep. William Delahunt (D-MA) and as S. 34 by Senator Mike Enze (R-WY), for the following reasons:

(1) As Congress works to develop an economic stimulus package to provide much needed relief to businesses, individuals, and states, the Sales Tax Fairness and Simplification Act would provide tens of billions of dollars in funding to many states and local governments at minimal or no cost to the federal government.

(2) The Sales Tax Fairness and Simplification Act would ensure a fairer and more equitable sales tax system by requiring all retailers, both Main Street brick-and-mortar retailers and remote retailers, to collect and remit state sales and use taxes.

(3) Under previous United States Supreme Court decisions, the states' ability to collect sales and use taxes from remote retailers is restricted. However, the Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote retailers.

(4) In an effort to address the collection issues identified by the United States Supreme Court, North Carolina is one of 22 states that have

enacted legislation to simplify their sales and use tax laws to conform to the uniformity requirements of the Streamlined Sales and Use Tax Agreement

(5) North Carolina has collected thirty-six million dollars ($36,000,000) in revenues since October 2005 through the voluntary remittance of sales and use taxes by remote sellers under the Streamlined Sales and Use Tax Agreement. This amount is far less than the estimated amount the State is not collecting from sales by remote sellers.

SECTION 2. G.S. 105-164.3(45a) reads as rewritten:

"(45a) Streamlined Agreement. – The Streamlined Sales and Use Tax Agreement as amended as of ~~June 23, 2007.~~September 5, 2008."

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

BILL DRAFT 2009-RBz-5:
Streamlined Sales and Use Tax Update

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Bill Draft		Committee Staff

SUMMARY: This bill draft would do two things:

- ***It would encourage the 111th Congress to enact the provisions of the Sales Tax Fairness and Simplification Act, which would give states that have adopted the uniformity and simplification measures of the Streamlined Sales and Use Tax Agreement the ability to require collection of use tax by remote sellers.***
- ***It would update the statutory reference to the Agreement by changing the date from June 23, 2007, to September 5, 2008. North Carolina does not need to amend any of its sales and use tax laws to conform to any of the changes made in the Agreement since June 23, 2007.***

The bill would become effective when it becomes law.

CURRENT LAW: The Streamlined Sales and Use Tax Project (Project) is entering its ninth year of efforts to provide simplification and uniformity to the administration of sales and use tax. The adoption of the Streamlined Sales and Use Tax Agreement (Agreement) in 2002 provided the framework for participating states to achieve the uniformity and simplification measures initially established by a coalition of states, local governments, and businesses. The goal of the Project is to achieve sufficient simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in those states that have adopted the uniform provisions of the Agreement. Based on decisions by the United States Supreme Court, states cannot require remote sellers that do not have a physical presence in the state to collect and remit its use tax.

North Carolina is one of twenty-two states represented on the Streamlined Sales Tax Governing Board. A state becomes a member of the Governing Board when its sales and use tax laws are found to conform to the uniformity and simplification measures in the Agreement. The Governing Board established a central registration system in October 2005 that allows sellers to register for sales and use tax purposes in all member states. Over 1,000 sellers have registered since the system's inception.

Since October 2005, North Carolina has collected approximately $36 million in use tax revenue from remote sellers. The State has received $7.9 million during the 2008-2009 fiscal year to date. The amounts collected voluntarily are far less than the estimated amounts the State is not collecting in use tax revenue from sales by remote sellers. A University of Tennessee study, commissioned a few years ago, estimated a revenue loss to state and local governments of more than $30 billion a year from uncollected use taxes on remote sales. The Governing Board has recently commissioned a study to provide an update on this estimate.

The United States Supreme Court has stated in its decisions that Congress has the authority to grant states the ability to require collection of sales and use tax by remote sellers. Sen. Mike Enzi (R-WY) and Rep. William Delahunt (D-MA) introduced a bipartisan bill in the 110th Congress to provide the

necessary authorization to those states that had adopted the simplification and uniformity measures established in the Agreement. Although Congress did not enact the legislation last biennium, the Governing Board believes that the 111th Congress may represent the best opportunity for action on the Streamlined-related legislation, known as the Sales Tax Fairness and Simplification Act (STFSA). The National Conference of State Legislatures has recommended that Congress include the provisions of the STFSA as part of the economic stimulus legislation it is working to develop. The provisions of the STFSA would provide tens of billions of dollars in funding to states and local governments at a minimal or no cost to the federal government.

BILL ANALYSIS: The Revenue Laws Study Committee recognizes this year may be the best opportunity for action by Congress on the STFSA. Section 1 of the proposal would encourage Congress to consider and implement the provisions of the STFSA. The proposal provides both policy and fiscal reasons to support the enactment of the legislation. Not only would the legislation ensure a fairer and more equitable sales tax system for both Main Street brick-and-mortar retailers and remote retailers, but also

Section 2 of the proposal would update the State's statutory reference to the Agreement from June 23, 2007, to September 5, 2008. North Carolina does not need to amend its sales and use tax laws to conform to the changes made in the Agreement since June 23, 2007. A copy of the Agreement, as well as a document summarizing the changes made to the Agreement since June 23, 2007, may be found on the Streamlined Sales Tax Project's website: www.streamlinedsalestax.org.

LEGISLATIVE PROPOSAL #4

REAL PROPERTY SALES INFORMATION

LEGISLATIVE PROPOSAL #4

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED.

SHORT TITLE: Real Property Sales Information.

SPONSORS:

BRIEF OVERVIEW: This proposal would assist the counties and Department of Revenue in obtaining the true value or market value of real property for property tax appraisal purposes by requiring that a sales information report be filed with the county whenever property changes hands.

FISCA L IMPACT:

EFFECTIVE DATE: This act would become effective January 1, 2010.

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-LAz-5 [v.4] (1/6)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/7/2009 8:56:13 AM

Short Title: Real Property Sales Information. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS BY REQUIRING A REPORT OF SALES INFORMATION WHEN REAL PROPERTY IS TRANSFERRED.

Whereas, the Constitution of North Carolina requires that property must be taxed by uniform rule and that every classification must be made by general law uniformly applicable in every county, city and town, and other unit of local government; and

Whereas, the North Carolina General Statutes require that all property, real and personal, must so far as practicable be appraised or valued at its true value which is interpreted as meaning market value; and

Whereas, taxes levied by all counties and municipalities must be levied uniformly on assessments determined by the true value of most property; and

Whereas, to help ensure that tax values of real property reflect fair market value when the counties value their property for property tax purposes, the North Carolina Department of Revenue must conduct annual studies of the ratio of the appraised value of real property to its true value and establish for each county the median ratio as determined by the study for each calendar year; and

Whereas, one of the most accurate and cost efficient methods of producing a fair revaluation of property based on the true value of the property is to require that sales information reports be filed with the county whenever property changes hands; Now, therefore,

The General Assembly of North Carolina enacts:

SECTION 1. Article 19 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-317.2. Report on transfers of real property.**

To facilitate the accurate appraisal of real property for taxation, the information listed in this section must be reported to the county tax assessor on a form developed by the Department of Revenue. G.S. 161-32 prohibits recording a deed until the report is filed. The following information is required:

(1) The name of each grantor and grantee.

(2) A brief description of the property.

(3) The total sales price.

(4) Whether the transaction involves family members or affiliated companies.

(5) A listing of any personal property conveyed with the transaction.

(6) Whether the transaction is the result of a forced sale."

SECTION 2. Article 2 of Chapter 161 of the General Statutes is amended by adding a new section to read:

"**§ 161-32. Report on transfer of real property.**

The register of deeds may not accept for registration a deed transferring real property unless the county tax assessor certifies that a sales information report required by G.S. 105-317.2 has been filed. Failure to comply with this section does not affect the validity of a duly recorded deed."

SECTION 3. This act becomes effective January 1, 2010.

BILL DRAFT 2009-LAz-5:
Real Property Sales Information

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Martha Walston
Version:	Draft		Committee Counsel

SUMMARY: This proposal would assist the counties and Department of Revenue in obtaining the true value or market value of real property for property tax appraisal purposes by requiring that a sales information report be filed with the county whenever property changes hands.

CURRENT LAW: Real property must be appraised for property tax purposes at least every eight years. The appraisal value must be its market or true value as of January 1 of the year of the general reappraisal.[1] Market or true value is the price at which property would change hands between a willing and financially able buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all the uses to which property is adapted and for which it is capable of being used. To assist the counties in determining the true value, the Department of Revenue conducts yearly sales assessment ratio studies for each county. These studies compare the appraised value of parcels with the sales price. The closer the comparison is to 100%, the closer the property's appraised value is to the fair market value. Consequently, more frequent reappraisal schedules lessen the discrepancy between the appraised value of the property and the true value of the property.

Prior to the 2008 Session, the Revenue Laws Study Committee adopted a proposal to change the eight year appraisal cycle to a four year cycle. The version of this proposal ratified in S.L. 2008-146 requires advancement of the eight year schedule only for a county with a population of 75,000 or greater and when the sales assessment ratio for that county drops below .85 or becomes greater than 1.15.[2] For these counties, new values must be implemented by January 1 of the third year following notice by the Department of the sales assessment ratio study. All other counties retain the eight-year schedule.

BILL ANALYSIS: This bill would require that the following information be reported to and certified by the county tax assessor before a deed transferring property may be accepted by the county's register of deeds:

1. The name of each grantor and grantee.
2. A brief description of the property.
3. The total sales price.
4. Whether the transaction involves family members or affiliated companies.
5. A listing of any personal property conveyed with the transaction.
6. Whether the transaction is the result of a forced sale.

The above information would be reported on a form developed by the Department of Revenue.

[1] The following types of property are appraised at their use value: farmland, working waterfront property, and wildlife conservation property.

[2] Based upon the 2007 population estimates and 2008 sales ratios, only ten counties are affected by the 2008 legislation.

This proposed statewide sales information report is supported by comments made during meetings with tax assessors from large urban counties and smaller rural counties. Staff from the Revenue Laws Study Committee and the Property Tax Division within the Department of Revenue recently made field trips to the tax offices of Mecklenburg County and Chowan County. There they met with the tax assessors from those counties and surrounding counties to get the assessors' input on advancing the property tax appraisal schedule. The counties agreed that the advantage of advancing the schedule is that the appraised value of the property will be more equivalent to the fair market value of the property. However, the smaller more rural counties pointed out that revaluations are expensive and that they do not have the manpower or revenue to conduct them. The group discussed several recommendations to help them meet the statutory fair market appraisal standard. They concluded that one of the most helpful and cost efficient recommendations would be to require a statewide sales information report. They felt that the information on these reports could be used to generate a sales information list which would certainly help the counties obtain appraisal values that are closer to the true value of the property in the counties. Based upon information compiled by the Department of Revenue, 50 counties are already sending out letters requesting information to confirm a property transfer and six counties are requiring a transfer affidavit.[3]

EFFECTIVE DATE: This proposal would become effective January 1, 2010.

[3] Five of the six counties that require an affidavit also assess a local land transfer tax. They are Camden, Chowan, Currituck, Dare, and Pasquotank.

LEGISLATIVE PROPOSAL #5

MODERNIZE SALES TAX STATUTES/ DIGITAL PRODUCTS

LEGISLATIVE PROPOSAL #5

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO MODERNIZE THE SALES AND USE TAX STATUTES BY TREATING MUSIC, MOVIES, COMPUTER SOFTWARE, AND BOOKS THAT ARE DELIVERED ELECTRONICALLY THE SAME AS THOSE THAT ARE PURCHASED IN A TANGIBLE MEDIUM AND BY REVISING THE "MAIL ORDER" SALES TAX PROVISION TO INCLUDE SPECIFIC REFERENCES TO INTERNET SALES.

SHORT TITLE: Modernize Sales Tax Statutes/Digital Products.

SPONSORS:

BRIEF OVERVIEW: This proposal would apply the State and local general rate of sales and use tax audio works, audiovisual works, books, and computer software that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium. It also revises the "mail order sales" provision by setting out specifically circumstances under which remote retailers are presumed to be soliciting business in this State for purposes of collecting sales tax.

FISCAL IMPACT: This proposal is estimated to generate in FY 2009-2010 a General Fund gain of $8.4 million and a gain of $3.7 million in local revenues.

EFFECTIVE DATE: The revisions to the mail order sale provisions become effective when the act becomes law. The remainder of the act becomes effective January 1, 2010, and applies 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 2009

U D

BILL DRAFT 2009-SVxz-5 [v.8] (01/23)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/29/2009 10:26:45 AM

Short Title: Modernize Sales Tax Stat/Digital Products. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODERNIZE THE SALES AND USE TAX STATUTES BY TREATING MUSIC, MOVIES, BOOKS, AND COMPUTER SOFTWARE THAT ARE DELIVERED ELECTRONICALLY THE SAME AS THOSE THAT ARE PURCHASED IN A TANGIBLE MEDIUM AND BY REVISING THE "MAIL ORDER" SALES TAX PROVISIONS TO INCLUDE SPECIFIC REFERENCES TO INTERNET SALES.

The General Assembly of North Carolina enacts:

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

"**§ 105-164.3. Definitions.**

The following definitions apply in this Article:

...

(1b) Audio work. – A series of musical, spoken, or other sounds, including a ringtone.

(1c) Audiovisual work. – A series of related images and any sounds accompanying the images, that impart an impression of motion when shown in succession.

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

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

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

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

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

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

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

...

(7a) Digital code. – A code that gives a purchaser of the code a right to receive electronic delivery an item by electronic delivery or electronic access. A digital code may be obtained by an electronic means or by tangible means. A digital code does not include a gift certificate or a gift card.

~~(7a)~~(7h)Direct mail. – Printed material delivered or distributed by the United States Postal Service or other delivery service to a mass audience or to addresses on a mailing list provided by the purchaser or at the direction of the purchaser when the cost of the items is not billed directly to the recipients. The term includes tangible personal property supplied directly or indirectly by the purchaser to the direct mail seller for inclusion in the package containing the printed material. The term does not include multiple items of printed material delivered to a single address.

...

~~(17a) Load and leave. – Delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser.~~

...

(35f) Ringtone. – A digitized sound file that is downloaded onto a device and that may be used to alert the user of the device with respect to a communication.

..."

SECTION 2. G.S. 105-164.4(a) reads as rewritten:

"(a) A privilege tax is imposed on a retailer at the following percentage rates of the retailer's net taxable sales or gross receipts, as appropriate. The general rate of tax is four and one-half percent (4.5%).

...

(6b) The general rate applies to the sales price of an item that is listed in this subdivision, is delivered or accessed electronically, and would be taxable under this Article if sold in a tangible medium. The retail sale of a digital code that is used to obtain any of the items taxed by this subdivision is considered a sale of that item. The tax applies regardless

of whether the purchaser of the item has a right to redistribute it, to use it permanently, or to use it without making continued payments. The tax does not apply to an item that is taxed under another subdivision of this subsection or under G.S. 105-164.4C. A person who sells an item that is taxable under this subdivision is considered a retailer under this Article. The following items are subject to tax under this subdivision:

a. An audio work.

b. An audiovisual work.

c. A book.

d. Computer software."

SECTION 3.(a) G.S. 105-164.3(18) is recodified as G.S. 105-164.3(33g) and reads as rewritten:

"~~(18)~~(33g) ~~Mail order~~ Remote sale. – A sale of tangible personal property, ordered by mail, by telephone, ~~computer link,~~ via the Internet, or other similar method, to a purchaser who is in this State at the time the order is remitted, from a retailer who receives the order in another state and transports the property or causes it to be transported to a person in this State. It is presumed that a resident of this State who remits an order was in this State at the time the order was remitted."

SECTION 3.(b) The catchline of G.S. 105-164.8 reads as rewritten:

"**§ 105-164.8. Retailer's obligation to collect tax; ~~mail order~~ remote sales subject to tax.**"

SECTION 3.(c) G.S. 105-164.8(b) reads as rewritten:

"(b) ~~Mail Order~~ Remote Sales. – A retailer who makes a ~~mail order~~ remote sale is engaged in business in this State and is subject to the tax levied under this Article if at least one of the following conditions is met:

(1) The retailer is a corporation engaged in business under the laws of this State or a person domiciled in, a resident of, or a citizen of, this State.

(2) The retailer maintains retail establishments or offices in this State, whether the ~~mail order~~ remote sales thus subject to taxation by this State result from or are related in any other way to the activities of such establishments or offices.

(3) The retailer ~~has representatives in this State who solicit business or transact business on behalf of the retailer,~~ solicits or transacts business in this State by employees, independent contractors, agents, or other representatives whether the ~~mail order~~ remote sales ~~thus~~ subject to taxation by this State result from or are related in any other way to ~~such~~ the solicitation or transaction of business. A retailer is presumed to be soliciting or transacting business by an independent contractor, agent, or other representative if the retailer enters into an agreement with a resident of this State under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an Internet website or otherwise, to the retailer, if the cumulative gross receipts from sales by the retailer to purchasers in

this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of ten thousand dollars ($10,000.00) during the preceding four quarterly periods. This presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the seller that would satisfy the nexus requirement of the United States Constitution during the four quarterly periods in question.

(4) Repealed by Session Laws 1991, c. 45, s. 16.

(5) The retailer, by purposefully or systematically exploiting the market provided by this State by any media-assisted, media-facilitated, or media-solicited means, including direct mail advertising, distribution of catalogs, computer-assisted shopping, television, radio or other electronic media, telephone solicitation, magazine or newspaper advertisements, or other media, creates nexus with this State.

(6) Through compact or reciprocity with another jurisdiction of the United States, that jurisdiction uses its taxing power and its jurisdiction over the retailer in support of this State's taxing power.

(7) The retailer consents, expressly or by implication, to the imposition of the tax imposed by this Article. For purposes of this subdivision, evidence that a retailer engaged in the activity described in subdivision (5) shall be prima facie evidence that the retailer consents to the imposition of the tax imposed by this Article.

(8) The retailer is a holder of a wine shipper permit issued by the ABC Commission pursuant to G.S. 18B-1001.1."

SECTION 4. G.S. 105-164.13(43a) is repealed.

SECTION 5. G.S. 105-467(a) is amended by adding a new subdivision to read:

"(8) The sales price of an audio work, audiovisual work, a book, and computer software that is subject to the general rate of tax under G.S. 105-164.4(a)(6b)."

SECTION 6. Section 4 of Chapter 1096 of the 1967 Session Laws, as amended, reads as rewritten:

"Sec. 4. Scope of Sales Tax. The sales tax which may be imposed under this division after the holding of a special election is limited to a tax at the rate of one per cent (1%) of: (1) the sale price of those articles of tangible personal property now subject to the general rate of sales tax imposed by the State under G. S. ~~105-164.4(a)(1) and (4b);~~ 105-164.4(a)(1), (4b), and (6b); (2) the gross receipts derived from the lease or rental of tangible personal property when the lease or rental of the property is subject to the general rate of sales tax imposed by the State under G.S. 105-164.4(a)(2); (3) the gross receipts derived from the rental of any room or lodging furnished by any hotel, motel, inn, tourist camp or other similar public accommodations now subject to the general rate of sales tax imposed by the State under G. S. 105-164.4(a)(3); (4) the gross receipts derived from services rendered by laundries, dry cleaners, cleaning plants and similar type businesses now subject to the general rate of sales tax imposed by the State under G.

S. 105-164.4(a)(4); (5) The sales price of food and other items that are not otherwise exempt from tax pursuant to G.S. 105-164.13 but are exempt from the State sales and use tax pursuant to G.S. 105-164.13B; and (6) The sales price of prepaid telephone calling service taxed as tangible personal property under G.S. 105-164.4(a)(4d). The taxes authorized by this division do not apply to sales that are taxable by the State under G.S. 105-164.4 but are not specifically listed in this section.

"The exemptions and exclusions contained in G.S. 105-164.13 and the sales and use tax holiday contained in G.S. 105-164.13C apply with equal force and like manner to the local sales tax authorized to be imposed and levied under this division. The county shall have no authority, with respect to the local sales and use tax imposed under this division, to change, alter, add, or delete any exemptions or exclusions contained under G.S. 105-164.13.

"The local sales tax authorized to be imposed and levied under the provisions of this division shall be applicable to such retail sales, leases, rentals, rendering of services, furnishing of lodging or accommodations and other taxable transactions which are made, furnished or rendered by retailers whose place of business is located within the taxing county. The tax imposed shall apply to the furnishing of rooms, lodging or other accommodations within the county which are rented to transients. The sourcing principles in G.S. 105-164.4B apply in determining whether the local sales tax applies to a transaction. Provided, however, no tax shall be imposed where the tangible personal property sold is delivered by the retailer or his agent to the purchaser at a point outside this State."

SECTION 7. Section 3 of this act is effective when it becomes law. The remainder of this act becomes effective January 1, 2010, and applies to sales made on or after that date.

DRAFT 2009-SVxz-5: Modernize Sales Tax Statutes/Digital Products

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	January 27, 2009
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft Proposal 2009-SVxz-5		Committee Counsel

SUMMARY: ***This legislative proposal would apply the State and local general rate of sales and use tax to audio works (music and ringtones), audiovisual works (movies), books, and computer software that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium. The draft also revises the mail order sale statute to specifically set out certain circumstances that constitute soliciting business in this State for purposes of requiring a remote retailer to collect sales tax.***

CURRENT LAW: Under current law, the general rate of State and local sales and use tax applies to the sale, lease, or rental of tangible personal property and some services. Tangible personal property is defined as "personal property that may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses." Digital goods, such as downloaded music and movies, are not tangible personal property, and, therefore, are not taxed. Prewritten computer software is specifically included within the definition of tangible personal property, but it is exempt from sales tax when it is delivered electronically or by load and leave.[1]

G.S. 105-164.8 sets out the circumstances under which a "remote" retailer is required to collect sales tax on mail order sales. Generally speaking, a remote retailer is one that does not maintain a "brick and mortar" establishment in this State. This statute reflects principles enunciated in a series of cases that set out circumstances under which a retailer has sufficient nexus with a state to require it to collect sales tax. Several of these cases involved businesses that used independent contractors or other commissioned agents to solicit orders in a state in which the business was not physically located. One of the leading cases in this area is *Scripto v. Carson*, in which the United States Supreme Court held that a state could require tax collection by a remote retailer that had contracts with 10 in-state residents deemed independent contractors who solicited orders for products on its behalf. This principle has been codified in G.S. 105-164.8, which states, in part, that a retailer who makes a mail order sale must collect the sales tax if:

> "The retailer has representatives in this State who solicit business or transact business on behalf of the retailer, whether the mail order sales thus subject to taxation by this State result from or are related in any other way to such solicitation or transaction of business."

BILL ANALYSIS: This proposal does the following three things:

- It applies the general rate of State and local sales tax to certain digital goods when the tangible equivalent of the good would be subject to sales tax.
- It eliminates the sales and use tax exemption on prewritten computer software delivered electronically or via load and leave.

[1] The term "load and leave" is defined as "delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser."

- It revises the "mail order sale" provision by modernizing the terminology and by providing that a retailer is presumed to be soliciting business in this State when it enters into certain commission agreements with in-State residents and the contractual arrangement generates in excess of $10,000 in sales to the retailer.

The proposal imposes the general rate of sales and use tax on audio works, audiovisual works, books, and computer software that is delivered or accessed electronically and that would be taxable if purchased in a tangible format. The tax applies regardless of whether the purchaser has a right to redistribute it, to use it permanently, or to use it without making continued payments. The tax does not apply to a product that is taxed under another sales tax provision or the telecommunications statute. The purchase of a digital code used to obtain one of these items is considered a sale of that item.

The proposal also revises the mail order sales provision in two ways. First, it changes the term "mail order sale" to "remote sale," which covers all transactions that are not "face-to-face" but reflects more modern terminology and the prevalence of Internet sales. Second, it provides that a retailer is presumed to solicit or transact business in this State and is, therefore, required to collect sales tax if all of the following conditions are met:

4. The retailer has entered into an agreement with a resident of this State.
5. Under the agreement, the resident receives a commission or other consideration in exchange for directly or indirectly referring potential customers, whether by a link on an Internet website or otherwise, to the retailer.
6. The cumulative gross receipts from sales by the retailer to purchasers in this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of $10,000 during the preceding four quarterly periods.

This presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution.

In a recent New York Supreme Court[2] case, Amazon challenged an identical provision in the New York sales tax statutes alleging that it violates the Commerce Clause of the United States Constitution as well as both the Federal and State Constitutions' Due Process and Equal Protection Clauses. The court dismissed the complaint for failure to state a cause of action. The court disagreed with Amazon's assertion that the commissioned agents were mere advertisers concluding that the provision requires tax collection only when an out-of-state seller avails itself of the benefit of in-state contractors who are compensated for referrals and who generate actual business for the seller. Moreover, the court stated that "Amazon should not be permitted to escape tax collection indirectly, through use of an incentivized New York sales force to generate revenue, when it would not be able to achieve tax avoidance directly through the use of New York employees engaged in the very same activities."

EFFECTIVE DATE: Section 3, which revises the mail order provisions, becomes effective when the act becomes law. The remainder of the act becomes effective January 1, 2010, and applies to sales made on or after that date.

[2] The New York Supreme Court is a trial-level court.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

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, 2009

TO: 2009 Revenue Laws Study Committee

FROM: Sandra Johnson
Fiscal Research Division

RE: Modernize Sales Tax Statutes/Digital Products

FISCAL IMPACT ($ In Millions)

	Yes (X)	No ( )	No Estimate Available ( )		
	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
REVENUES:					
General Fund	$ 3.7	9.2	10.2	11.3	12.7
Local Impact	$1.7	4.1	4.5	5.1	5.7
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE: January 1, 2010

BILL SUMMARY: The proposed legislation does the following three things:

- Applies the general rate of State and local sales tax to certain digital goods when the tangible equivalent of the good would be subject to sales tax.

- Eliminates the sales and use tax exemption on prewritten computer software delivered electronically or via load and leave.
- Revises the "mail order sale" provision by modernizing the terminology and by providing that a retailer is presumed to be soliciting business in this State when it enters into certain commission agreements with in-State residents and the contractual arrangement generates in excess of $10,000 in sales to the retailer.

The proposal imposes the general rate of sales and use tax on audio works, audiovisual works, books, and computer software that is delivered or accessed electronically and that would be taxable if purchased in a tangible format. The tax applies regardless of whether the purchaser has a right to redistribute it, to use it permanently, or to use it without making continued payments. The tax does not apply to a product that is taxed under another sales tax provision or the telecommunications statute. The purchase of a digital code used to obtain one of these items is considered a sale of that item.

ASSUMPTIONS AND METHODOLOGY: Fiscal Research estimates that North Carolina's digital download sales during the 2009-10 fiscal year will generate roughly $3.7 million in State tax revenue. The outline below reviews the data sources and methodology used to estimate digital download sales tax revenue for each of the six products: 1) music, 2) video games, 3) movies and other filmed entertainment, 4) books, 5) computer software via digital download and 6) computer software provided through load and leave services.

It is important to note that the $3.7 million is estimated tax revenue given a, January 1st, mid-fiscal year effective date. The $3.7 million figure is solely based on the projected sales by vendors with a North Carolina nexus. In determining nexus versus non-nexus sales, the California Board of Equalization estimates that 65% of E-commerce sales are from vendors with nexus, a brick and mortar affiliation, in the state. The remaining 35% of E-commerce sales, according to the Board, are by out-of-state vendors and require individual purchasers to remit a use tax. Use taxes, the tax revenue from sales by vendors outside of the state, if remitted, would increase General Fund availability by an additional $3.7 million for a total of $5.4 million in FY 2009-10. Use taxes from online purchases are reported at a minimal rate.

To estimate North Carolina's digital download sales, Fiscal Research made state level inferences from national retail trends. North Carolina's retail sales represented roughly 3% of the nation's retail sales during the most recent Economic Census in 2002.

Music

If enacted for a full fiscal year, North Carolina's digital music sales would generate roughly $1.6 million in tax revenue in 2009-2010. Assuming that the State represents 2.9% of all U.S. retail sales and a 16% annual growth rate, this figure would represent $2.9 million by 2013.

The International Federation of the Phonographic Industry (IFPI), Digital Music Report 2009 estimates that international music sales via online and mobile channels rose from zero to $3.7 billion within six years, making music more digitally advanced than any entertainment sector except games. Digital music now accounts for roughly 20 percent of all music sales and the 2009 IFPI report cites the U.S. as the world's biggest digital music market. America's online and mobile music sales account for $1.9 billion or 50% of international revenues.

The U.S. Census, in addition to a state level economic census every five years, tracks the nation's annual retail sales including E-commerce and mail order sales. Mail-order and E-commerce music sales

increased by 16% between 2005 and 2006. The fiscal estimate assumes a 16% percent annual growth rate in digital music sales based on the 2005-2006 trend.

Video Games

North Carolina's digital gaming industry is expected to generate roughly $2.7 million in sales tax revenue per fiscal year, a figure that is expected to grow by 6.3% annually representing $3.5 million dollars in 2013. This fiscal estimate is based on information provided by the 2008 IFPI Music Industry report and PricewaterhouseCoopers' *Global Entertainment and Media Outlook: 2008-2012* report.

According to PricewaterhouseCoopers, the U.S. video game industry is being driven by the next generation of platforms, online and wireless games. The video and online gaming industry represented $8.6 billion in 2007 and will increase at an average annual rate of 6.3 percent to $11.7 billion in 2012. While PricewaterhouseCoopers projects $11.7 billion in overall video game sales, the IFPI Digital Music Report 2008, estimates that digital downloads represents $4 billion, 35 percent, of the video game industry.

Movies and Other Filmed Entertainment

Data on digitally downloaded filmed entertainment also comes from the PricewaterhouseCoopers' *Global Entertainment and Media Outlook: 2008-2012* report. The report states that, "Download-to-own movies streamed over the Internet will increase rapidly from a small base, rising at a compound annual growth rate of 51.4 percent equaling $900 million in 2012, in the U.S." In North Carolina, digitally downloaded movies will generate approximately $0.21 million in sales tax revenue per fiscal year.

Books

North Carolina's digital book sales are expected to generate $0.4 million tax revenue per fiscal year. Digital browsing and electronic books, according to PricewaterhouseCoopers, will revitalize the consumer book market, with consumer print books increasing from $21.7 billion in 2007 to $22.5 billion in 2012. PricewaterhouseCoopers also projects that the consumer and educational book market will grow by 0.8% annually. IFPI estimates that, $434 million, or roughly 2% of all book sales are in the form of digital media.

Computer Software

According the U.S. Census E-stats program, Americans purchased roughly $2 billion in computer software through online vendors in 2006 an increase from $1.5 billion in 2004. Between 2004 and 2006, online computer software purchases increased at rate of 12% annually. Using historical online commerce growth rates and assuming that 80 percent of online computer software purchases are digitally downloaded, North Carolina can expect to collect roughly $2.5 million in tax revenue from digital computer software sales.

Computer Software provided through Load and Leave

The digital download legislation would also repeal the sales and use tax exemption for computer software included in G.S. 164.13 (43a). The statute currently exempts software delivered electronically or by load and leave from the sales and use tax. A repeal of G.S. 164.13 (43a) would generate roughly $1.3 million in tax revenue per fiscal year.

SOURCES OF DATA:

California Board of Equalization. "Revenue Estimate: Electronic Commerce and Mail Order Sales. 2007." Available at: http://www.boe.ca.gov/legdiv/pdf/e-commerce-07.pdf

Condon, Stephanie. "States May Tax i-Tunes, Other Digital Downloads." CNET.com. Published August 12, 2008. Available at: http://news.cnet.com/8301-13578_3-10013327-38.html. Last accessed January 2009.

International Federation of the Phonographic Industry (IFPI). *Digital Music Report 2008*. Available at: http://www.ifpi.org/content/library/DMR2008.pdf.

International Federation of the Phonographic Industry (IFPI). *Digital Music Report 2009*. January 2009. Available at: http://www.ifpi.org/content/library/DMR2009.pdf.

PricewaterhouseCoopers. *Global Entertainment and Media Outlook: 2008-2012*, Available at: http://www.pwc.com/extweb/pwcpublications.nsf/docid/5AC172F2C9DED8F5852570210044EEA7?opendocument&vendor=none.

U.S. Census. E-Stats Program. Table 6. "U.S. Electronic Shopping and Mail-Order Houses (NAICS 4541) - Total and E-commerce Sales by Merchandise Line: 2006 and 2005." Available at: http://www.census.gov/eos/www/2006/2006tables.html. Last accessed January 2009.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #6

REVENUE LAWS TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES

LEGISLATIVE PROPOSAL #6

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2009 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

SHORT TITLE: Revenue Laws Technical, Clarifying, and Administrative Law Changes.

SPONSORS:

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

FISCAL IMPACT:

EFFECTIVE DATE: Except as otherwise specifically provided, the act is effective when it becomes law.

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

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2009

U D

BILL DRAFT 2009-SVz-4 [v.10] (12/31)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
1/30/2009 10:51:44 AM

Short Title: Rev Laws Technical & Admin Changes. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-41(a) reads as rewritten:

"(a) Every individual in this State who practices a profession or engages in a business and is included in the list below must obtain from the Secretary a statewide license for the privilege of practicing the profession or engaging in the business. A license required by this section is not transferable to another person. The tax for each license is fifty dollars ($50.00).

...

(12) A home inspector or an associate home inspector licensed under Article 9F of Chapter 143 of the General Statutes."

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

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

SECTION 3. G.S. 105-130.18 reads as rewritten:

"**§ 105-130.18. Failure to file returns; supplementary returns.**

If the Secretary determines that a corporation has failed to file a return or to include in a return filed, either intentionally or through error, items of taxable income, the Secretary may require from the corporation a return or supplementary return, under affirmation, of all the items of income that the corporation received during the year for which the return is made, whether or not taxable under this Part. If from a supplementary return or otherwise the Secretary finds that any items of income, taxable under this Part, have been omitted from the original return, that any items returned as taxable are not taxable, or that any item of taxable income is overstated or understated,

the Secretary may require that the item be disclosed under affirmation of the corporation, and be added to or deducted from the original return. The filing of a supplementary return and the correction of the original return does not relieve the corporation from any of the penalties under G.S. 105-236. The Secretary may proceed under the provisions of G.S. ~~105-241.1,~~ 105-241.9, whether or not the Secretary requires a return or a supplementary return under this section."

SECTION 4. Section 4(b) of S.L. 2008-134 reads as rewritten:

"**SECTION 4.(b)** This section is effective for taxable years beginning on or after January 1, ~~2009.~~2008."

SECTION 5.(a) G.S. 105-228.5B reads as rewritten:

"**§ 105-228.5B. (Effective until June 30, 2010) Proceeds credited to High Risk Pool.**

~~Within 75 days after the end of each fiscal year,~~ By November 1 of each year, the State Treasurer must transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund established in G.S. 58-50-225 an amount equal to the growth in net revenue from the tax applied to gross premiums under G.S. 105-228.5(d)(2). The growth in revenue from this tax is the difference between the amount of revenue collected during the preceding fiscal year on premiums taxed under that subdivision less $475,545,413, which is the amount of revenue collected during fiscal year 2006-2007 on premiums taxed under that subdivision. The Treasurer must draw the amount required under this section from revenue collected on premiums taxed under that subdivision."

SECTION 5.(b) G.S. 105-228.5B, as amended by S.L. 2008-118, reads as rewritten:

"**§ 105-228.5B. (Effective June 30, 2010) Distribution of part of tax proceeds to High Risk Pool.**

~~Within 75 days after the end of each fiscal year,~~ By November 1 of each year, the State Treasurer must transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund established in G.S. 58-50-225 an amount equal to thirty percent (30%) of the growth in revenue from the tax applied to gross premiums under G.S. 105-228.5(d)(2). The growth in revenue from this tax is the difference between the amount of revenue collected during the preceding fiscal year on premiums taxed under that subdivision less $475,545,413, which is the amount of revenue collected during fiscal year 2006-2007 on premiums taxed under that subdivision. The Treasurer must draw the amount required under this section from revenue collected on premiums taxed under that subdivision."

SECTION 5.(c) Subsections (a) and (c) of this section are effective when they become law. Subsection (b) of this section becomes effective June 30, 2010.

SALES TAX CHANGES

SECTION 6.(a) G.S. 105-164.14(j)(2)n. reads as rewritten:

"n. Solar electricity generating materials manufacturing. Solar ~~energy~~ electricity generating materials manufacturing means the development and production of one or more of the following:

1. Photovoltaic materials or modules used in producing electricity.
2. Polymers or polymer films primarily intended for incorporation into photovoltaic materials or modules used in producing electricity."

SECTION 6.(b) This section is effective July 1, 2008, and applies to purchases made on or after that date.

SECTION 7. G.S. 105-187.51C(c) reads as rewritten:

"(c) Forfeiture. – If the required level of investment to qualify as an eligible datacenter is not timely made, then the rate provided under this section is forfeited. If the required level of investment is timely made but any eligible machinery and equipment is not located and used at an eligible datacenter, then the rate provided for that machinery and equipment under this subdivision is forfeited. A taxpayer that forfeits a rate under this subdivision is liable for all past sales and use taxes avoided as a result of the forfeiture, computed at the combined general rate from the date the taxes would otherwise have been due, plus interest at the rate established under G.S. ~~105-241.1(i).~~ 105-241.21. If the forfeiture is triggered due to the lack of a timely investment required by this section, then interest is computed from the date the sales or use tax would otherwise have been due. For all other forfeitures, interest is computed at the combined general rate from the time as of which the machinery or equipment was put to a disqualifying use. A credit is allowed against the sales or use tax owed as a result of the forfeiture provisions of this subsection for privilege taxes paid pursuant to this section. For purposes of applying this credit, the fact that payment of the privilege tax occurred in a period outside the statute of limitations provided under G.S. ~~105-266~~ 105-241.6 shall not be considered. Interest shall not be computed against the amount of taxes offset by this credit. The past taxes and interest are due 30 days after the date of forfeiture. A taxpayer that fails to pay the past taxes and interest by the due date is subject to the provisions of G.S. 105-236."

PROPERTY TAX CHANGES

SECTION 8.(a) G.S. 105-273(6) reads as rewritten:

"(6) Corporation. – An organization having capital stock represented by shares or an incorporated, nonprofit organization."

SECTION 8.(b) G.S. 105-277.1B(i) reads as rewritten:

"(i) Disqualifying Events. – Each of the following constitutes a disqualifying event:

(1) The owner transfers the residence. Transfer of the residence is not a disqualifying event if (i) the owner transfers the residence to a co-owner of the residence or, as part of a divorce proceeding, to his or her spouse and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(2) The owner dies. Death of the owner is not a disqualifying event if (i) the owner's share passes to a co-owner of the residence or to his or her

spouse ~~residence~~ and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(3) The owner ceases to use the property as a permanent residence."

SECTION 9.(a) G.S. 105-282.1(a)(1) reads as rewritten:

"(1) No application required. – Owners of the following exempt or excluded property do not need to file an application for the exemption or exclusion to be entitled to receive it:

a. Property exempt from taxation under G.S. 105-278.1 or G.S. 105-278.2.

b. Special classes of property excluded from taxation under G.S. 105-275(15), (16), (26), (31), (32a), (33), (34), (37), (40), ~~or (42).~~(42), or (44).

c. Property classified for taxation at a reduced valuation under G.S. 105-277(g) or G.S. 105-277.9."

SECTION 9.(b) This section is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

SECTION 10. G.S. 105-275 reads as rewritten:

"§ 105-275. Property classified and excluded from the tax base.

The following classes of property are ~~hereby~~ designated special classes under ~~authority of~~ Article V, Sec. 2(2), of the North Carolina Constitution and ~~shall not be listed, appraised, assessed, or taxed~~are excluded from tax as provided in this section if they satisfy the application requirements in G.S. 105-282.1.

...."

SECTION 11.(a) G.S. 105-277.1(d) reads as rewritten:

"§ 105-277.1. (Effective for taxes imposed for taxable years beginning before July 1, 2009) Property tax homestead exclusion.

...

(d) Multiple Ownership. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of this exclusion notwithstanding that only one of them meets the age or disability requirements of this section. When a permanent residence is owned and occupied by two or more persons other than husband and wife as tenants by the entirety and one or more of the owners qualifies for this exclusion, each qualifying owner is entitled to the full amount of the exclusion not to exceed his or her proportionate share of the valuation of the property. No part of an exclusion available to one co-owner may be claimed by any other co-owner and in no event may the total exclusion allowed for a permanent residence exceed the exclusion amount provided in this section.

SECTION 11.(b) G.S. 105-277.1(d) and (e) read as rewritten:

"§ 105-277.1. (Effective for taxes imposed for taxable years beginning on or after July 1, 2009) Elderly or disabled property tax homestead exclusion.

...

(d) Ownership by ~~Spouses.~~Tenants by the Entirety. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full

benefit of this exclusion notwithstanding that only one of them meets the age or disability requirements of this section.

(e) Other Multiple Owners. – This subsection applies to co-owners who are not husband and ~~wife.~~wife as tenants by the entirety. Each co-owner of a permanent residence must apply separately for the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and none of the co-owners qualifies for the exclusion allowed under G.S. 105-277.1C, each co-owner is entitled to the full amount of the exclusion allowed under this section. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and one or more of the co-owners qualify for the exclusion allowed under G.S. 105-277.1C, each co-owner who qualifies for the exclusion under this section is entitled to the full amount of the exclusion. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the greater of the exclusion allowed under this section and the exclusion allowed under G.S. 105-277.1C."

SECTION 12. G.S. 105-277.1B reads as rewritten:

"**§ 105-277.1B. (Effective for taxes imposed for taxable years beginning on or after July 1, 2009) Property tax homestead circuit breaker.**

(a) Classification. – A permanent residence owned and occupied by a qualifying owner is designated a special class of property under Article V, Section 2(2) of the North Carolina Constitution and is taxable in accordance with this section.

(b) Definitions. – The definitions provided in G.S. 105-277.1 apply to this section. 'Deferred taxes' means the principal amount of tax deferred under this section.

(c) Income Eligibility Limit. – The income eligibility limit provided in G.S. 105-277.1(a2) applies to this section.

(d) Qualifying Owner. – For the purpose of qualifying for the property tax homestead circuit breaker under this section, a qualifying owner is an owner who meets all of the following requirements as of January 1 preceding the taxable year for which the benefit is claimed:

(1) The owner has an income for the preceding calendar year of not more than one hundred fifty percent (150%) of the income eligibility limit specified in subsection (c) of this section.

(2) The owner has ~~owned and~~ occupied the property as a permanent residence for at least five ~~years.~~years and has owned the property as a permanent residence for at least five consecutive years.

(3) The owner is at least 65 years of age or totally and permanently disabled.

(4) The owner is a North Carolina resident.

(e) Multiple Owners. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of the property tax homestead circuit breaker notwithstanding that only one of them meets the length of occupancy ~~occupation~~ requirement and the age or disability requirement of this section. When a permanent residence is owned and occupied by two or more persons other than husband and ~~wife,~~wife as tenants by the entirety, no property tax homestead circuit breaker is allowed unless all of the owners qualify and elect to defer taxes under this section.

(f) Tax Limitation. – A qualifying owner may defer the portion of tax imposed on his or her permanent residence if it exceeds the percentage of the qualifying owner's income set out in the table in this subsection. If a permanent residence is subject to tax by more than one taxing unit and the total tax liability exceeds the tax limit imposed by this section, then both the taxes due under this section and the taxes deferred under this section must be apportioned among the taxing units based upon the ratio each taxing unit's tax rate bears to the total tax rate of all units.

Income Over	**Income Up To**	**Percentage**
-0-	Income Eligibility Limit	4.0%
Income Eligibility Limit	150% of Income Eligibility Limit	5.0%

(g) Temporary Absence. – An otherwise qualifying owner does not lose the benefit of this circuit breaker because of a temporary absence from his or her permanent residence for reasons of health, or because of an extended absence while confined to a rest home or nursing home, so long as the residence is unoccupied or occupied by the owner's spouse or other dependent.

(h) Deferred Taxes. – The difference between the taxes due under this section and the taxes that would have been payable in the absence of this section are a lien on the real property of the taxpayer as provided in G.S. 105-355(a). The difference in taxes for the three fiscal years preceding the ~~current~~ tax year in which a disqualifying event occurs shall be carried forward in the records of the taxing unit or units as deferred taxes. The deferred taxes are due and payable in accordance with G.S. 105-277.1F when the property loses its eligibility for deferral because of the occurrence of a disqualifying event as provided in subsection (i) of this section. On or before September 1 of each year, the collector shall ~~notify each residence owner to whom a tax deferral has previously been granted of the accumulated sum of deferred taxes and interest.~~send to the mailing address of a residence on which taxes have been deferred a notice stating the amount of deferred taxes and interest that are due and payable upon the occurrence of a disqualifying event.

(i) Disqualifying Events. – Each of the following constitutes a disqualifying event:

(1) The owner transfers the residence. Transfer of the residence is not a disqualifying event if (i) the owner transfers the residence to a co-owner of the residence or, as part of a divorce proceeding, to his or her spouse and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(2) The owner dies. Death of the owner is not a disqualifying event if (i) the owner's share passes to a co-owner of the residence or to his or her spouse ~~residence~~ and (ii) that individual occupies or continues to occupy the property as his or her permanent residence.

(3) The owner ceases to use the property as a permanent residence.

(j) Gap in Deferral. – If an owner of a residence on which taxes have been deferred under this section is not eligible for continued deferral for a tax year, the three years for which the deferred taxes ~~deferred from the prior tax years~~ are carried forward are not due and payable ~~but are carried forward~~ until a disqualifying event occurs. If the owner of the residence qualifies for deferral after one or more years in which he or she did not qualify for deferral, the years in which the owner did not qualify are disregarded in determining the three years for which the deferred taxes are carried forward.

(k) **(Repealed effective for taxes imposed for taxable years beginning on or after July 1, 2008)** Prepayment. – All or part of the deferred taxes and accrued interest may be paid to the tax collector at any time. Any partial payment is applied first to accrued interest. A residence owner to whom a tax deferral has previously been granted may revoke the application for deferral at any time by notifying the assessor in writing.

(l) Creditor Limitations. – A mortgagee or trustee that elects to pay any tax deferred by the owner of a residence subject to a mortgage or deed of trust does not acquire a right to foreclose as a result of the election. Except for requirements dictated by federal law or regulation, any provision in a mortgage, deed of trust, or other agreement that prohibits the owner from deferring taxes on property under this section is void.

(m) Construction. – This section does not affect the attachment of a lien for personal property taxes against a tax-deferred residence.

(n) Application. – An application for property tax relief provided by this section should be filed during the regular listing period, but may be filed and must be accepted at any time up to and through June 1 preceding the tax year for which the relief is claimed. Persons may apply for this property tax relief by entering the appropriate information on a form made available by the assessor under G.S. 105-282.1"

SECTION 13. G.S. 105-277.1C reads as rewritten:

"**§ 105-277.1C. (Effective for taxes imposed for taxable years beginning on or after July 1, 2009) Disabled veteran property tax homestead exclusion.**

(a) Exclusion. – A permanent residence owned and occupied by an owner who is a North Carolina resident and who is an honorably discharged disabled veteran or the unmarried surviving spouse of an honorably discharged disabled veteran is designated a special class of property under Article V, Section 2(2) of the North Carolina Constitution and is taxable in accordance with this section. The first forty-five thousand dollars ($45,000) of appraised value of the residence is excluded from taxation. An owner who receives an exclusion under this section may not receive other property tax relief.

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

(1) Disabled veteran. – A veteran who, as of January 1 preceding the taxable year for which the exclusion allowed by this section is

claimed, ~~receives~~ received benefits under 38 U.S.C. § 2101 or has a veteran's disability certification.

(2) Owner. – Defined in G.S. 105-277.1.

(3) Permanent residence. – Defined in G.S. 105-277.1.

(4) Property tax relief. – Defined in G.S. 105-277.1.

(5) Veteran. – A veteran of any branch of the Armed Forces of the United States.

(6) Veteran's disability certification. – A certification by the United States Department of Veterans Affairs or another federal agency that a veteran has a permanent total disability that is service-connected.

(c) Temporary Absence. – An owner does not lose the benefit of this exclusion because of a temporary absence from his or her permanent residence for reasons of health or because of an extended absence while confined to a rest home or nursing home, so long as the residence is unoccupied or occupied by the owner's spouse or other dependent.

(d) Ownership by ~~Spouses.~~Tenants by the Entirety. – A permanent residence owned and occupied by husband and wife as tenants by the entirety is entitled to the full benefit of this exclusion notwithstanding that only one of them meets the requirements of this section.

(e) Other Multiple Owners. – This subsection applies to co-owners who are not husband and ~~wife.~~wife as tenants by the entirety. Each co-owner of a permanent residence must apply separately for the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and none of the co-owners qualifies for the exclusion allowed under G.S. 105-277.1, each co-owner is entitled to the full amount of the exclusion allowed under this section. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the exclusion allowed under this section.

When one or more co-owners of a permanent residence qualify for the exclusion allowed under this section and one or more of the co-owners qualify for the exclusion allowed under G.S. 105-277.1, each co-owner who qualifies for the exclusion allowed under this section is entitled to the full amount of the exclusion. The exclusion allowed to one co-owner may not exceed the co-owner's proportionate share of the valuation of the property, and the amount of the exclusion allowed to all the co-owners may not exceed the greater of the exclusion allowed under this section and the exclusion allowed under G.S. 105-277.1.

(f) Application. – An application for the exclusion allowed under this section should be filed during the regular listing period, but may be filed and must be accepted at any time up to and through June 1 preceding the tax year for which the exclusion is claimed. An applicant for an exclusion under this section must establish eligibility for the exclusion by providing a copy of the veteran's disability certification or evidence of benefits received under 38 U.S.C. § 2101."

SECTION 14. G.S. 105-282.1(a) reads as rewritten:

"(a) Application. – Every owner of property claiming exemption or exclusion from property taxes under the provisions of this Subchapter has the burden of establishing that the property is entitled to it. If the property for which the exemption or exclusion is claimed is appraised by the Department of Revenue, the application shall be filed with the Department. Otherwise, the application shall be filed with the assessor of the county in which the property is situated. An application must contain a complete and accurate statement of the facts that entitle the property to the exemption or exclusion and must indicate the municipality, if any, in which the property is located. Each application filed with the Department of Revenue or an assessor shall be submitted on a form approved by the Department. Application forms shall be made available by the assessor and the Department, as appropriate.

Except as provided below, an owner claiming an exemption or exclusion from property taxes must file an application for the exemption or exclusion annually during the listing period.

(1) No application required. – Owners of the following exempt or excluded property do not need to file an application for the exemption or exclusion to be entitled to receive it:

a. Property exempt from taxation under G.S. 105-278.1 or G.S. 105-278.2.

b. Special classes of property excluded from taxation under G.S. 105-275(15), (16), (26), (31), (32a), (33), (34), (37), (40), ~~or (42).~~(42), or (44).

c. Property classified for taxation at a reduced valuation under G.S. 105-277(g) or G.S. 105-277.9.

(2) **(Effective for taxes imposed for taxable years beginning before July 1, 2009)** Single application required. – An owner of one or more of the following properties eligible to be exempted or excluded from taxation must file an application for exemption or exclusion to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the exemption or exclusion:

a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 105-278.5, 105- 278.6, 105-278.7, or 105-278.8.

b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (31e), (35), (36), (38), (39), ~~or (41)~~(41), or (45) or under G.S. 131A-21.

c. Special classes of property classified for taxation at a reduced valuation under G.S. 105-277(h), 105-277.1, 105-277.10, 105-277.13, 105-278.

d. Property owned by a nonprofit homeowners' association but where the value of the property is included in the appraisals of property owned by members of the association under G.S. 105-277.8.

(2) **(Effective for taxes imposed for taxable years beginning on or after July 1, 2009 and before July 1, 2010)** Single application required. – An owner of one or more of the following properties eligible for a property tax benefit must file an application for the benefit to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the benefit.

a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 105-278.5, 105-278.6, 105-278.7, or 105-278.8.

b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (31e), (35), (36), (38), (39), ~~or (41)~~(41),or (45) or under G.S. 131A-21.

c. Special classes of property classified for taxation at a reduced valuation under G.S. 105-277(h), 105-277.1, 105-277.1C, 105-277.10, 105-277.13, 105-277.14, or 105-278.

d. Property owned by a nonprofit homeowners' association but where the value of the property is included in the appraisals of property owned by members of the association under G.S. 105-277.8.

e. Repealed by Session Laws 2008-35, s. 1.2, effective for taxes imposed for taxable years beginning on or after July 1, 2008.

(2) **(Effective for taxes imposed for taxable years beginning on or after July 1, 2010)** Single application required. – An owner of one or more of the following properties eligible for a property tax benefit must file an application for the benefit to receive it. Once the application has been approved, the owner does not need to file an application in subsequent years unless new or additional property is acquired or improvements are added or removed, necessitating a change in the valuation of the property, or there is a change in the use of the property or the qualifications or eligibility of the taxpayer necessitating a review of the benefit.

a. Property exempted from taxation under G.S. 105-278.3, 105-278.4, 105-278.5, 105-278.6, 105-278.7, or 105-278.8.

b. Special classes of property excluded from taxation under G.S. 105-275(3), (7), (8), (12), (17), (18), (19), (20), (21), (31e),

(35), (36), (38), (39), ~~or (41)~~(41), or (45) or under G.S. 131A-21.

c. Special classes of property classified for taxation at a reduced valuation under G.S. 105-277(h), 105-277.1, 105-277.1C, 105-277.10, 105-277.13, ~~105-278, or 105-277.15.~~105-277.14, 105-277.15, or 105-278.

d. Property owned by a nonprofit homeowners' association but where the value of the property is included in the appraisals of property owned by members of the association under G.S. 105-277.8.

e. Repealed by Session Laws 2008-35, s. 1.2, effective for taxes imposed for taxable years beginning on or after July 1, 2008."

SECTION 15. G.S. 105-277.14(d) is repealed.

SECTION 16. G.S. 105-361(a) reads as rewritten:

(a) Duty to Furnish a Certificate. – On the request of any of the persons prescribed in subdivision (a)(1), below, and upon the condition prescribed by subdivision (a)(2), below, the tax collector shall furnish a written certificate stating the amount of any taxes and special assessments owed for the current year and for any prior ~~years in his hands for collection (together with any penalties, interest, and costs accrued thereon) including the amount due under G.S. 105-277.4(c) if the property should lose its eligibility for the benefit of classification under G.S. 105-277.2 et seq. that are a lien on a parcel of real property in the taxing unit.~~years. The certificate shall include deferred taxes that are due and payable because of the occurrence of a disqualifying event.

(1) Who May Make Request. – Any of the following persons shall be entitled to request the certificate:

a. An owner of the real property;

b. An occupant of the real property;

c. A person having a lien on the real property;

d. A person having a legal interest or estate in the real property;

e. A person or firm having a contract to purchase or lease the property or a person or firm having contracted to make a loan secured by the property;

f. The authorized agent or attorney of any person described in subdivisions (a)(1)a through e above."

OCCUPANCY TAX CHANGES

SECTION 17. Section 1 of S.L. 2008-33 reads as rewritten:

"**SECTION 1.** Chapter 1055 of the 1983 Session ~~Laws~~ Laws, as amended by Section 21(e) of S.L. 2007-527, reads as rewritten:

'Section 1. ~~Levy of Tax.~~ Occupancy Tax. –

(a) Authorization and scope. – The Cherokee County Board of Commissioners may ~~by resolution, after not less than 10 days' public notice and after a public hearing held pursuant thereto,~~ levy a room occupancy and tourism development ~~tax.~~

~~(b) Collection of the tax, and liability therefor, shall begin and continue only on and after the first day of a calendar month set by the Cherokee County Board of Commissioners in the resolution levying the tax, which in no case may be earlier than the first day of the second succeeding calendar month after the date of adoption of the resolution.~~

~~'Sec. 2. Occupancy Tax.~~

~~(a) The county room occupancy and tourism development tax that may be levied under this act shall be a percentage~~ tax of three percent (3%) of the gross receipts derived from the rental of any room, lodging, or similar accommodation furnished by any hotel, motel, inn, tourist camp, or other similar place within the county ~~now~~ that is subject to ~~the three percent (3%)~~ sales tax imposed by the State under G.S. ~~105-164.4(3).~~ 105-164.4(a)(3). ~~During the first year in which a tax levied under this act is in effect, the tax shall be three percent (3%) of the gross receipts derived from the rental of taxable accommodations in the county. Thereafter, the rate of tax shall continue to be three percent (3%) unless the Cherokee County Board of Commissioners, by resolution, adopts a rate of less than three percent (3%). A change in the occupancy tax rate adopted by the board of commissioners becomes effective the first day of the second succeeding calendar month following the date of adoption of the resolution. The Cherokee County Board of Commissioners may not change the occupancy tax rate more than once a year.~~

~~(b)~~ The occupancy tax is in addition to any State or local sales tax. This tax does not apply to accommodations furnished by nonprofit charitable, educational, ~~benevolent,~~ or religious organizations.

(b) Authorization of additional tax. – In addition to the tax authorized by subsection (a) of this section, the Cherokee County Board of Commissioners may levy an additional room occupancy tax of up to three percent (3%) of the gross receipts derived from the rental of accommodations taxable under subsection (a) of this section. The levy, collection, administration, and repeal of the tax authorized by this subsection shall be in accordance with the provisions of this act. Cherokee County may not levy a tax under this subsection unless it also levies the tax authorized under subsection (a) of this section.

'Sec. 3. Administration of Tax. – A tax levied under this act shall be levied, collected, administered, and repealed as provided in G.S. 153A-155. The penalties provided in G.S. 153A-155 apply to a tax levied under this act.

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

~~(b) Any person, firm, corporation, or association who fails or refuses to file the return required by this act shall pay a penalty of ten dollars ($10.00) for each day's omission.~~

~~(c) In case of failure or refusal to file the return or pay the tax for a period of 30 days after the time required for filing the return or for paying the tax, there shall be an additional tax, as a penalty, of five percent (5%) of the tax due in addition to the penalty prescribed in subsection (b), with an additional tax of five percent (5%) for each additional month or fraction thereof until the occupancy tax is paid.~~

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

~~'Sec. 4. Collection of Tax. Every operator of a business subject to the tax levied pursuant to this act shall collect the tax on and after the effective date of the levy of the tax.~~

~~This tax shall be collected as part of the charge for the furnishing of any taxable accommodations. The tax shall be stated and charged separately from the sales records, and shall be paid by the purchaser to the operator of the business as trustee for and on account of Cherokee County. The room occupancy tax levied under this act shall be added to the sales price and shall be passed on to the purchaser instead of being borne by the operator of the business. The county shall design, print, and furnish to all appropriate businesses in the county the necessary forms for filing returns and instructions to ensure the full collection of the tax.~~

'Sec. 5. ~~Disposition of Taxes Collected.~~Distribution and use of tax revenue. – Cherokee County ~~shall~~ shall, on a quarterly basis, remit the net proceeds of ~~all revenues received from~~ the room occupancy tax to the Cherokee County Tourism Development Authority.~~Authority appointed pursuant to this act.~~ The Authority shall use at least two-thirds of the funds remitted to it under this act to promote travel and tourism in Cherokee County and shall use the remainder for tourism-related expenditures. ~~"Net proceeds" means gross proceeds less the cost to the county of administering and collecting the tax. The Authority may expend these funds only to further the development of travel, tourism, and conventions in the county through advertising and promotion.~~

The following definitions apply in this section:

(1) Net proceeds. – Gross proceeds less the cost to the county of administering and collecting the tax, as determined by the finance officer, not to exceed three percent (3%) of the first five hundred thousand dollars ($500,000) of gross proceeds collected each year and one percent (1%) of the remaining gross receipts collected each year.

(2) Promote travel and tourism. – To advertise or market an area or activity, publish and distribute pamphlets and other materials, conduct market research, or engage in similar promotional activities that attract

tourists or business travelers to the area. The term includes administrative expenses incurred in engaging in the listed activities.

(3) Tourism-related expenditures. – Expenditures that, in the judgment of the Tourism Development Authority, are designed to increase the use of lodging facilities, meeting facilities, or convention facilities in a county or to attract tourists or business travelers to the county. The term includes tourism-related capital expenditures.

'Sec. 6. ~~Appointment, Duties of~~ Cherokee County Tourism Development Authority.~~–~~

(a) Appointment and membership. – When the Cherokee County Board of Commissioners adopts a resolution levying a room occupancy ~~tax,~~ tax under this act, it shall also adopt a resolution creating a County Tourism Development ~~Authority composed of the director of the Cherokee County Chamber of Commerce and the following four members appointed by the Cherokee County Board of Commissioners:~~

~~(1) an owner of a hotel, motel, or other accommodations subject to the tax levied by this act;~~

~~(2) a member of the board of county commissioners;~~

~~(3) a town commissioner or the mayor of the Town of Murphy; and~~

~~(4) a town alderman or the mayor of the Town of Andrews.~~

~~The director of the Cherokee County Chamber of Commerce shall serve as an ex officio member of the Authority. The members appointed by the board of county commissioners shall serve three- year terms, except the initial appointees. Of the initial appointees, the board of commissioners shall designate one to serve a one-year term, two a two-year term, and one a three-year term. Vacancies created by an appointed member shall be filled by the board of commissioners. Members appointed to fill vacancies shall serve the remainder of the unexpired term for which they are appointed to fill.~~ Authority, which shall be a public authority under the Local Government Budget and Fiscal Control Act. The resolution shall provide for the membership of the Authority, including the members' terms of office, and for the filling of vacancies on the Authority. At least one-third of the members must be individuals who are affiliated with businesses that collect the tax in the county, and at least one-half of the members must be individuals who are currently active in the promotion of travel and tourism in the county. The board of commissioners shall designate one member of the Authority as chair and shall determine the compensation, if any, to be paid to members of the Authority.

The Authority shall meet at the call of the chair and shall adopt rules of procedure to govern its meetings. The Finance Officer for Cherokee County shall be the ex officio finance officer of the Authority.

(b) Duties. – The Authority shall expend the net proceeds of the tax levied under this act for the purposes provided in this act. The Authority shall promote travel, tourism, and conventions in the county, sponsor tourist-related events and activities in the county, and finance tourist-related capital projects in the county. ~~The members of the Tourism Development Authority shall elect from its membership a chairman. The Authority shall meet at the call of the chairman and shall adopt rules of procedure to~~

~~govern its meetings. The finance officer of Cherokee County shall serve ex officio as accountant for the Authority.~~

(c) Reports. – The ~~Tourism Development~~ Authority shall report quarterly and at the close of the fiscal year to the board of county commissioners on its receipts and disbursements for the preceding quarter and for the year in such detail as the board may require.

'~~Sec. 7. Repeal of Levy.~~

~~(a) The board of county commissioners may by resolution repeal the levy of the room occupancy tax in Cherokee County, but no repeal of taxes levied under this act is effective until the end of the fiscal year in which the repeal resolution was adopted.~~

~~(b) No liability for any tax levied under this act that attached prior to the date on which a levy is repealed is discharged as a result of the repeal, and no right to a refund of a tax that accrued prior to the effective date on which a levy is repealed may be denied as a result of the repeal.~~

'Sec. 8. This act is effective upon ratification."

SECTION 18. The catchline for Section 21(j) of S.L. 2007-527 reads as rewritten:

"**SECTION 21.(j)** Subsection (a) of Section 4 of Chapter 929 of the 1985 Session ~~Laws as amended by S.L.1985-929~~ Laws, as amended by Chapter 319 of the 1987 Session Laws, reads as rewritten:"

SECTION 19. Section 1(b) of S.L. 2005-68 reads as rewritten:

"**SECTION 1.(b)** Administration. – Except as otherwise provided in this act, a tax levied under this section shall be levied, administered, and collected as provided in Part IV of Chapter 908 of the 1983 Session Laws, as amended by Chapters 821 and 922 of the 1989 Session ~~Laws and S.L. 2001-402.~~ Laws, S.L. 2001-402, and Section 21(cc) of S.L. 2007-527. The penalties provided in Part IV of Chapter 908 of the 1983 Session Laws, as amended by Chapters 821 and 922 of the 1989 Session Laws and S.L. 2001-402, apply to a tax levied under this section."

MOTOR FUEL TAX CHANGES

SECTION 20. G.S. 105-449.72 is amended by adding a new subsection to read:

"(f) Exemption. – The requirement to obtain a bond or irrevocable letter of credit does not apply to a distributor, importer, or motor fuel transporter that supplies motor fuel when the market for motor fuel is disrupted and emergency supplies are needed, as identified by an executive order of the Governor."

SECTION 21. G.S. 105-449.121(b)(2) reads as rewritten:

"(2) Audit a distributor, a retailer, a ~~bulk end user,~~ bulk end-user, or a motor fuel user that is not licensed under this Article."

SECTION 22. G.S. 105-449.136 reads as rewritten:

"**§ 105-449.136. Tax on alternative fuel.**

A tax at the motor fuel rate is imposed on liquid alternative fuel used to operate a highway vehicle by means of a vehicle supply tank that stores fuel only for the purpose of supplying fuel to operate the vehicle. A tax at the equivalent of the motor fuel rate is

imposed on all other alternative fuel used to operate a highway vehicle. The Secretary must determine the equivalent rate. The exemptions from the tax on motor fuel in ~~G.S. 105-449.88(2), (3), and (4)~~ G.S. 105-449.88 apply to the tax imposed by this section. The refunds for motor fuel tax allowed by Part 5 of Article 36C of this Chapter apply to the tax imposed by this section, except that the refund allowed by G.S. 105-449.107(b) for certain vehicles that use power takeoffs does not apply to a vehicle whose use of alternative fuel is taxed on the basis of miles driven. The proceeds of the tax imposed by this section must be allocated in accordance with G.S. 105-449.125."

OTHER CHANGES

SECTION 23. Section 67(a) of S.L. 2008-134 reads as rewritten:

"**SECTION 67.(a)** G.S. ~~58-5-25(a)(2)~~58-6-25(a)(2) is repealed."

SECTION 24.(a) G.S. 153A-156.1 reads as rewritten:

"**§ 153A-156.1. (For effective date, see note) Heavy equipment gross receipts tax in lieu of property tax.**

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

(1) Heavy equipment. – Earthmoving, construction, or industrial equipment that is mobile, weighs at least 1,500 pounds, and meets any of the descriptions listed in this subdivision. The term includes an attachment for heavy equipment, regardless of the weight of the attachment.

a. It is a self-propelled vehicle that is not designed to be driven on a highway.

b. It is industrial lift equipment, industrial material handling equipment, industrial electrical generation equipment, or a similar piece of industrial equipment.

(2) Short-term lease or rental. – Defined in G.S. 105-187.1.

(b) Tax Authorized. – A county may, by ~~resolution,~~ordinance, impose a tax at the rate of one and two-tenths percent (1.2%) on the gross receipts from the short-term lease or rental of heavy equipment by a person whose principal business is the short-term lease or rental of heavy equipment at retail. The heavy equipment subject to this tax is exempt from property tax under G.S. 105-275, and this tax provides an alternative to a property tax on the equipment. A person is not considered to be in the short-term lease or rental business if the majority of the person's lease and rental gross receipts are derived from leases and rentals to a person who is a related person under G.S. 105-163.010.

The tax authorized by this section applies to gross receipts that are subject to tax under G.S. 105-164.4(a)(2). Gross receipts from the short-term lease or rental of heavy equipment are subject to a tax imposed by a county under this section if the place of business from which the heavy equipment is delivered is located in the county.

(c) Payment. – A person whose principal business is the short-term lease or rental of heavy equipment is required to remit a tax imposed by this section to the county finance officer. The tax is payable quarterly and is due by the last day of the month following the end of the quarter. The tax is intended to be added to the amount

charged for the short-term lease or rental of heavy equipment and paid to the heavy equipment business by the person to whom the heavy equipment is leased or rented.

(d) Enforcement. – The penalties and collection remedies that apply to the payment of sales and use taxes under Article 5 of Chapter 105 of the General Statutes apply to a tax imposed under this section. The county finance officer has the same authority as the Secretary of Revenue in imposing these penalties and remedies.

(e) Effective Date. – A tax imposed under this section becomes effective on the date set in the ~~resolution~~ ordinance imposing the tax. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted.

(f) Repeal. – A county may, by ~~resolution,~~ ordinance, repeal a tax imposed under this section. The repeal is effective on the date set in the ~~resolution.~~ ordinance. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted."

SECTION 24.(b) G.S. 160A-215.2 reads as rewritten:

"**§ 160A-215.2. (For effective date, see note) Heavy equipment gross receipts tax in lieu of property tax.**

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

(1) Heavy equipment. – Defined in G.S. 153A-156.1.

(2) Short-term lease or rental. – Defined in G.S. 105-187.1.

(b) Tax Authorized. – A city may, by ~~resolution,~~ ordinance, impose a tax at the rate of eight tenths percent (0.8%) on the gross receipts from the short-term lease or rental of heavy equipment by a person whose principal business is the short-term lease or rental of heavy equipment at retail. The heavy equipment subject to this tax is exempt from property tax under G.S. 105-275, and this tax provides an alternative to a property tax on the equipment. A person is not considered to be in the short-term lease or rental business if the majority of the person's lease and rental gross receipts are derived from leases and rentals to a person who is a related person under G.S. 105-163.010.

The tax authorized by this section applies to gross receipts that are subject to tax under G.S. 105-164.4(a)(2). Gross receipts from the short-term lease or rental of heavy equipment are subject to a tax imposed by a city under this section if the place of business from which the heavy equipment is delivered is located in the city.

(c) Payment. – A person whose principal business is the short-term lease or rental of heavy equipment is required to remit a tax imposed by this section to the city finance officer. The tax is payable quarterly and is due by the last day of the month following the end of the quarter. The tax is intended to be added to the amount charged for the short-term lease or rental of heavy equipment and paid to the heavy equipment business by the person to whom the heavy equipment is leased or rented.

(d) Enforcement. – The penalties and collection remedies that apply to the payment of sales and use taxes under Article 5 of Chapter 105 of the General Statutes apply to a tax imposed under this section. The city finance officer has the same authority as the Secretary of Revenue in imposing these penalties and remedies.

(e) Effective Date. – A tax imposed under this section becomes effective on the date set in the ~~resolution~~ ordinance imposing the tax. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted.

(f) Repeal. – A city may, by ~~resolution,~~ ordinance, repeal a tax imposed under this section. The repeal is effective on the date set in the ~~resolution.~~ ordinance. The date must be the first day of a calendar quarter and may not be sooner than the first day of the calendar quarter that begins at least two months after the date the ~~resolution~~ ordinance is adopted."

SECTION 24.(c) This section does not affect the rights or liabilities of a county or city, a taxpayer, or another person arising under G.S. 160A-215.2 or G.S. 153A-156.1 before the effective date of this section; nor does it affect the right to any refund or credit of a tax that accrued under G.S. 160A-215.2 or G.S. 153A-156.1 before the effective date of this section. All existing ordinances or resolutions enacted under G.S. 160A-215.2 or G.S. 153A-156.1 prior to the effective date of this section shall continue in full force and effect until repealed, modified, or amended.

EFFECTIVE DATE

SECTION 25. Except as otherwise provided, this act is effective when it becomes law.

BILL ANALYSIS

DRAFT BILL 2009-SVz-4: Revenue Laws Technical, Administrative, & Clarifying Changes

Committee:	Revenue Laws Study Committee	**Date:**	January 7, 2009
Introduced by:		**Summary by:**	Trina Griffin, Cindy Avrette, & Martha Walston Committee Counsel
Version:	Draft		

SUMMARY: ***This legislative proposal makes several technical, clarifying, and administrative changes to the revenue laws and related statutes.***

BILL ANALYSIS: This draft proposal makes the following technical, clarifying, and administrative changes:

Section	Explanation
Corporate, Excise, and Insurance Taxes	
1	Adds associate home inspectors to the State privilege license provision enacted last year for home inspectors so that associate home inspectors will be taxed similarly. S.L. 2008-206 imposed an annual State privilege license tax of $50 on a home inspector licensed under the Home Inspector Act. The Home Inspector Act also licenses associate home inspectors, which are defined separately. However, they were not included in the law change. Without this change, associate home inspectors would be subject to local privilege license tax in each city that levies the tax.
2	Changes the term 'nonbusiness activities' to 'activities producing nonapportionable income', which is a defined term in the statute that sets out the manner in which corporations must allocate and apportion their income to North Carolina for income tax purposes. In 2002, the terms 'business income' and 'nonbusiness income' were replaced by apportionable and nonapportionable. This subsection was missed when those changes were made.
3	Changes an incorrect statutory reference.
4	Corrects an effective date relating to changes made to the statute designating who may sign an income tax return. These changes were originally part of the major rewrite of the tax appeals procedure in 2007 (SB 242).
5(a) & (b)	Changes the date by which the State Treasurer must make a transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund. The current statute provides that ***within 75 days after the end of each fiscal year***, the Treasurer must transfer to the Fund an amount equal to the growth in net revenue from the gross premiums tax on insurance companies. Insurance tax returns are due by March 15. Insurance companies are also required to prepay their tax in installments. The first installment of the fiscal year is due by October 15. Therefore, until those installments are remitted, little or no funds are available for transfer. This section changes the date from within 75 days after the end of the fiscal year, or September 14, to November 1, as recommended by the Department of Revenue.

Sales and Use Tax Changes	
6	Replaces the word 'energy' with the word 'electricity' for consistency. This term appears in the statute enacted last year authorizing a sales tax refund for materials used to build a facility that manufactures solar electricity generating materials.
7	Corrects two incorrect statutory references.
Property Tax Changes	
8(a) & (b)	Reinserts the words 'shares' and 'residence', which were inadvertently deleted when changes were made in 2008 to the circuit breaker statute.
9	Makes a conforming change to the statute that sets out the application procedure for property tax exemption related to the exemption for drug samples enacted last year.
10	Clarifies that in order for property to be excluded from tax, it must first satisfy any statutory application requirements.
11(a) & (b)	Clarifies treatment of property owned by husband and wife as tenants by the entirety as opposed to tenants in common when qualifying for the homestead exclusion. If owned in tenancy by the entirety, only one spouse has to meet the age or disability requirement.
12	Makes the following clarifying and technical changes to the homestead circuit breaker: • Defines deferred taxes. • Clarifies that the property owned by a qualifying owner must have been the owner's permanent residence for at least five consecutive years but that the owner's five-year occupancy does not have to be consecutive. • Clarifies that the occupancy requirement refers to "length" of occupancy. • Removes an unnecessary word. • Clarifies that only the deferred taxes for the last three years prior to the disqualifying event become due and payable. • Clarifies that notice of the sum of deferred taxes and interest that are due and payable must be sent annually to the mailing address of the residence subject to the circuit breaker benefit as opposed to mailing notice to each owner of the property.
13	Makes the following clarifying changes to the disabled veteran homestead exclusion: • Clarifies that the exclusion is available to a disabled veteran who "received" instead of "receives" federal benefits to adapt his or her housing, since these benefits are generally a one-time payment. • Clarifies that if the permanent residence is owned by spouses as tenants by the entirety, only one spouse has to meet the exclusion requirements.
14	Makes the following conforming changes to the statute that sets out the application procedure for property tax exemptions: • Adds drug samples to the list of exempt property not requiring an application. • Adds solar energy electric systems to the list of property excluded from taxation that must file a single application. • Adds working waterfront property to the list of property classified for taxation

	at reduced valuation that must file a single application • Makes a technical correction.
15	Repeals an unnecessary statute.
16	Clarifies that the amount of taxes that a tax collector must report on a tax certificate includes any deferred taxes.
Occupancy Tax Changes	
17	Adds a Session Law reference that was inadvertently omitted when the Cherokee County local occupancy tax act was amended last year. In 2007, a number of local occupancy tax local acts were amended to change the due date for remitting occupancy tax proceeds and filing returns from the 15th to the 20th of the month to conform to current sales tax statutes. The Cherokee County local occupancy tax act was one of the acts so amended. However, when the rest of the local act was amended in 2008, the 2007 change was not incorporated. To make this technical change, the entire local act must be set out under drafting convention. However, no substantive change is being made.
18	Corrects an incorrect Session Law reference.
19	Adds to S.L. 2005-68, a Session Law reference to the 2007 act referenced above that made changes to a number of local occupancy tax acts related to the due date of the tax and return. S.L. 2005-68 is the act that authorized the additional occupancy tax to finance the NASCAR Hall of Fame Museum.
Motor Fuel Tax Changes	
20	Provides an exception to the requirement that a distributor, importer, or motor fuel transporter must obtain a bond or irrevocable letter of credit when the person is supplying motor fuel into the State because the market for motor fuel has been disrupted and emergency supplies are needed, as identified by an executive order of the Governor. The bonding requirement became an issue during the recent motor fuel supply shortages in the western part of the State.
21	Corrects a misspelled word.
22	Conforms the tax exemptions for alternative fuel to the tax exemptions for motor fuel.
Other Changes	
23	Corrects an incorrect statutory reference.
24(a) & (b)	Replaces the word 'resolution' with the word 'ordinance' in each of the statutes authorizing cities and counties to levy a gross receipts tax in lieu of a property tax on the short-term rental of heavy equipment.

APPENDIX A

AUTHORIZING LEGISLATION
ARTICLE 12L OF CHAPTER 120
OF THE
GENERAL STATUTES

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

ARTICLE 12L

Revenue Laws Study Committee

§ 120-70.105. Creation and membership of the Revenue Laws Study Committee.

(a) Membership. -- The Revenue Laws Study Committee is established. The Committee consists of 16 members as follows:

(1) Eight members appointed by the President Pro Tempore of the Senate; the persons appointed may be members of the Senate or public members.

(2) Eight members appointed by the Speaker of the House of Representatives; the persons appointed may be members of the House of Representatives or public members.

(b) Terms. -- Terms on the Committee are for two years and begin on January 15 of each odd-numbered year, except the terms of the initial members, which begin on appointment. Legislative members may complete a term of service on the Committee even if they do not seek reelection or are not reelected to the General Assembly, but resignation or removal from service in the General Assembly constitutes resignation or removal from service on the Committee.

A member continues to serve until a successor is appointed. A vacancy shall be filled within 30 days by the officer who made the original appointment. (1997-483, s. 14.1; 1998-98, s. 39.)

§ 120-70.106. Purpose and powers of Committee.

(a) The Revenue Laws Study Committee may:

(1) Study the revenue laws of North Carolina and the administration of those laws.

(2) Review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable.

(3) Call upon the Department of Revenue to cooperate with it in the study of the revenue laws.

(4) Report to the General Assembly at the beginning of each regular session concerning its determinations of needed changes in the State's revenue laws.

These powers, which are enumerated by way of illustration, shall be liberally construed to provide for the maximum review by the Committee of all revenue law matters in this State.

(b) The Committee may make interim reports to the General Assembly on matters for which it may report to a regular session of the General Assembly. A report to the General Assembly may contain any legislation needed to implement a recommendation of the Committee. When a recommendation of the Committee, if enacted, would result in an increase or decrease in State revenues, the report of the Committee must include an estimate of the amount of the increase or decrease. (1997-483, s. 14.1.)

§ 120-70.107. Organization of Committee.

(a) The President Pro Tempore of the Senate and the Speaker of the House of Representatives shall each designate a cochair of the Revenue Laws Study Committee. The Committee shall meet upon the joint call of the cochairs.

(b) A quorum of the Committee is nine members. No action may be taken except by a majority vote at a meeting at which a quorum is present. While in the discharge of its official duties, the Committee has the powers of a joint committee under G.S. 120-19 and G.S. 120-19.1 through G.S. 120-19.4.

(c) The Committee shall be funded by the Legislative Services Commission from appropriations made to the General Assembly for that purpose. Members of the Committee receive subsistence and travel expenses as provided in G.S. 120-3.1 and G.S. 138-5. The Committee may contract for consultants or hire employees in accordance with G.S. 120-32.02. Upon approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional staff to assist the Committee in its work. Upon the direction of the Legislative Services Commission, the Supervisors of Clerks of the Senate and of the House of Representatives shall assign clerical staff to the Committee. The expenses for clerical employees shall be borne by the Committee. (1997-483, s. 14.1.)

APPENDIX B

MEETING AGENDAS

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr | Rep. Paul Luebke

Wednesday, October 22, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. **Welcoming Remarks**

II. **Overview of 2008 Finance Law Changes and Fate of the Revenue Laws Study Committee's Recommendations to the 2008 General Assembly**
– Cindy Avrette, Research Division

III. **Budget Outlook**
– Barry Boardman, Fiscal Research Division

IV. **Overview of Issues Raised by Advancing the Reappraisal Schedule for Property Taxes (S.L. 2008-146 Property Tax Modifications)**
– Martha Walston, Fiscal Research Division

V. **Overview of Exemptions for Nonprofits**
– Trina Griffin, Research Division
– Rodney Bizzell, Fiscal Research Division
– Lee Dixon, Fiscal Research Division

Discussion of the Illinois *Provena Covenant Medical Center* Case
– Stan Jenkins, Supervisor of Assessments
Champaign County, Illinois

VI. **Adjournment**

Next Meeting Date: Wednesday, November 19, 2008
All meetings in Room 544, LOB at 9:30 a.m.

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr | Rep. Paul Luebke

Wednesday, November 19, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from October 22 Meeting

II. Update on Combined Reporting

- *Cindy Avrette, Research Division*
- *Mark Morton, General Counsel for Revenue Operations, West Virginia Tax Department*

III. Privilege License Taxes in North Carolina

- *Christopher McLaughlin, Assistant Professor of Public Law and Government, UNC School of Government*
- *Trina Griffin, Research Division*

IV. Sales Tax Treatment of Food vs. Prepared Food

- *Sandra Johnson, Fiscal Research Division*

V. Adjournment

Next Meeting Date: Monday, December 15, 2008
All meetings in room 544, LOB, at 9:30 a.m.

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr | Rep. Paul Luebke

Monday, December 15, 2008
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from November 19 Meeting

II. Alternative Methods of Business Taxation

- *Cindy Avrette, Research Division*
- *Karey Barton, Principal, Ryan, Austin, Texas*

III. Current Law on Combinations in North Carolina

- *Greg Radford, Department of Revenue*
- *Bill Nelson, Attorney, Smith Anderson Blount Dorsett Mitchell & Jernigan, LLP*

IV. Update on Privilege License Taxation Issue

Update on Fiscal Estimates

- *Rodney Bizzell, Fiscal Research Division*

Response and Comments

- *League of Municipalities*
- *Association of County Commissioners*

V. Overview of Issues Raised by Advancing the Reappraisal Schedule for Property Taxes

– Martha Walston, Fiscal Research Division

VI. Adjournment

Next Meeting Date: Wednesday, January 7, 2009
In Room 544 LOB, at 9:30 a.m.

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr | Rep. Paul Luebke

Wednesday, January 7, 2009
Room 544, Legislative Office Building
9:30 a.m.

I. Approval of Minutes from December 15 Meeting

II. Review of Property Tax Recommendations

– Martha Walston, Fiscal Research Division

III. IRC Update

– Heather Fennell, Research Division
– Barry Boardman, Fiscal Research Division

IV. Taxation for the Digital Age

– Trina Griffin, Research Division

V. Resale of Tickets via the Internet & 2009 Sunset

– Cindy Avrette, Research Division

VI. Update on Streamlined Sales Tax Project

–Andy Sabol, Department of Revenue

VII. Comments on Changing the Corporate Tax Structure

– Andy Ellen, Retail Merchants Association
– Mark Prak, Brooks, Pierce, McLendon, Humphrey & Leonard
– John McAlister, NC Chamber
– Joseph Crosby, COST

Next Meeting Date: Wednesday, January 21, 2009
In Room 544 LOB, at 9:30 a.m.

VIII. Revenue Laws Technical and Administrative Changes – Part I

– Trina Griffin, Research Division

IX. Adjournment

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr | Rep. Paul Luebke

Tuesday, January 27, 2009
Room 1228, Legislative Building
9:30 a.m.

I. Approval of Minutes from January 7 Meeting

II. Department of Revenue

- Introduction of Secretary-Elect, Kenneth Lay
- Reports:
  - Revenue Generated from Captive REIT Provision, *William Spencer, Department of Revenue*
  - Small Business Protection Act, Quality Control Improvements, *Linda Millsaps, Department of Revenue*

III. North Carolina Hospital Association

- Report on Charity Care and Community Benefit Data, *Hugh Tilson*

IV. Budget Outlook Update

- Barry Boardman, Fiscal Research Division

V. Legislative Proposals For Consideration

- #1: IRC Update

Heather Fennell, Research Division

- #2: Modernize Corporate Income Tax Filings

Cindy Avrette, Research Division

- #3: Streamlined Sales and Use Tax Update

Cindy Avrette, Research Division

- #4: Real Property Sales Information

Martha Walston, Fiscal Research Division

- #5: Modernize Sales Tax Statutes/Digital Products

Trina Griffin, Research Division

  - *Comments from Brooks Raiford, President & CEO, NC Technology Association*

- #6: Revenue Laws Technical, Administrative, & Clarifying Changes -
  - Part I – *Trina Griffin, Research Division*
  - Part II (Property Tax Changes) – *Martha Walston, Fiscal Research Division*

APPENDIX C

DISPOSITION OF COMMITTEE'S RECOMMENDATIONS TO THE 2008 SESSION OF THE 2007 GENERAL ASSEMBLY

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

SHORT TITLE	SENATE SPONSORS	HOUSE SPONSORS	BILL #	FINAL STATUS*
Procedure for Tax Class Actions	Clodfelter		SB 1715	Enacted* SL 2008-107, Sec. 28.28(a) (Budget Bill)
IRC Update	Kerr	Luebke, Wainwright, Weiss, Gibson	HB 2416 SB 1939	Enacted SL 2008-107, Sec. 28.1(a) (Budget Bill)
Corporate Tax Law Changes		Gibson, Luebke, Wainwright, Weiss	HB 2508	Enacted* SL 2008-107, Sec. 28.7(a) (Budget Bill) SL 2008-107, Sec. 28.8(a) (Budget Bill)
Estate and Gift Tax Law Changes	Hoyle		SB 1756	Enacted* SL 2008-107, Sec. 28.17(a) (Budget Bill) SL 2008-107, Sec. 28.18(a) (Budget Bill) SL 2008-107, Sec. 28.18(b) (Budget Bill)
Deferred Property Tax Program Changes	Clodfelter	Brubaker, Hill	SB 1876 HB 2483	Enacted* SL 2008-35
Property Tax Modifications	Clodfelter	Brubaker, Hill	SB 1878 HB 2476	Enacted* SL 2008-146
Exempt Disaster Assistance Debit Sales	Hartsell		SB 1703	Enacted SL 2008-107, Sec. 28.6(a) (Budget Bill)
Revenue Laws Technical, Clarifying & Administrative Changes	Hartsell	Luebke, Gibson, Wainwright, Weiss	SB 1704 HB 2352	Enacted* SL 2008-134
Tax on Short-Term Heavy Equipment Rentals	Brunstetter	Saunders	SB 1852 HB 2446	Enacted* SL 2008-144
Extend R & D Credit	Hoyle	Weiss, Luebke, Wainwright, Gibson	SB 1755 HB 2336	Enacted* SL 2008-107, Sec. 28.2(a) (Budget Bill)

* Bills were modified prior to enactment.

SHORT TITLE	SENATE SPONSORS	HOUSE SPONSORS	BILL #	FINAL STATUS*
Extend State Ports Tax Credit	**Boseman**	**McComas, Wainwright, Gibson**	HB 2366 SB 1731	**Enacted** **SL 2008-107, Sec. 28.5(a) (Budget Bill)**
Expand Small Business Health Benefits Credit		**Weiss, Luebke, Wainwright, Gibson**	HB 2335	**Enacted*** **SL 2008-107, Sec. 28.9A(a) (Budget Bill)**
Sunset Recycling Facility Credits	**Hoyle**	**Wainwright, Gibson**	SB 1747 HB 2472	Not enacted
Supplemental PEG Support	**Clodfelter**	**Luebke, Brubaker, Hill, McComas**	SB 1716 HB 2342	**Enacted*** **SL 2008-148**

* Bills were modified prior to enactment.

APPENDIX D

REMARKS FROM BROOKS RAIFORD, PRESIDENT & CEO NORTH CAROLINA TECHNOLOGY ASSOCIATION

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

NCTA
North Carolina Technology Association

North Carolina General Assembly
Revenue Laws Study Committee
January 27, 2009

Remarks from:
Brooks Raiford, President & CEO
North Carolina Technology Association

Mr. Chairman, thank you for the opportunity to speak briefly today about the issue of digital taxation.

My name is Brooks Raiford, and I serve as the new president of the North Carolina Technology Association, known as NCTA, which has 400 member companies of all sizes, primarily from the technology sector. We just had our Annual Meeting a couple of weeks ago, and noted to our Members that our agenda for 2009 is driven by three things: jobs, jobs, and jobs. A significant number of people in North Carolina depend on the technology sector to support them and their families. Not only are there over 100,000 information technology workers in North Carolina, but many technology-oriented companies of course have non-IT workers as well who depend on the financial health of their employer.

So as you consider changes to the tax laws, we want to offer some comments. We don't come today with a blanket objection to taxes – our member firms pay income, payroll, and property taxes, among others. We do ask that as you explore revisions to the tax structure, that you remain mindful of several considerations:

- We're concerned about the impact on both the consumer and on commerce of new or increased taxes during an economic downturn, so would urge that new taxes not be imposed .

- We would emphasize the importance of the technology sector to the state's current and future economy, and would object to the technology sector being singled out for new taxation when there are dozens of examples of other cases of various sales tax exemptions.

- As you consider digital taxation, we would encourage you to note that purchasing digital products encourages "green" commerce – it avoids packaging, along with reducing the need for buildings and physical infrastructure to support the sale and distribution of hard copies of software, books, etc.

The General Assembly has been a great partner over the years in recognizing the impact of these companies and these workers. For example:

- This past Session, you encouraged the creation of jobs and growth of companies here by extending the R&D Tax Credit for five years, and raised the cap on the Qualified Business Ventures credit, which encourages investment in early-stage companies.

- In the 2007 Session, you encouraged software development in North Carolina by reducing the sales tax for equipment used in R&D for software development.

- Also in that Session, you encouraged research at our colleges and universities by increasing the tax credit percentage for R&D done in North Carolina, including at our colleges and universities.

So there is a history of tax policy that enhances the growth of the increasingly important technology sector in our state.
We understand the desire to streamline and make the imposition of sales taxes more fair, and appreciate the willingness of the Committee and staff to hear from those affected. Our request is that the technology sector not be singled out for changes, and that deliberate care is taken to avoid any unintended consequences of changing the definitions of what is taxed and how.
Mr. Chairman, you and the Committee staff have been generous in allowing our input to this point, and we'd ask that we continue to be included in discussions as legislation moves forward.
Thank you for giving me these few minutes to share our comments.

For more information, please contact:
Brooks Raiford, President & CEO
North Carolina Technology Association
4020 Westchase Boulevard, Suite 350
Raleigh, NC 27650
919-856-0393, ext. 224
braiford@nctechnology.org
www.nctechnology.org

APPENDIX E

LIST OF COUNTIES IMPACTED BY 2008 LEGISLATION ADVANCING REAPPRAISAL SCHEDULE

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

SALES RATIO (Shaded Counties are Impacted By 2008 Legislation)						
County	2007 Population Estimates	2008 Sales Ratio	Parcel Count	Last Reval	Current Cycle Length	Next Reval
Gates	11,819	0.4350	9,000	2001	8	2009
Pamlico	12,947	0.4841	14,300	2004	8	2012
Graham	8,144	0.5164	8,675	2002	8	2010
Mitchell	15,950	0.5419	16,300	2001	8	2009
Clay	10,326	0.5549	15,500	2002	8	2010
Pender	50,430	0.5566	43,500	2003	8	2011
Warren	19,919	0.5996	22,200	2001	8	2009
Polk	19,040	0.6080	15,500	2001	8	2009
Madison	33,626	0.6546	20,000	2004	8	2012
Craven	96,406	0.6615	52,600	2002	8	2010
Swain	13,889	0.6629	11,250	2005	4	2009
Anson	25,332	0.6769	19,500	2002	8	2010
Beaufort	46,070	0.6802	43,000	2002	8	2010
Avery	18,292	0.7107	23,295	2006	8	2014
Montgomery	27,588	0.7200	30,500	2004	8	2012
Hyde	5,447	0.7243	8,500	2003	6	2009
Martin	20,495	0.7291	15,500	2001	8	2009
Edgecombe	51,813	0.7597	30,000	2001	8	2009
Duplin	53,133	0.7800	36,500	2001	8	2009
Tyrrell	4,290	0.7834	5,000	2005	4	2009
Watauga	44,696	0.7838	44,600	2006	4	2010
Ashe	26,003	0.7896	36,500	2006	5	2011
Orange	127,344	0.7933	52,500	2005	4	2009
Transylvania	30,758	0.7971	31,000	2002	7	2009
McDowell	23,906	0.8000	27,000	2003	8	2011
Sampson	64,522	0.8160	49,500	2003	8	2011
Cumberland	313,616	0.8172	129,000	2003	6	2009
Stanly	59,158	0.8191	37,500	2005	4	2009
Nash	92,915	0.8192	49,300	2001	8	2009
Harnett	106,506	0.8198	57,000	2003	6	2009
Onslow	169,302	0.8270	62,665	2006	4	2010
Wayne	115,225	0.8281	62,000	2003	8	2011
Mecklenburg	863,147	0.8290	322,000	2003	6	2009
Hertford	23,730	0.8324	15,500	2003	8	2011
Buncombe	225,609	0.8360	110,000	2006	4	2010
Haywood	57,031	0.8415	48,500	2006	4	2010
Robeson	129,425	0.8440	73,000	2005	5	2010
Columbus	54,460	0.8466	41,700	2005	8	2013
Currituck	23,731	0.8537	23,500	2005	8	2013
Yadkin	37,850	0.8542	28,000	2005	4	2009
Johnston	157,296	0.8555	81,000	2003	8	2011
Pasquotank	40,880	0.8578	20,113	2006	8	2014
Caldwell	79,376	0.8585	51,500	2005	4	2009
Washington	13,214	0.8607	9,800	2005	8	2013
Granville	55,667	0.8610	27,800	2002	8	2010
Halifax	55,352	0.8624	38,237	2007	8	2015
Alamance	143,154	0.8708	67,200	2001	8	2009
Jones	10,315	0.8744	8,500	2006	8	2014
Rockingham	91,646	0.8808	52,000	2003	6	2009
Bertie	19,971	0.8809	18,000	2004	8	2012
Scotland	36,830	0.8820	23,500	2003	8	2011
Chatham	59,168	0.8863	36,200	2005	4	2009
Person	37,640	0.8903	28,100	2005	4	2009

County	2007 Population Estimates	2008 Sales Ratio	Parcel Count	Last Reval	Current Cycle Length	Next Reval
Alleghany	11,088	0.8909	16,200	2007	8	2015
Stokes	46,257	0.8947	29,000	2005	4	2009
Greene	21,110	0.8981	11,000	2005	8	2013
Franklin	56,456	0.9013	37,500	2004	6	2010
Bladen	32,500	0.9069	31,213	2007	8	2015
Henderson	102,142	0.9075	72,000	2007	4	2011
Davie	40,447	0.9094	23,700	2005	4	2009
Lenoir	57,642	0.9105	34,500	2001	8	2009
Guilford	460,780	0.9160	200,000	2004	8	2012
Northampton	21,235	0.9180	19,700	2007	4	2011
Iredell	150,421	0.9210	89,000	2007	4	2011
Forsyth	338,679	0.9210	132,000	2005	4	2009
Randolph	139,422	0.9243	80,000	2007	6	2013
Dare	34,272	0.9246	41,700	2005	5	2010
Wilkes	67,182	0.9297	50,000	2007	4	2011
Rutherford	62,926	0.9324	53,500	2007	4	2011
Gaston	200,972	0.9327	102,523	2007	4	2011
New Hanover	189,922	0.9369	93,000	2007	4	2011
Lee	56,376	0.9394	30,531	2007	4	2011
Camden	9,519	0.9411	8,000	2007	8	2015
Moore	83,932	0.9412	66,654	2007	4	2011
Alexander	36,656	0.9474	23,000	2007	4	2011
Chowan	14,660	0.9516	12,100	2006	8	2014
Hoke	42,932	0.9556	22,000	2006	8	2014
Macon	44,064	0.9588	43,000	2007	4	2011
Burke	88,439	0.9641	55,000	2007	4	2011
Union	182,344	0.9645	86,500	2008	8	2016
Rowan	136,486	0.9672	81,200	2007	4	2011
Cleveland	97,144	0.9785	54,200	2008	4	2012
Catawba	153,404	0.9794	85,000	2007	4	2011
Brunswick	99,440	0.9807	130,000	2007	4	2011
Cherokee	27,026	0.9820	31,500	2008	4	2012
Carteret	63,294	0.9840	57,381	2007	4	2011
Surry	73,150	0.9878	39,800	2008	4	2012
Lincoln	72,776	0.9919	45,500	2008	4	2012
Pitt	151,970	0.9944	72,500	2008	4	2012
Yancey	18,550	0.9974	15,500	2008	8	2016
Wake	832,590	0.9991	314,000	2008	8	2016
Davidson	156,400	0.9998	92,000	2007	8	2015
Perquimans	12,722	1.0000	13,600	2008	8	2016
Caswell	23,508	1.0000	14,500	2008	4	2012
Jackson	36,815	1.0000	37,000	2008	4	2012
Vance	43,583	1.0000	25,000	2008	8	2016
Richmond	46,672	1.0000	30,500	2008	4	2012
Wilson	77,970	1.0000	36,500	2008	8	2016
Cabarrus	164,384	1.0000	77,500	2008	4	2012
Durham	254,740	1.0000	105,000	2008	8	2016

APPENDIX F

LIST OF COUNTIES THAT OBTAIN SALES INFORMATION OF REAL PROPERTY TRANSFERS

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

County	Does your County Send out Confirmation Letters?	Grantor, Grantee or Both	Does your County Require a Land Transfer Tax?	Is an Affidavit Required?
Alamance	NO		NO	
Alexander	YES	GRANTEE	NO	
Alleghany				
Anson				
Ashe	NO		NO	
Avery	YES	GRANTEE	NO*	
Beaufort	YES	GRANTEE	NO	
Bertie	YES	GRANTOR	NO	
Bladen	NO		NO	
Brunswick	YES	GRANTEE	NO	
Buncombe				
Burke	NO*		NO	
Cabarrus	YES	GRANTOR	NO	
Caldwell	YES		NO	
Camden	YES	BOTH	YES	YES
Carteret	YES	GRANTEE	NO	
Caswell	NO		NO	
Catawba				
Chatham	NO		NO	
Cherokee				
Chowan			YES	YES
Clay				
Cleveland	YES	GRANTEE	NO	
Columbus				
Craven	YES	GRANTEE	NO	
Cumberland	YES	GRANTEE	NO	
Currituck	NO		YES	YES*
Dare	NO		YES	YES*
Davidson	YES	GRANTEE	NO	
Davie	YES	GRANTEE	NO	
Duplin	NO		NO	
Durham	NO		NO	
Edgecombe	NO		NO	
Forsyth	YES*	BOTH		
Franklin	NO		NO	
Gaston	NO*		NO	
Gates	NO*		NO	
Graham	YES	GRANTEE	NO	
Granville	YES	BOTH	NO	
Greene	YES	GRANTEE	NO	
Guilford	YES*	GRANTOR	NO	
Halifax	NO		NO	
Harnett				
Haywood	YES	GRANTEE	NO	
Henderson	YES	GRANTEE	NO	
Hertford				
Hoke	YES	GRANTEE	NO	
Hyde				
Iredell	YES	BOTH	NO	
Jackson	YES	GRANTEE	NO	
Johnston	YES	GRANTEE	NO	
Jones	YES	BOTH	NO	
Lee	NO		NO	
Lenoir	YES	GRANTEE	NO	
Lincoln				
Macon	YES*	DID NOT SAY	NO	
Madison				
Martin	NO*			YES
McDowell	NO		NO	
Mecklenburg	YES	BOTH	NO	

County	Does your County Send out Confirmation Letters?	Grantor, Grantee or Both	Does your County Require a Land Transfer Tax?	Is an Affidavit Required?
Mitchell	NO		NO	
Montgomery	YES	GRANTEE	NO	
Moore	NO		NO	
Nash	YES	GRANTEE	NO	
New Hanover	YES	BOTH	NO	
Northampton	YES	BOTH	NO	
Onslow	YES	GRANTEE	NO	
Orange				
Pamlico	YES	GRANTEE	NO	
Pasquotank	NO		YES	YES
Pender	NO*		NO	
Perquimans				
Person	NO*		NO	
Pitt	YES	GRANTEE	NO	
Polk	NO		NO	
Randolph	YES	BOTH	NO	
Richmond	YES	GRANTEE	NO	
Robeson				
Rockingham	YES	GRANTEE	NO	
Rowan	YES	BOTH	NO	
Rutherford	YES	GRANTEE	NO	
Sampson				
Scotland	YES	GRANTEE	NO	
Stanly	NO		NO	
Stokes	NO		NO	
Surry	YES	BOTH	NO	
Swain	YES	GRANTEE	NO	
Transylvania	YES	BOTH	NO	
Tyrrell				
Union	YES	GRANTEE	NO	
Vance	NO		NO	
Wake	NO		NO	
Warren	YES	GRANTEE	NO	
Washington				
Watauga	YES*	GRANTEE	NO	
Wayne	NO		NO	
Wilkes	YES	GRANTEE	NO	
Wilson	NO		NO	
Yadkin	YES	GRANTEE	NO	
Yancey	NO		NO	

Avery	Considering imposing a transfer tax, it will be considered for the next general election.
Burke	We have a Conformation of Information Form that most attorneys complete and submit at the ROD.
Currituck	We require either an "Affidavit of Consideration or Value" or a copy of the sales contract. (We receive contracts about 20% of the time.□□
Dare	We required an affidavit or a copy of the sales contract.
Forsyth	Forsyth County uses qualification letters to both the grantor and grantee ONLY AFTER other methods are exhausted.
Gaston	We plan to do this in 2009 & 2010 for our 2011 reappraisal. Grantee only.
Gates	We ask for a confirmation form to be filled out at the time of recording.
Guilford	We have sent sales confirmation letters in the past, but did not in 2008. We may send out letters for 2009.
Macon	Yes we send out verification letters for prior two years leading up to a revaluation
Martin	We don't send out letters, but we do confirm selling price with the lawyer or who ever come is to the ROD. An affidavit is required.
Pender	We will start this procedure this month with revaluation. Probably Grantor only.
Person	We request sales information and new billing address from closing attorney prior to recording a deed.
Watauga	Randomly select sales to send confirmation letters.

Stats

Total # Counties Responded	# of Counties that Send a Confirmation Letter	# of Counties w/ a Transfer Tax
81	50	5
	Percentage	Percentage
	62%	6%

If you count Burke, Gaston, Gates, Pender & Person as sending out Confirmation Letters the percentage goes to 68%.

APPENDIX G

EXAMPLES OF
REAL PROPERTY SALES INFORMATION FORMS

CABARRUS COUNTY
DARE COUNTY
PERQUIMANS COUNTY

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

CABARRUS COUNTY 2008 APPRAISAL MANUAL

June 14, 2007

«M_2_____»
«M_3_____»
«M_4_____»
«M_5_____»
«M_6_____»«M_7_» «M_8_____»

Parcel Number:«M_10_____» Acct #:«M_1_____» Township:«M_24»
Legal Description: «M_11_____»«M_12_____»
Deed Book/Page:«M_26___»/«M_27__» Sales Date:«M_29»/2007

Congratulations on your recent purchase of real property. We extend our invitation to you to contact us or visit our office if you have any questions regarding your new property. In turn, we would appreciate your help. North Carolina law requires each county to conduct a sales-assessment ratio study that measures the sales price of real property in relation to the county's assessed value. This information is then used to adjust public service company values for taxation, determine funding for school facility needs and contribute to the fair and equitable assessment of all properties.

This questionnaire is strictly confidential and NOT open to public inspection. Please confirm the preprinted information above, complete the remainder of the form and return it within ten (10) days. We have enclosed a self-addressed, stamped envelope for your convenience. Please contact our Real Estate Appraisal Department at (704)920-2178 if you have any questions. Thank you for your assistance.

Cabarrus County Real Property Manager

Name of person completing form:_____

Daytime Telephone Number:(____)_____

1. Total Purchase Price:_____
2. Is this sale between relatives/related businesses? Yes___ No___
3. Was this an auction/foreclosure sale? Yes___ No___
4. Is the property being rented? Yes___ No___ Rent per month $_____
5. Was any personal property exchanged in this sale (mobile home, furniture, machinery, etc.)? Yes___ No___ If so, what? _____
6. Do you consider the total sales price to be the fair market value of the real estate on the date of the sale? Yes___ No___ If no, explain:

_____

7. At the time of purchase, was the property vacant land or was the home already built? (circle one)
8. Type of financing? Conventional ___ FHA ___ VA ___ Owner ___ Other ___ explain

_____

Signature:_____ Date:_____

Marcy Mann
Dare County
Transfer Tax
P O Box 1000
962 Marshall Collins Dr.
Manteo NC 27954
(252) 475-5956

AFFIDAVIT OF CONSIDERATION OR VALUE

TAX OFFICE USE ONLY

**COMPLETE ALL SECTIONS OF THIS AFFIDAVIT OR IT MAY BE REJECTED. AN AFFIDAVIT MAY BE REQUIRED WITH ANY INSTRUMENT CONVEYING REAL PROPERTY.

1. TRANSFER DATA

GRANTOR _____ GRANTEE_____
ADDRESS _____ ADDRESS_____
CITY, STATE_____CITY, STATE _____

2. PROPERTY LOCATION

TAX DISTRICT _____ TAX PARCEL ID_____

SUBDIVISION_____SECTION _____ BLOCK_____ LOT _____

PROPERTY DESCRIPTION CHECK ONE

Vacant Residential	Improved Residential	Condominium	Timeshares
Vacant Commercial	Improved Commercial	Townhouse	Co-ownership

3. CONSIDERATION OR VALUE DATE (ITEMS 1-5 MUST BE COMPLETED)

1. ACTUAL CASH CONSIDERATION _____
2. OTHER CONSIDERATION _____
3. TOTAL CONSIDERATION _____
4. FAIR MARKET VALUE _____
5. EXPLANATION OF ABOVE OR LEASE VALUE COMPUTATION

4. SIGNATURE AND NOTARY

Under the penalties of law, I declare that I have examined this Affidavit, including accompanying statements, and to the best of my knowledge and belief, it is true, complete and correct. I do declare that the above real estate has been reported at true market value.

SIGNATURE OF AFFIANT_____(SEAL) DATE_____

SWORN TO AND SUBSCRIBED BEFORE ME THIS_____ DAY OF_____, 20____ _____(NOTARY PUBLIC)

NOTARY SEAL

MY COMMISSION EXPIRES___ _____ ____ __

PERQUIMANS COUNTY, NC
AFFIDAVIT
REGARDING CONVEYANCE
OF REAL PROPERTY

P.O. Box 7
Hertford, NC 27944
Effective Date: October 10, 1992
Revised: May 23, 2007

FOR TAX OFFICE ONLY

I, the undersigned, being duly sworn says that the information set out below is true and correct to the best of my knowledge and belief.

1. GRANTOR(S) _____

2. GRANTEE(S) _____
ADDRESS: _____

PHONE #: _____

3. TOWNSHIP _____
4. SUBDIVISION _____
5. STATE ROAD _____
6. LOT SIZE _____
7. BUILDINGS _____
8. PARCEL NUMBER _____
9. TRANSFER:
STRAIGHT/COMPLETE _____
SPLIT/PARTIAL _____
10. ACREAGE
CLEARED _____
WOODED _____

11. CONSIDERATION/VALUE
CASH CONSIDERATION $ _____
OTHER CONSIDERATION $ _____
TOTAL CONSIDERATION $ _____
FOR TAX OFFICE USE ONLY
TRANSFER TAX
X 1% = $ _____

12. Who will assume the taxes for the current year? GRANTEE GRANTOR
13. Have any lots previously been conveyed from the tract from which this lot is being conveyed? (Since 01/01/76) YES NO
14. Has the subdivision of land been approved by the Perquimans County Planning Board or Subdivision Review Officer? YES NO
15. How was this property acquired? DEED BOOK _____ PAGE _____
WILL FILE _____ - E - _____
16. Does this transaction involve family members or between known affiliated companies? YES NO
17. Does this transaction include conveyance of personal property (mobile homes, household goods, machinery, equipment, etc.)? YES NO
18. Was this transaction as a result of a forced sale? YES NO

DATE: _____ SIGNATURE: _____

Sworn to and subscribed before me this _____th day of _____, year _____

_____ _____/_____/_____
Notary Public My commission expires

SEAL

APPENDIX H

NORTH CAROLINA HOSPITAL ASSOCIATION
REPORT ON
CHARITY CARE AND COMMUNITY BENEFIT DATA

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

Mr. Don Dalton, All NCHA
ANDI Participation Update **Requests Reports** **Help** **Log Out**

Community Benefit Report

Hospital or Group Name	**All NCHA Members**
Time Period	**FY 2007**
Statistic Type	**Total**
Last Updated	1/27/2009 9:39 am
Number of Completed Surveys	106

Community Benefits

A. Estimated Costs of Treating Charity Care Patients*	$503,021,411
B. Estimated Unreimbursed Costs of Treating Medicare Patients*	$653,578,040
C. This includes an adjustment in this period's Medicare revenues for extraordinary adjustments2 of:	$ 54,731,976
D. Without this Medicare adjustment, Medicare Losses would have been (B + C):	$708,484,530
E. Estimated Unreimbursed Costs of Treating Medicaid Patients*	$324,342,641
F. This includes an adjustment in this period's Medicaid revenues for extraordinary adjustments2 of:	$ 69,822,891
G. Without this Medicaid adjustment, Medicaid Losses would have been (E + F):	$394,165,532
H. Estimated Unreimbursed Costs of Treating Patients from Other Non-Negotiated Government Programs*	$ 23,003,141
I. This includes an adjustment in this period's Other Non-Negotiated Government Programs revenues for extraordinary adjustments2 of:	$ 12,519,835
J. Without this adjustment, Other Non-Negotiated Government Programs Losses would have been (H + I):	$ 35,522,976
K. Community Health Improvement Services & Community Benefit Operations	$ 44,251,356
L. Health Professions Education	$258,608,026
M. Subsidized Health Services3	$280,629,382

N. Research Costs	$ 4,071,920
O. Cash and In-kind Contributions to Community Groups	$ 49,245,465
P. Community Building Activities4	$ 9,203,559

Q. Total Community Benefits1 with Settlements and Extraordinary Adjustments (A + B + E + H + K + L + M + N + O + P) $2,148,889,482

R. Total Community Benefits1 without Settlements and Extraordinary Adjustments (A + D + G + J + K + L + M + N + O + P)

$2,286,138,69

8

Bad Debt Costs

S. Estimated Costs of Treating Bad Debt Patients* $ 592,347,112

Notes:

(1) Grant monies received to support any community benefit activities. These amounts have not been netted from Total Community Benefits.

$61,789,21

8

(2) Notes about prior period adjustments
(3) Notes about Subsidized Health Services
(4) Notes about Community Building Activities
(5) URL with additional information about this community benefits report
(6) Other Notes

«Back To Reports

If you see any statistic in any report that looks odd to you, please email andi@ncha.org us and let us know. All we need is the column and line description that looks suspicious. Thank you.

Report Error Key

divide by zero error	The formula for this item includes division and when your value was being calculated, it was determined to have a denominator value of zero.
N/A	There is an error in your hospital's response to this report item and no answer will be returned until corrected.

n/a error This number cannot be calculated. Possible reasons include

- It is (0/0)
- you have asked for a standard deviation based on one number (2 is minimum number of valid responses required in order to calculate a standard deviation.)
- A necessary threshold of variation has not been met.
- A facility "weight" statistics has been requested, but there is an error in the facility's answer (so it can't be used in the weighted average).

no supporting survey error	This report item is dependent upon information in another survey which has not been released yet, or is for a pre-ANDI (prior to FiscalYear 2003) time period.
not answered error	One or more of the questions needed to calculate this report item were not answered in this survey. Often this is because the question was accidentally left blank (signifying "Missing Value") rather than having a zero in it.
not completed error	This survey has not been completed by this hospital.
not in survey error	One or more of the questions needed to calculate this report item were not asked in this survey (so ANDI could not calculate a value). Try selecting a different survey.
out of range error	Your value for this report item is considered either too high or too low and is suspected of being incorrect. If

the value is correct, please contact me so that I can adjust the range to accept this value.

too few resp error

The number of valid responses is less that the group's minimum number of facilities needed to calculate aggregate or rank statistics. In the first five years of ANDI we learned how many responses are needed to get a stable average (one that doesn't change much when another facility marks its survey complete). In general averages reach the first level of stability at 65%, but they really stop moving with each newly completed survey at 80% (this is the overall reponse rate statistic). We have restricted ANDI to not show averages where participation rates are below that first threshold (65%). In this way you can have more confidence that the averages you can see today are relatively stable averages. We recommend that you always add a column for the overall response rate when asking for any group statistic.

Export Options

HTML Table Export

The HTML Table option outputs the data from this page into a new Web page. Most ANDI users will be able to select the commands in the *Edit* menu to *Select All*, and then *Copy*, the data, then switch to Excel and *Paste* the data into a spreadsheet. For detailed export instructions, please see the FAQ.

Delimited Export

The Semicolon-Delimited option outputs the data into a new Web page with semicolon-delimited values. Most ANDI users will be able to select the commands in the *Edit* menu to *Select All*, and then *Copy*, the data, then switch to Excel and *Paste* the data into a spreadsheet. For detailed export instructions, please see the FAQ.

This page was generated on January 29, 2009 8:37 AM

APPENDIX I

NORTH CAROLINA DEPARTMENT OF REVENUE
REPORT ON
REVENUE GENERATED
FROM CAPTIVE REIT PROVISION

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

January 27, 2009

Report to

The Revenue Laws Study Committee

Amount of Corporate Income Tax Revenue Generated by the Requirement that Captive REITS Add Dividends Paid to Taxable Income

Tax Year 2007

As required by Section 31.18.(d) of Session Law 2007-323, this is to report that the amount of corporate income tax revenue generated in the 2007 taxable year by the addition of dividends paid by captive REITs to taxable income required by G.S. 105-130.5(a)(19) is $ 12,805,806.

APPENDIX J

NORTH CAROLINA DEPARTMENT OF REVENUE
REPORT ON
CUSTOMER SERVICE INITIATIVES

ALL MATERIALS DISTRIBUTED AT MEETINGS MAY BE VIEWED ON THE COMMITTEE'S WEBSITE:
http://www.ncleg.net/committees/

North Carolina Department of Revenue

Beverly Eaves Perdue
Governor

January 27, 2009

Kenneth R. Lay
Secretary

MEMORANDUM

TO: The Honorable Marc Basnight
President Pro Tempore

Senator John H. Kerr, III
Revenue Laws Study Committee Chairman

The Honorable Joe Hackney
Speaker of the House

Representative Paul Luebke
Revenue Laws Study Committee Chairman

FROM: Kenneth R. Lay
Secretary of Revenue

SUBJECT: Customer Service Initiatives

This report is prepared pursuant to Session Law 2008-107, Section 28.16(i) and addresses customer service initiatives undertaken by the Department of Revenue. The report covers five specific reporting requirements contained in the statute.

The Department has taken a comprehensive approach to customer service improvement. Delivering quality service to taxpayers and other constituents is a key strategic objective of the agency. The Department, in an effort to focus attention on this strategic objective, conducted service excellence training sessions in the fall of 2008. Over 1,400 agency personnel attended a total of 57 training sessions. This training emphasized the need to provide quality customer service in all instances, equipped employees with several tools and techniques for providing such service, and provided feedback on additional training and quality improvement issues to be considered in future efforts made by the agency regarding this important issue.

The agency also crafted a service excellence vision and nine guiding principles supporting this vision. This information became a focal point of the training efforts and other discussions about customer service improvement.

The remainder of this report provides specific information related to the five reporting requirements contained in Section 28.16(i):

P.O. Box 25000, Raleigh, North Carolina 27640
Phone (919) 733-7211

1. *Efforts to ensure that inquiries on complicated tax matters are handled or reviewed by appropriate personnel within the Department.*

Standard operating procedures for taxpayer inbound calls have been reviewed and enhanced. The procedures cover agency employees located at our Taxpayer Assistance and Call Center (TACC) and Taxpayer Assistance personnel located in Raleigh and in our service centers across the state. These procedures insure that employees with the requisite technical knowledge address complicated tax matters for various tax types.

The improved procedures also addressed several relevant points:

(a) Additional and divisions on complex tax issues frequent training for personnel
(b) Development of frequently asked questions with periodic updates
(c) Enhancement and evaluations of the competency level of personnel responding to tax matters
(d) Improved internal communication flow for complex tax matters
(e) Consultation with Tax Administration

At each service center location across the state, Taxpayer Assistance managers serve as the primary contact for complicated tax matters. The managers address tax matters in consultation with administrative officers with this division based in Raleigh.

2. A review of the Department's efforts to provide accurate and timely information regarding changes in tax law resulting from legislative changes, court decisions, or revised interpretations.

The Department's efforts to provide accurate and timely information are noted in the following actions:

(1) The 2008 Tax Law Changes publication was placed on the DOR website on September 12, 2008. The publication documents the law changes enacted in 2008 and laws changes enacted in prior legislative sessions that affect 2008 tax returns. (applies to all tax schedules)

(2) The Corporate, Excise and Insurance Tax Division published a 2008 Supplement to the 2007/2008 Rules and Bulletins that modified the sections of the Rules and Bulletins that were affected by law changes enacted during the 2008 legislative session. The supplement was posted to the Department's website on September 26, 2008.

(3) Our Corporate, Excise and Insurance Tax Division developed a document titled "Important Notice Regarding Requirement for Licensed Home Inspectors to Obtain a State Privilege License" which was sent via e-mail to the North Carolina Home Inspector Licensure Board. The Board subsequently distributed the document to all of its licensed home inspectors. Form B-202A, Application for State Privilege License, was revised to include home inspectors in the list of occupations that requires a license.

(4) Created and added to the Department's website a Hot Topic titled "Internet Resale of Admission Tickets". Form TR-110, Internet Resale of Admission Tickets Report, was developed and added to the website.

(5) Refund of Unsaleable Other Tobacco Products - Form B-A-101R, was renamed and revised to reflect that the refund provision is no longer limited to cigars.

(6) Tax forms and instructions are revised each year to reflect law changes. The instructions include a section titled "Important Legislative Changes for 2008" that addresses law changes.

(7) The Department maintains on its website information about the tax credit allowed to a film production company in the form of frequently asked questions. That information was revised on August 22, 2008 to reflect legislative changes in 2008 and other policy changes.

(8) The Corporate, Excise and Insurance Tax Division published two Directives during 2008, both of which are available on the Department's website. Directive CD 08-1, dated January 23, 2008, addressed the allocation of premium income from group life insurance policies. Directive CD 08-2, dated September 15, 2008, revised the Department's guidelines for renewable energy tax credit

(9) The Personal Taxes Division revised the Individual Income, Gift, and Estate Tax Bulletins to reflect all law and administrative tax changes and posted the info to the website, including a special notice about the new earned income tax credit.

(10) All general information for Personal Taxes schedules on the website has been updated to reflect any law or administrative changes.

(11) The 2008 individual income tax return instructions include language on the front of the booklet highlighting the law changes.

(12) Personal Taxes posted a notice to the website on Jan. 6, 2009 regarding the administrative position on the addback treatment for bonus depreciation.

(13) Motor Fuels provides all licensed taxpayers with an annual notice of tax law changes. This is usually mailed to the taxpayer in the Fall. We also send these notices to the NC Petroleum Marketers Association and the NC Trucking Association to be included in their monthly newsletters. All correspondence is placed on the web for further reference.

3. A review of the Department's outreach efforts designed to assist taxpayers, particularly small business taxpayers, in complying with the State's tax laws.

The Department's outreach efforts to small businesses fall into two primary categories:

- Creating new communications and outreach channels to small business owners and entrepreneurs
- Improving the Department's existing outreach and education efforts

New Communication and Outreach Channels

The Department established a partnership with the Community College System in August 2008 in an effort to assist small businesses to better under tax laws by providing free seminars at each of the 58 community college locations across our state. The seminars continue in 2009 and cover five key topics:

1. Tax implications for starting a business
2. Tax implications for growing a business
3. The basics of sales and use tax
4. The basics of withholding taxes
5. Dealing with the N.C. Department of Revenue.

In the first four months of the program, more than 250 small business owners and entrepreneurs attended tax seminars at the community colleges. Feedback from the attendees has been very positive, with most of the seminars rated as excellent or very good.

The N.C. Community College System Small Business Center Network also launched a website, www.sbcn.nc.gov, with a section dedicated to tax information provided by the Revenue Department. The site is a one-stop resource for small business owners and offers a variety of helpful information such as entrepreneurship training, guides and tools for starting a business, information on government contracts and business publications. Small business owners can sign up for confidential one-on-one counseling through the website.

The site also features a section from the Department of Revenue that focuses specifically on tax issues for small business owners. The key items are tax obligations, current announcements

from the Department, a tax checklist for starting a business, a guide for getting tax assistance and a list of helpful links for small businesses. The tax section is located at: www.sbcn.nc.gov/taxInfo/default.aspx

The Department has also begun issuing "plain-English" announcements about topics such as tax law changes, new electronic services, compliance issues and new reporting and filing requirements. Some of these announcements are more general and others are targeted at specific types of businesses. The announcements are similar to news releases and are designed for organizations to use in newsletters or on websites. They offer easy-to-understand explanations of complex tax issues and links to the Department's website for additional information. They are specifically designed for small business owners who operate without the help of accountants, attorneys or tax preparers.

The announcements that apply to most businesses are sent to a network of organizations that include the North Carolina Chamber of Commerce, the North Carolina Retail Merchants Association (more than 25,000 members), local chambers of commerce across the state, business incubator organizations like the Upper Coastal Plains Council of Governments and the Rural Center. They have been sent by these organizations to members in e-mails, have appeared on websites, been published in newsletters and have gone out in broadcast faxes. The announcements have covered topics including:

1. The introduction of the new online file and pay system for businesses.
2. The introduction of the new online business registration system.
3. The introduction of the partnership with the Small Business Center Network.
4. The sales tax holiday.
5. A change in reporting for alcoholic beverage excise tax returns.
6. The phase-out of the excise tax on piped natural gas.

Many of these same announcements are also sent to tax preparer organizations like the N.C. Association of CPAs and the N.C. Society of Tax Professionals. These organizations also use the announcements frequently, which helps the Department reach businesses that employ professional tax preparation assistance.

Improving Existing Outreach Efforts

Department representatives have always been available to speak to groups of taxpayers about tax issues. This year the Department began offering public speaking training to its tax experts to improve the quality of its outreach efforts. This training covers the basics of public speaking, translating tax jargon into plain language and answering questions effectively in light of the Small Business Protection Act. It also includes a practical exercise in which the attendees make a presentation to their colleagues and receive feedback. Approximately 50 people have gone through the training and the feedback has been tremendous. Many of the attendees have reported back on how their presentations have improved and on the positive responses from their audiences.

The Department offers a comprehensive website as an information resource for taxpayers (including small business owners). Newcomers to the site often report that it is difficult to navigate and that they don't know which tax laws apply to them. In one of the first steps toward improving the site, the Department launched a Taxpayer Education section on the site. This new section helps taxpayers (including small business owners) navigate the site and find the information they need. It provides shortcuts to:

- Information about Tax Seminars and Presentations offered by the Department
- Current Tax Announcements
- Technical Bulletins, Directives and Notices
- Brochures and other Publications

This section was just launched recently. The Department will continue adding more content to make the section more robust and useful for small business owners.

Our Motor Fuels Division conducts annual motor carrier seminars throughout the State, usually during the month of August. In 2008, we conducted 2 seminars in Hickory, 1 in Charlotte, 1 in Asheboro, 1 in Greenville, 1 in Wilmington, and 1 in Cary. There was 56% attendance based on registration forms. Approximately 400 taxpayers attended the seminars. We have been conducting motor carrier seminars since 1999.

4 A review of the Department's efforts to ensure that taxpayers are informed of their rights to request written advice from the Department upon which they may reasonably rely.

The Department maintains a website section entitled "Verbal Advice" that addresses both verbal and written advice. It explains how a taxpayer can request written advice, as well as when and how the Department will document verbal advice given to a taxpayer.

This information is also included in the Department's 2008 Tax Law Change document. It was included in the sales and use tax law change information sent to all registered taxpayers.

Our tax seminars conducted at the Small Business Centers also include information on how to get help and information from the Department. Most of the instructors cover written advice regardless of the seminar topic. The seminar on Dealing with the Department covers the common interactions small business owners have with the Department. It includes specific information on how a taxpayer can request written advice.

5. A review of the Department's plan to record telephone calls at the Department's Taxpayer Assistance Center.

The Department has evaluated call recording software for the TACC. A Service Level Request for call recording will be submitted after a final price quote is provided by ITS.

KRL/at

North Carolina Department of Revenue

Beverly Eaves Purdue
Governor

Kenneth R. Lay
Secretary

February 1, 2009

MEMORANDUM

TO: The Honorable Marc Basnight
President Pro Tempore

Senator John H. Kerr, III
Revenue Laws Study Committee Chairman

The Honorable Joe Hackney
Speaker of the House

Representative Paul Luebke
Revenue Laws Study Committee Chairman

FROM: Kenneth R. Lay
Secretary of Revenue

SUBJECT: Semi-Annual Report:
Tax Compliance Initiatives and Results, July 1, 2008 – December 31, 2008
Revenue Projections, July 1, 2008-June 30, 2009

This semi-annual report is prepared pursuant to G.S. 105-256(a)(8). This report reflects the combined efforts of our Collection, Examination, and Taxpayer Assistance Divisions within our Tax Compliance organization in the Department of Revenue (DOR).

Our Tax Compliance personnel focus on enforcement of the revenue laws and education of the citizens of our state about compliance requirements. Our plan for addressing non-compliance and enhancing voluntary compliance consists of numerous initiatives implemented by this agency. These initiatives are determined through various analytical techniques utilized to monitor areas of non-compliance within our voluntary tax system. Once identified, we allocate Departmental resources to recover lost General Fund revenue.

P.O. Box 25000, Raleigh, North Carolina 27640
Phone (919) 733-7211
State Courier 51-71-00
Website: www.dornc.com
An Equal Opportunity Employer

Exhibit 1 lists the Department's existing initiatives to increase compliance with the tax laws.

Exhibit 2 reflects revenue projections from the combined efforts noted in this report. These revenue projections are estimates by tax type and are presented for the fiscal year July 1, 2008 – June 30, 2009.

Exhibit 3 lists some of the key initiatives that are part of the Department's long-term collection plan for the fiscal year 2008-2009.

Exhibit 4 provides the results of our combined collection efforts. The exhibit provides information regarding the age and collection of assessments for the period July 1, 2008 through December 31, 2008.

Exhibit 5 reflects the total of tax debt collections by tax type for the period July 1, 2008 – December 31, 2008.

Exhibit 6 is a summary, for July 1, 2008 through December 31, 2008, on the use of the proceeds of the 20% collection assistance fee imposed by G.S. 105-243.1.

Exhibit 1 - Department's Existing Initiatives

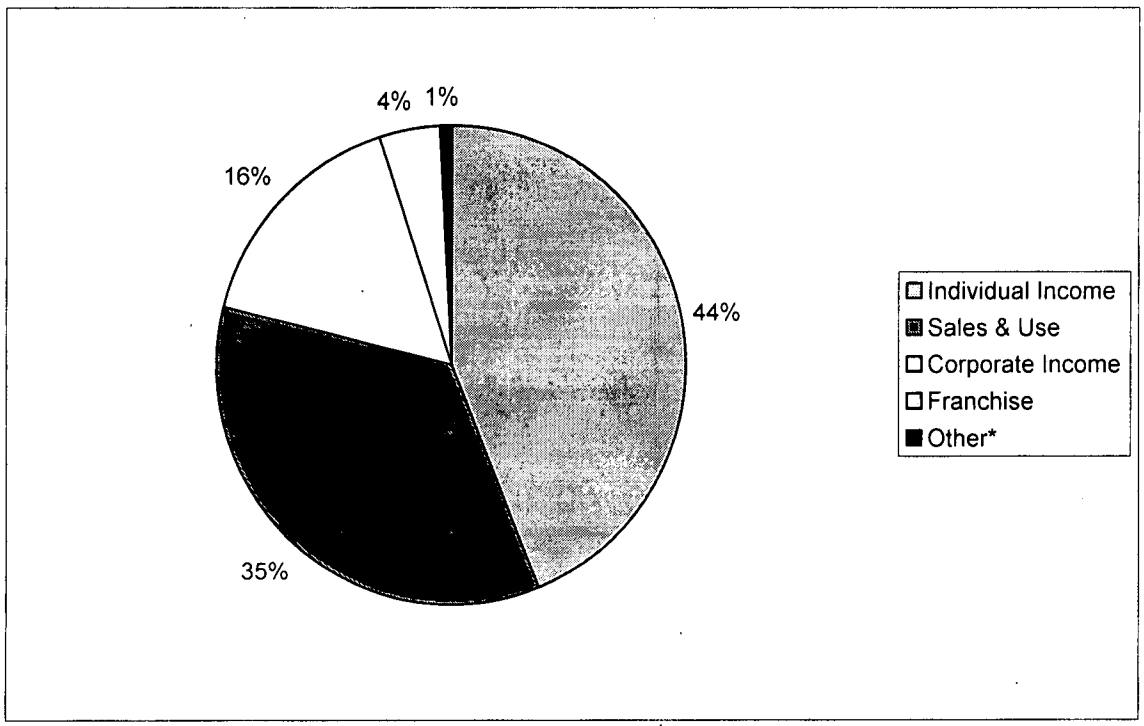
Abusive Tax Avoidance Transactions (ATAT) – DOR and IRS share information to identify and recapture lost revenue as a result of individuals and corporations involvement in abusive tax avoidance transactions. DOR's most recent focus involves conservation easement donation audit cases where taxpayers have engaged in transactions designed to improperly inflate the value assigned to an easement.
Audit Selection Criteria – The Department's Integrated Tax Administration System (ITAS) allows the Examination Division to identify taxpayers that meet certain selection criteria through the use of queries to the system. Those taxpayers meeting the selected criteria are identified as potential audit candidates and will be assigned for examination.
Automated Installment Agreements – The Department works with taxpayers to establish installment payment agreements to repay past-due tax debts.
Bankruptcy Processing – The Bankruptcy Unit within our Collection Division processes and maintains all aspects of cases involving taxpayers who have filed for protection under the US Bankruptcy Code.
Consumer Use Tax – Many North Carolina residents fail to remit and pay the proper use tax on purchases of tangible personal property obtained from vendors outside this state. This agency utilizes a number of matching data sources to identify these purchases. The U.S. Customs Service, Wildlife Resource Commission, Southeastern Association of Tax Administrators, and manufacturers of all terrain vehicles and watercraft provide these data sources.
Corporate Income and Franchise Taxes: Non-Filers –This examination initiative identifies non-filers from ITAS and external data sources. The Employment Security Commission, Internal Revenue Service (IRS), and Secretary of State furnish the external data sources to the Department.
Criminal Procedures – Regionally based revenue officers work with local district attorneys to develop and prosecute misdemeanor cases of willful failure to file or pay state taxes.
E-File – Specific criteria are used to query electronically filed tax returns to identify fraudulent preparers, fictitious, and abusive tax returns. Identified tax returns are selected for potential audit candidates.
Federal Refund Offsets – DOR sends debt information to the Internal Revenue Service which offsets any federal tax refunds due for repayment of state tax debts.
Fraudulent Preparer Return – These are returns that have been completed by a "paid tax preparer" and which contain false or fictitious itemized deductions and/or Schedule C business losses. The preparer cases are referred to the Criminal Investigation Division for possible prosecution. At the conclusion of the investigation by CID or prosecution of the "paid preparer", the individual income tax returns of the *clients* of the "paid preparer" are referred for examination.
Guest Workers – DOR has identified tax returns filed under an ITIN that utilize a false social security number to claim tax withheld. Examination of identified tax returns under this initiative indicates excessive allowances and erroneous filing status. A separate initiative utilizes federal extract tapes to identify ITIN holders that are recipients of 1099 misc. income. Examinations under this initiative indicate the identified ITIN holders are generally non-filers and should be classified as employees subject to withholding tax.

Exhibit 1 (continued)

Individual Income - Schedule A & C – Audit selection criteria identify potential individual income tax returns with abusive Schedule A and/or Schedule C deductions. These returns overstate itemized deductions. Other returns filed with Schedule C will understate gross business income and/or overstate business expenses.
Individual Income Tax Non-Filers – This initiative identifies North Carolina residents that file federal tax returns but do not file state individual income tax returns based on information provided under the Federal Data Extract Program.
Jeopardy Assessments – When the Department determines that collection of an account is in jeopardy, the law allows the Department to assess non-filed periods and immediately begin the collection process. This action is used primarily to collect business trust taxes.
Large Corporate Cases/Income Shifting – This initiative addresses a number of tax avoidance techniques utilized by corporations to shift net income from taxation by this state through inter-company transactions within a consolidated group or to create expenses between wholly owned subsidiaries to reduce net income taxable in this state.
Levy Officer Program – NC Gen. Stat. §105-242(b) gives the Department the authority to seize and sell personal property. Eight specially trained revenue officers perform this function for the Department.
NC-3: Employer Withholding Reports – This examination initiative focuses on employer withholding reports and identifies employees with no state income tax withheld or under-withheld based on gross wages.
Non-Filer Cross Tax Type Match – The Department's Integrated Tax Administration System (ITAS) allows the Examination Division to match taxpayer information against the system to determine if the taxpayer is properly registered for appropriate tax schedule(s).
Non-Resident Real Estate Conveyances –Non-resident individual income tax non-filers are identified from Form 1099NRS or electronically through County register of deeds offices. Non-residents are required to file a North Carolina income tax return and report any income that is derived from North Carolina sources, including income that is attributable to the ownership in real property located in this state.
Offer-In-Compromise – NC Gen. Stat. §105-237.1 provides authority to the Secretary to settle tax debt for an amount less that the full amount due in certain limited situations, generally involving financial hardship.
On-Line Notice Payments – The Department provides a system that permits taxpayers to pay tax bills on-line using credit cards or ACH bank drafts.
Responsible Corporate Officers – Responsibility for certain business taxes owed by businesses can be transferred to responsible corporate officers and partners of limited liability companies. This process is used frequently to collect past due business trust taxes such as sales or withholding tax.
Revenue Agent Reports (RAR) – Through the Federal Data Exchange Program, the Internal Revenue Service furnishes to DOR copies of federal audit reports conducted on individuals and corporations. This information is received pursuant to Internal Revenue Code Section 6103(d) and results in subsequent changes to North Carolina tax liability.
Tax Credits – The focus of this examination initiative involves the eligibility and proper calculation of tax credits for individuals and corporations.
Voluntary Disclosure Program-This initiative is designed to promote compliance among taxpayers, which have not previously registered or filed a return with the Department and want to voluntarily discharge a tax liability.

Exhibit 2 - Revenue Projections by Tax Type
July 1, 2008 – June 30, 2009

Tax Type		Collections
Individual Income*	$	235,400,000
Sales & Use		187,250,000
Corporate Income		85,600,000
Franchise		22,470,000
Other**		4,280,000
Total Revenue Projected	***$***	***535,000,000***



*** Individual Income includes: individual income taxes, employer withholding taxes and amounts due on partnership returns.**
**** Other includes: license and excise taxes, insurance premium tax, and estate/gift taxes.**

Exhibit 3 - Long-Term Collection Plan
July 1, 2008 – June 30, 2009

The Collection Division has developed a comprehensive long-term collection plan. The primary elements of the plan include key strategies and initiatives as identified below.

Long Term Collection Plan

- **Improved Information Exchange**— Significant effort is directed to improving collaboration and sharing best practices among the five DOR divisions with primary responsibility for general tax compliance and the collection of delinquent taxes

- **Increased Use of Special Procedures**—Expanded use of all collection tools, including a more strategic use of jeopardy assessments, transferee liabilities, and successor liabilities.

- **Organizational Focus**— The Taxpayer Assistance and Collection Center (TACC) is fully integrated into the Department's collection program. This integration allows the TACC to act upon lower dollar cases and lower yield per case. Highly trained revenue officers located throughout the state in our field offices work higher value and more complex collection cases. This strategy enables the Department to boost revenue generation through the efficient allocation of valuable resources, and greater attention to current collection cases (less than 120 days old). Under this strategy, the right collection resources are applied to the right case at the right time.

- **Performance Measures**— The Collection Division continues to track performance of the collection program through various performance measures. Collections are tracked at the division, office and individual collector level. The data from this tracking effort is used to devise better, more efficient strategies for collection of taxes and to allocate resources in an effective manner.

- **Reduce Accounts Receivable** – The Collection Division manages the accounts receivable for most of the General Fund taxes levied by the State of North Carolina. Additionally, the Department collects certain tax debts that are distributed back to municipal governments across North Carolina. The Department has been diligent in its efforts to discover and assess taxpayers that are attempting to avoid filing income taxes, hide income or embellish deductions and credits. The Collection Division is aggressively working to collect accounts receivable during fiscal year 2008-2009.

Exhibit 4 -Tax Debt Collections by Age of Account
July 1, 2008 – December 31, 2008

Age of Assessments	20% Fee Warning Letters	Other DOR Collection Efforts	Totals
0-30 days	$	$8,163,516	$8,163,516
31-60 days		$17,633,368	$17,633,368
61-90 days	$2,277,282	$13,860,306	$16,137,588
91-120 days	$8,318,517	$25,300,567	$33,619,084
121-180 days	$6,567,779	$29,281,721	$35,849,500
181-365 days	$2,365,263	$37,143,460	$39,508,723
366-730 days	$1,661,356	$16,732,214	$18,393,570
Older than 730 days	$118,287	$3,394,103	$3,512,390
Totals	$21,308,484	$151,509,255	$172,817,739

Total Final Assessment and Delinquent Collections	$172,817,739
Collections – Proposed Audit Assessments	$125,210,098
Grand Total- Tax Debt Collections (July 1, 2008 – December 31, 2008)	**$298,027,837**

Exhibit 5
Grand Total -Tax Debt Collections By Tax Type
July 1, 2008 – December 31, 2008

Tax Type	July	August	September	October	November	December	Total
Individual Income *	$23,923,302	$20,341,627	$21,386,858	$22,120,550	$21,291,567	$21,194,459	$130,258,362
Sales & Use	$14,940,650	$14,594,493	$9,947,758	$17,977,302	$11,069,362	$46,552,164	$115,081,729
Corporate	$1,765,042	$1,415,800	$11,046,332	$27,877,042	$1,338,203	$508,937	$43,951,356
Franchise	$1,635,851	$376,817	$587,776	$2,113,748	$1,551,640	-$524,277	$5,741,556
Other **	$486,884	$147,911	$182,063	$262,535	$1,338,802	$576,639	$2,994,834
TOTAL	$42,751,729	$36,876,648	$43,150,787	$70,351,177	$36,589,574	$68,307,922	$298,027,837

*** Individual Income includes: individual income taxes, employer withholding taxes and any amounts due on partnership returns.**
**** Other includes: license and excise taxes, insurance premium tax, and estate/gift taxes.**

Exhibit 6 -Use of Proceeds of 20% Collection Assistance Fee
July 1, 2008 – December 31, 2008

20% Collection Assistance Fee Expenditures Related to Collection of Overdue Tax Debts

	FY 2008-2009	TOTAL
14700/1660 - Examination and Collection		
Salaries and Benefits (140 Positions)	$3,638,427	**$3,638,427**
14700/1661 - Project Collect Tax		
Salaries and Benefits (52 Positions)	$1,383,122	
Contractual Services	72,870	
Maintenance	26,021	
Travel	4,859	
Communication and Data Processing	212,475	
Supplies	7,228	
Equipment (Office, Hardware and Software)	9,708	
Legal Expenses	32,544	
Other Administrative Expenses	1,939	**$1,750,766**
14700/1662 - Taxpayer Call Center		
Salaries and Benefits (109 Positions)	$1,905,618	
Contractual Services	4,325	
Utility/Energy Services	13,082	
Maintenance	18,204	
Rent/Leases	433,097	
Travel	27,488	
Communication and Data Processing	535,051	
Supplies	617	
Equipment (Office, Hardware and Software)	14,858	
Other Administrative Expenses	1,168	**$2,953,508**
GRAND TOTAL		**$8,342,701**

State of North Carolina
Department of the Secretary of State

ELAINE F. MARSHALL
SECRETARY OF STATE

MEMORANDUM

To: Revenue Laws Study Committee

From: Gene Laviner, Securities Division

Date: September 25, 2008

Subject: **Qualified Business Registration 2008 Annual Report**

Enclosed for your review is the Qualified Business Registration 2008 Annual Report pursuant to §105-163.013(g). The report has been created in an Excel spreadsheet format. Since the spreadsheet is too long to print on one letter size sheet, the report had to be put on multiple legal size pages. The information is divided into four (4) parts. The format is as follows:

Report to the Revenue Laws Study Committee
Attachment A – Business Name and Place of Business
Attachment B – Number of Jobs Created, Average Wages Paid, & Minority Status
Attachment C – Brief Description of Business Activity

If you have any questions, I may be contacted at 919-733-3924.

PO BOX 29622 • RALEIGH, NC 27626-0622

State of North Carolina
Department of the Secretary of State

ELAINE F. MARSHALL
SECRETARY OF STATE

REPORT TO THE REVENUE LAWS STUDY COMMISSION

Qualified Business Registration 2008 Annual Report

(As of October 2008*)

Number of Registrations	**151**
Number of Minority Owned Businesses	**6**
Number of Jobs Created	**706**
Total Average Wages Paid	**$31,228.96**

*These figures reflect the time period from October 2007 through October 2008, and includes Qualified Business Ventures that have been revoked by operation of law but may still choose to reinstate their QBV status pursuant to G.S.§ 105-163.013(b).

PO BOX 29622 • RALEIGH, NC 27626-0622

Business Name	Type	Authorized Representative	Place of Business	Address 2	City	State	Zip
A Bunch of Us Productions, LLC	QBV	Terry J. Lineham, Manager	517 Charlotte Ave.		Carolina Beach	NC	28428
AC-2, LLC	QBV	Mr. Paul W. Skillicorn, Manaager	101 West Harper Street		Snow Hill	NC	28580
Addrenex Pharmaceutical, Inc.	Grantee	Mr. Moise Khayrallah, President	4825 Creekstone Drive	Suite 100	Durham	NC	27703
Advanced Digital Systems, Inc.	QBV	Ms. Carolee E. Nail, VP Opperations	P.O. Box 12076	2 Davis Drive	RTP	NC	27709
Advanced Liquid Logic Inc.	Grantee	Mr. Richard M. West, President & CEO	615 Davis Drive, Suite 800	P O Box 14025	RTP	NC	27709
Affinergy, Inc.	Grantee	Mr. Jonathan Gindes, CFO&Sr. VP	617 Davis Drive, Suite 100	PO Box 14650	RTP	NC	27709
Aldagen, Inc.	QBV	Mr. Edward L. Field, President	2810 Meridian Parkway	Suite 148	Durham	NC	27713
Alpha Theory, LLC	QBV	Mr. Cameron Hight, President	327 Wilby Drive		Charlotte	NC	28270
Arbor Pharmaceutical, Inc.	QBV	Mr. Jarrett Disbrow, President & CEO	4505 Falls of the Neuse Rd.	Suite 420	Raleigh	NC	27609
Arbovax, Inc.	QBV	Mr. Malcolm Thomas, President &CEO	617 Hutton Street	Suite 101	Raleigh	NC	27606
ArtusLabs, Inc.	QBV	Mr. Robin Smith, President	4220 Hwy 55, Suite 160	Suit 160	Durham	NC	27713
Asklepios Biopharmaceutical, Inc.	Grantee	Mr. Richard J. Samulski, CEO	45 N. Chatham Parkway		Chapel Hill	NC	27517
Atomfan . Com, Inc.	QBV	Mr. Robert Pozner, President	1 Landover Court		Durham	NC	27713
Aurora Enrichment Fund, L.L.C.	Grantee	Mr. B. Jefferson Clark/Manager	2525 Meridian Parkway	Suite 220	Durham	NC	27713
Aurora Ventures IV, L.L.C.	Grantee	Mr. B. Jefferson Clark/Manager	2525 Meridian Parkway	Suite 220	Durham	NC	27713
Aurora Ventures V, L.P.	Grantee	Mr. B. Jefferson Clark/Manager	2525 Meridian Parkway	Suite 220	Durham	NC	27713
AvidXchange, Inc.	QBV	Mr. David Miller, President	4421 Stuart Andrew Blvd.	Suite 200	Charlotte	NC	28217
Beroe, Inc.	QBV	Mr. Amudhanvel Dhinagaravel, President & CEO	2054 Kildaire Farm Rd	PMB 430	Cary	NC	27518
BioMarck Pharmaceuticals, Ltd.	Grantee	Mr. Mark W. Mueller	7200 Falls of Neuse Rd., Suite 202		Raleigh	NC	27615
Biotechnology Research & Development, LLC	QBV	Mr. Paul W. Skillicorn, Manaager	101 West Harper Street		Snow Hill	NC	28580
Bioptigen, Inc.	QBV	Mr. Eric L. Buckland, President, CEO	112 Mariners Point Lane		Hickory	NC	28601
BioResource International, Inc.	QBV	Dr. Giles C. Shih, President	627 Davis Drive	Suite 600	Morrisville,	NC	27560
Blue Ridge Analytics, Inc.	QBV	Mr. Michael Detwiler, CEO	101 W. Worthington Ave.	Suite 206	Charlotte	NC	28203
Blue Ridge BioFuels, LLC	QBV	Mr. Briam Winslett	109 Roberts Street		Asheville	NC	28801
Bright Door Systems, Inc.	QBV	Mr. Sean Harrison, COO	6501 Weston Parkway	Suite 320	Cary	NC	27513
Bright View Technologies, Inc.	QBV	Mr. David Reed, Vice President	5151 McCrimmon Parkway	Suite 200	Morrisville	NC	27560
BUILDERadius, Inc.	QBV	Mr. William S. Ward, President &CEO	16 Biltmore Avenue	Suite 300	Asheville	NC	28801
BuildLinks, Inc.	QBV	Mr. Tom Cavanagh, CEO	3800 Paramount Parkway	Suite 100	Morrisville	NC	27560
Carolina Warehousing & Transportation Group, Inc.	QBV	Mr. Marion Boyce, Jr., President	2905 Westinghouse Blvd. Bldg. #800	P.O. Box 19087	Charlotte	NC	28219
Charlotte Angel Partners, LLC	Grantee	Mr. W. Brent Kulman, Fund Executive	1907 Baytree Drive		Greensboro	NC	27455
Chesson Laboratory Associates, Inc.	QBV	Mr. David R. Terry, President & CEO	607 Ellis Road		Durham	NC	27703
Civatech Oncology, Inc.	QBV	Mr. Robert D.Black, President	301 Village Crossing Drive	PO Box 2347	Chapel Hill	NC	27515
Clean Burn Fuels, LLC	QBV	Mr. Tom Williamson, CFO	211 W. Martin Street	Suite 210	Raleigh	NC	27601
CleanTechnics International, Inc.	QBV	Mr. Ritchie C. Russell, CEO,Treasurer	311 Amhurst Avenue		High Point	NC	27260
ClickBrick, Inc.	QBV	Mr. Timothy L. Mercer, President	142 E. Chisholm Street	PO Box 4214	Sanford	NC	27330
Clinical Ink, LLC	QBV	Mr. Douglas Edward Pierce, Jr. CEO	301 N. Main Street	Suite 2481	Winston-Salem	NC	27101
Columbia Life Systems, Inc.	QBV	Mr. John C. Taube. President	301 Village Crossing Drive	P.O. Box 2347	Chapel Hill	NC	27515
Companioncabinet Software, LLC	QBV	Mr. Brent Jackson, Manager	8701 Mallard Creek Rd	Suite 104	Charlotte	NC	28262
Consolidated Asset Recovery Systems, Inc.	QBV	Mr. Steve Norwood, President & CEO	8399 Falls of Neuse Rd.	Suite 108	Raleigh	NC	27615
Edgewater Movie, LLC	QBV	Mr. John W. Beach, Manager	717 North Poplar Street		Charlotte	NC	28202
Effectur, Inc.	QBV	Mr. Kenneth Johnson, President	3150 N. Elm Street	Suite 100-A	Greensboro	NC	27408
Electronic Document Logistics, Inc.	QBV	Mr. Richard D. Bowlin, President & CEO	P.O. Boxx 58309		Raleigh	NC	27658
Endacea, Inc. (fka Link Technology, Inc.)	Grantee	Mr. Donald H. Wilson, III, Pres./CEO	2 Davis Drive	PO Box 12076	RTP	NC	27709
Entegrion, Inc.	QBV	Mr. Richard E. Martin, VP & CFO	79 TW Alexander Drive, Suite 200	4401 Research Commons	RTP	NC	27709
EnSolve Biosystems, Inc.	Grantee	Mr. Jason A. Captan, President & CEO	5805 Departure Drive	Suite B	Raleigh	NC	27616
Eqmentor, Inc.	QBV	Ms Izzy S. Justice, CEO	19315 West Catawba	Suite 220	Cornelius	NC	28031
ESP Systems LLC (Now INC.)	QBV	Mr. Scott Boulware, Vice President	1422 East 4th Street		Charlotte	NC	28202
Eyeborgs, LLC	QBV	Mr. Charles J. Peller, VP & CFO	110 Livingston Court		Clemmons	NC	27012
Field2Base, Inc.	QBV	Mr. Robert McKenzie, Treasurer	101 J Morris Commons Lane	Suite 115	Morrisville	NC	27560
Family Linen Productions LLC	QBV	Ms. Clariinda Ross, Manager	% Elm Entertainment	20031/2 Cheremoya Ave.	Los Angeles	Ca	90068
FirstString Research, Inc.	QBV	Mr. Spencer Robert, CEO	2 Davis Drive		RTP	NC	27709
FloLogic, Inc.	QBV	Mr. Charles R. De Smet	7413-130 Six Forks Road		Raleigh	NC	27615
Focus 3, Inc.	QBV	Ms. Kristy Peters, President	7005 Orchard Knoll Dr.		Apex	NC	27539
F-Origin, Inc.	QBV	Mr. Merrill M. Mason, Secretary	1004 Pinehurst Drive		Chapel Hill	NC	27514
Foundery Pictures 1, LLC	QBV	Mr. John P. Jackman, President	7846 Beech Forest Rd.		Lewisville	NC	27023
Freedom Shopping, Inc.	QBV	Mr. Michael A. Dailey, President	920 Tate Blvd, South East,	Suite #103/104	Hickory	NC	28602
Gentris Corporation	QBV	Ms. Dawn L. Bordeaux, Vice President	133 Southcenter Ct.	Ste. 400	Morrisville	NC	27560
Get Interactive, Inc.	QBV	Mr. J. Phillips L. Johnston, Sr, Chairman & CFO	221 West 4th Street		Winston-Salem	NC	27101
Greatwall Systems, Inc.	Grantee	Mr. Robert E. Anderson, President	635 West Fourth Street	Suite 200	Winston-Salem	NC	27101
GoGo Baby . Com LLC	QBV	Mr. Sanjay L. Vyas. President	1800 Camden Road	Suite 106	Charlotte	NC	28203
Going Again Productions I, LLC	QBV	Mr. Tracy Kilpatrick, Manager	1922 Castle Street		Wilmington	NC	28403
Hatteras Venture Affiliates III, LP	Grantee	Mr. John C. Crumpler, Manager	324 Blackwell Street	Suite 510	Durham	NC	27701
Hope Stout, LLC	QBV	Mr. Bert C. Hesse, Manager	1318 Central Avenue	Suite A-2	Charlotte	NC	28205
Horticultural Asset Management, Inc.	QBV	Mr. Douglas W. Cowles, President,&CEO	107 Edinburgh South Drive	Suite 205	Cary	NC	27511

Attachment A

Huemetrix	QBV	Ms. Bonnie L. Parr, Secretary/Treasurer	840 Main Campus Drive	Suite 3570	Raleigh	NC	27629
Inception Micro Angel Fund LLC	Grantee	Mr. Timothy R. Janke, Organizer	4149 Chatham Hill Drive		Winston-Salem	NC	27104
Idea Fund 1. L.P.	Grantee	Mr. Jon Cambier, General Partner	4505 Emperor Blvd.	Suite 130	Durham	NC	27703
IFAN Corporation	QBV	Mr. J. Ralph Johnson, President	PO Box 396		Hendersonville	NC	28793
IFAN Health Products, Inc.	QBV	Mr.J. Ralph Johnson, President	PO Box 396		Hendersonville	NC	28793
Inception Micro Angel Fund, LLC	Grantee	Mr. Timothy R. Janke, Organizer	1959 N. Peace Haven Road	Suite 111	Winston-Salem	NC	27106
IMAF-East, LLC	Grantee	Mr. Timothy R. Janke, Organizer	1959 N. Peace Haven Road	Suite 111	Winston-Salem	NC	27106
IMAF- Kannapolis, LLC	Grantee	Mr. Timothy R. Janke, Organizer	1959 N. Peace Haven Road	Suite 111	Winston-Salem	NC	27106
IMAF - West, LLC	Grantee	Mr. Timothy R. Janke, Organizer	1959 N. Peace Haven Road	Suite 111	Winston-Salem	NC	27106
ImagineOptix Corporation	Grantee	Mr. Erin K. Clark, Vice President	7202 Doverton Court		Raleigh	NC	27615
InfoStrength, Inc.	QBV	Ms. Margaret E. Geiger, President/CEO	4220 Apex Highway,	Suite 200	Durham	NC	27713
3-C Institute For Social Development, Inc.	Grantee	Ms. Melissa E. DeRoiser, President	1903 N. Harrison Avenue	Suite 101	Cary	NC	27513
Inneroptic Technology, Inc.	Licensee	Mr. Kurtis Keller, President	106A North Churton Street		Hillsborough	NC	27278
Intercede, Inc.	QBV	Mr. Jerry M. Overcash, President&CEO	212 South Tryon Street,	Suite 1550	Charlotte	NC	28281
Intersouth Affiliates V, L.P.	Grantee	Mr. Mitchell Mumma, Member Manager	406 Blackwell Street	Suite 200	Durham	NC	27701
Intersouth Partners V, L.P.	Grantee	Mr. Mitchell Mumma, Member Manager	406 Blackwell Street	Suite 200	Durham	NC	27701
Intersouth Partners VI, L.P.	Grantee	Mr. Mitchell Mumma, Member Manager	406 Blackwell Street	Suite 200	Durham	NC	27701
Intersouth Partners VII, L.P.	Grantee	Mr. Mitchell Mumma, Member Manager	406 Blackwell Street	Suite 200	Durham	NC	27701
Intervolve, Inc.	QBV	Mr. William Kaluza, CEO	319 West Martin Street		Raleigh	NC	27601
Joseph Charles, LLC	QBV	Mr. Charles Alexander, Manager	2 Terrace Way	Suite C	Greensboro	NC	27403
Jute Networks, LLC	QBV	Mr. Sean McDonald, President	20 Battery Park Ave	Suite 406	Asheville	NC	28801
KeraNetics, LLC	QBV	Mr. Charles W. Johnson, Director	4220 Allistair Road		Winston-Salem	NC	27104
Klein Decisions LLC	QBV	Mr. Robert L. Padgette, Managing Director	801 Jones Franklin Road	Suite 200	Raleigh	NC	27606
Krenitsky Pharmaceuticals, Inc.	QBV	Mr. Wayne R. Eberhardt, Vice President	Four University Place	4611 University Drive	Durham	NC	27707
Kryosphere, Inc.	QBV	Mr. L. Eric Hallman, President	116 West Queen Street		Hillsborough	NC	27278
Laamscience, Inc.	QBV	Mr. Thomas H. Roberg, President & CEO	2108 Prescott Place		Raleigh	NC	27615
Learning Management Systems, Inc.	QBV	Mr. John Carl Zeigler, CEO	101 Hawthorne Avenue		Swannanoa	NC	28778
Liquidia Technologies, Inc.	QBV	Mr. Bruce Boucher, President	P. O. Box 110085		RTP	NC	27709
Listingbook, LLC	QBV	Mr. Randall R. Kaplin, Chairman	123 S. Elm Street,		Greensboro	NC	27401
Live Cargo, Inc.	QBV	Mr. Doug Young, CEO	6520 Airport Center Drive	Suite 102	Greensboro	NC	27409
Longfiber Cotton Gins, Inc.	QBV	Mr. J. Robert Tyler, III, Asst. Secretary	5410 Trinity Road.	Suite 400	Raleigh	NC	27607
Magnus Health Technology, Inc.	QBV	Mr. William Pittman, Vice President	920 Main Campus Drive	Suite 101	Raleigh	NC	27606
Mediplay, Inc.	QBV	Mr. Andrew M. Walker, President	526 Pylon Drive		Raleigh	NC	27606
MD Scientific, LLC	QBV	Mr. W. Patrick Burgess, M.D..Mamager	2815 Coliseum Drive	Suite 150	Charlotte	NC	28217
MediWave Star Techology Inc.	QBV	Mr. Thomas R. Sloan, Treasurer	705 Sunset Drive		Greensboro	NC	27408
Microphase Coatings Inc.	QBV	Mr. Brad Lienhart, Ast Secretary	2539 Asher View Ct.		Raleigh	NC	27606
Modality, Inc.	QBV	Mr. Stephen Mark Williams, President	905 W. Main Street	Suite 23C, Box #2	Durham	NC	27701
Moving Midway, LLC	QBV	Mr. John Jesse Spain, Manager	411 Kinsey Street	P.O. Box 50175	Raleigh	NC	27650
MyBode, Inc.	QBV	Mr. Jeffrey M. Johnston, President	3708 Lyckan Parkway	Suite 206	Durham	NC	27705
Near-Time, Inc.	QBV	Mr. Reid Conrad, CEO	1289 N. Fordham Blvd	Suite A-410	Chapel Hill	NC	27514
New Direction Biofueols, LLc	QBV	Mr. Tyson Warren, Manager/Member	P.O. Box 6558		Raleigh	NC	27628
Novan, Inc.	QBV	Mr. Nathan Stasko, President	1227 Holly Hill Drive		Durham	NC	27713
Oncoscope, Inc.	QBV	Mr. William Brown, CEO	209 Maywood Way		Chapel Hill	NC	27516
Patriot Software Systems, Inc.	QBV	Mr. Jeff L. Reese, President & CEO	104 Kalida Court		Cary	NC	27513
Paula Lee Haller Productions LLC	QBV	Ms. Paula Lee Haller, Manager	PO Box 1042		Wrightsville Beach	NC	28480
Piedmont Angel Network LLC	Grantee	Ms. Lou Anne Flanders-Stec, Fund Executive	2007 Yanceyville Street	Box 69	Greensboro	NC	27405
Piedmont Angel Network TWO LLC	Grantee	Mr. W.B. Rodman Davis, Manager	701 Green Valley Road	Suite 100	Greensboro	NC	27408
Piedmont Global Solutions, Inc.	QBV	Mr. David M. Daniels, President & CEO	5904 Crutchfield Farm Road		Oak Ridge	NC	27310
Piedmont Pharmaceuticals LLC	QBV	Mr. Roland Johnson, Manager/President	204 Muirs Chapel Road	Suite 200	Greensboro	NC	27410
Pogo Health LLC	QBV	Ms. Alicia Paladin, President	710 Morehead Avenue		Durham	NC	27707
Qualyst, Inc.	Grantee	Mr. Scott E. Neuville, President & CEO	5410 Trinity Road	Suite 108	Raleigh	NC	27607
Quartek Corporation	QBV	Mr. Reyad Sawafta, President & CEO	4180 Piedmant Parkway		Greensboro	NC	27410
RadarFind Corporation	QBV	Mr. B. Bobby Bahram, CFO & COO	2100 Gateway Centre Blvd.,	Suite 150	Morrisville	NC	27560
Realserv, LLC	QBV	Mr. William DePriest, Coperat Officer	84 W. Walnut Street	Suite 202	Asheville	NC	28802
Regado Biosciences, Inc.	QBV	Mr. Chris Courts, Controller	324 Blackwell Street	Suite 420	Durham	NC	27701
Remedease, Inc.	QBV	Ms. Amy D. Rix, President & CEO	5004 Butternut Road		Durham	NC	27707
Renewable Fibers, LLC	QBV	Mr. Paul W. Skillicorn, Manaager	101 West Harper Street		Snow Hill	NC	28580
Resource4Realtors, LLC	QBV	Mr. Ronald R. Rogers, Manager	81104 Alexander Street		Chapel Hill	NC	27517
Respirics, Inc.	QBV	Mr. Gilbert S. Mott, Jr., President & CEO	6008 Triangle Drive	Suite 101	Raleigh	NC	27617
R Path	QBV	Mr. David B. Welker, II, VP, Finance & Operations	701 Corporate Center Drive	Suite 450	Raleigh	NC	27607
Scion Neurostim, LLC	QBV	Mr. Lanty L. Smith, Chairman, President,Secretary	3105 Cone Manor Lane	Suite B	Raleigh	NC	27613
Semma Enterprises, Inc.	QBV	Mr. J. Robert Tyler, III, Asst. Secretary	5410 Trinity Road	Suite 400	Raleigh	NC	27607
Sequentric Energy Systems, LLC	QBV	Mr. Daniel Flohr, Manager	8 Cedar Island		Wilmington,	NC	28409
Sharedvue, Inc.	QBV	Mr. Michael R. Overcash, President	900 Ridgefield Road	Suite 140	Raleigh	NC	27609
Sicel Technologies, Inc. Changed from QGB to QBV	QBV	Mr. Michael Riddle, President & CEO	3800 Gateway Centre Boulevard	Suite 308	Morrisville	NC	27560
Slate Pharmaceuticals, Inc.	QBV	Mr. Robert Whitehead, President	318 Blackwell Street	Suite 240	Durham	NC	27701
Southern Capitol Technology Fund II, LP	Grantee	Mr. Benjamin T. Brooks, III	21 Glenwood Avenue	Suite 105	Raleigh	NC	27603
Southeast Techinventures, Inc.	Grantee	Ms. Karen LeVert, President	7030 Kit Creek Rd,	Suite 250	Morrisville	NC	27560

Attachment A

Specialty Wood Components, Inc.	QBV	Mr. Blane E. Rockafellow, CEO	7405 Kemp Road		Raleigh	NC	27613
Synermed Select Partners, Inc.	QBV	Mr. Ernest A. Knesel, Jr., President	1100 Revolution Mill Drive	Suite 1	Greensboro	NC	27405
Textile Film Initiative L.L.C.	QBV	Mr. Doug Adams, Manager	2424 N. Davidson Street	Suite 103	Charlotte	NC	28205
The List Productions, LLC	QBV	Mr. Robert Whitlow, President of Torch Media, Inc.	301 South McDowell Street	Suite 410	Charlotte	NC	28204
The Sacrifice Productions, LLC	QBV	Mr. Robert Whitllow, Manager	301 South McDowell Street	Suite 410	Charlotte	NC	28204
The Venue Network, Inc.	QBV	Mr. David Gardner, President	102 Anna Lake Lane		Cary	NC	27513
Trana Discovery, Inc.	Licensee	Mr. Michael A. Gallucci, Jr. Treasurer & CFO	659-193 Cary Towne Blvd		Cary	NC	27511
Transenterix, Inc.	QBV	Mr. William L. Athas, VP & COO	3908 Patriot Drive	Suite 170	Durham	NC	27703
Tri-State Investment Group IV, LLC	Grantee	Mr. Stephen Clossick, Administrator	6002 Meadow Run Ct.		Chapel Hill	NC	27516
Triad Specialty Products LLC	QBV	Mr. Roland Johnson, Manager	204 Muirs Chapel Road	Suite 200	Greensboro	NC	27410
U.S. Environmental Protection Service, LLC	QBV	Mr Albert J. Allen	3300 Battleground Avenue	Suite 305	Greensboro	NC	27410
Versatile Premium Products, LLC	QBV	Mr. James Larry Gates, Manager	300 Citation Lane, P.O. Box 2293		Smithfield	NC	27577
Vtflex, Inc.	QBV	Mr. Samir Hakooz, President	105 Lion's Gate Drive		Cary	NC	27518
Yap, Inc.	QBV	Mr. Igor Jablokov, CEO	1930 Camden Road	Suite 2040	Charlotte	NC	28203
ZetlComp, Inc.	QBV	Ms. Meg G. Richards, Secretary	3020 Pickett Rd.	Suite 327	Durham	NC	27705
Zenph Studios, Inc.	QBV	Mr. John Q. Walker, II, President	9660 Falls of Neuse Road	Suite 138-145	Raleigh	NC	27615
ZyCare, Inc.	QBV	Mr. Steven D. Holdaway, CEO/VP OP	3804 Sweeten Creek Road		Chapel Hill	NC	27514

Business Name	Number of Jobs Created	Average Wages Paid	Minority Business
A Bunch of Us Productions, LLC	4	$1,081.25	no
AC-2, LLC	n/a	n/a	no
Addrenex Pharmaceutical, Inc.	6	$100,000.00	no
Advanced Digital Systems, Inc.	0	$0.00	no
Advanced Liquid Logic Inc.	9	$63,778.00	no
Affinergy, Inc.	9	$57,722.00	no
Aldagen, Inc.	7	$119,285.00	no
Alpha Theory, LLC	5	$60,000.00	no
Arbor Pharmaceutical, Inc.	2	$108,000.00	no
Arbovax, Inc.	4	$81,250.00	no
ArtusLabs, Inc.	8	$90,000.00	no
Asklepios Biopharmaceutical, Inc.	4	$48,300.00	no
Atomfan . Com, Inc.	2	$0.00	no
Aurora Enrichment Fund, L.L.C.	n/a	n/a	no
Aurora Ventures IV, L.L.C.	n/a	n/a	no
Aurora Ventures V, L.P.	n/a	n/a	no
AvidXchange, Inc.	8	$64,000.00	no
Beroe, Inc.	1	$92,000.00	no
BioMarck Pharmaceuticals, Ltd.	0	$0.00	no
Biotechnology Research & Development, LLC	n/a	$0.00	no
Bioptigen, Inc.	5	$78,000.00	no
BioResource International, Inc.	3	$61,333.00	no
Blue Ridge Analytics, Inc.	6	$50,989.00	no
Blue Ridge BioFuels, LLC	1	$10,000.00	no
Bright Door Systems, Inc.	14	$40,884.18	no
Bright View Technologies, Inc.	17	$48,454.00	no
BUILDERadius, Inc.	29	$57,000.00	no
BuildLinks, Inc.	0	$0.00	no
Carolina Warehousing & Transportation Group, Inc.	n/a	n/a	Yes
Charlotte Angel Partners, LLC	0	$0.00	no
Chesson Laboratory Associates, Inc.	4	$94,000.00	no
Civatech Oncology, Inc.	n/a	n/a	no
Clean Burn Fuels, LLC	n/a	n/a	no
CleanTechnics International, Inc.	n/a	n/a	no
ClickBrick, Inc.	0	n/a	no
Clinical Ink, LLC	0	$0.00	no
Columbia Life Systems, Inc.	0	$0.00	no
Companioncabinet Software, LLC	2	$122,819.00	no
Consolidated Asset Recovery Systems, Inc.	4	$47,500.00	no
Edgewater Movie, LLC	0	$0.00	no
Effectur, Inc.	n/a	n/a	no
Electronic Document Logistics, Inc.	0	$0.00	no
Endacea, Inc. (fka Link Technology, Inc.)	0	$0.00	no
Entegrion, Inc.	0	$0.00	no
EnSolve Biosystems, Inc.	n/a	n/a	no
Eqmentor, Inc.	n/a	n/a	no
ESP Systems LLC (Now INC.)	11	$45,000.00	no
Eyeborgs, LLC	129	$70,749.73	no
Field2Base, Inc.	1	$120,000.00	no
Family Linen Productions LLC	n/a	n/a	no
FirstString Research, Inc.	n/a	n/a	no
FloLogic, Inc.	1	$30,000.00	no
Focus 3, Inc.	2	$56,250.00	no
F-Origin, Inc.	0	$0.00	no
Foundery Pictures 1, LLC	108	$61,884.00	no
Freedom Shopping, Inc.	n/a	n/a	no
Gentris Corporation	2	$36,750.00	no
Get Interactive, Inc.	5	$61,600.00	no
Greatwall Systems, Inc.	n/a	n/a	no
GoGo Baby . Com LLC	n/a	n/a	Yes
Going Again Productions I, LLC	n/a	n/a	no
Hatteras Venture Affiliates III, LP	n/a	n/a	no
Hope Stout, LLC	0	$0.00	no
Horticultural Asset Management, Inc.	1	$120,000.00	no

Huemetrix	2	$48,623.00	no
Inception Micro Angel Fund LLC	n/a	n/a	no
Idea Fund 1. L.P.	4	$172,477.00	no
IFAN Corporation	n/a	n/a	no
IFAN Health Products, Inc.	n/a	n/a	no
Inception Micro Angel Fund, LLC	n/a	n/a	no
IMAF-East, LLC	n/a	n/a	no
IMAF- Kannapolis, LLC	n/a	n/a	no
IMAF - West, LLC	0	n/a	no
ImagineOptix Corporation	n/a	n/a	no
InfoStrength, Inc.	2	87,500.00	Yes
3-C Institute For Social Development, Inc.	n/a	n/a	no
Inneroptic Technology, Inc.	1	$89,000.00	Yes
Intercede, Inc.	11	$75,000.00	no
Intersouth Affiliates V, L.P.	n/a	n/a	no
Intersouth Partners V, L.P.	n/a	n/a	no
Intersouth Partners VI, L.P.	n/a	n/a	no
Intersouth Partners VII, L.P.	n/a	n/a	no
Intervolve, Inc.	3	$66,333.33	no
Joseph Charles, LLC	2	$30,000.00	no
Jute Networks, LLC	n/a	n/a	no
KeraNetics, LLC	n/a	n/a	no
Klein Decisions LLC	1	$100,000.00	no
Krenitsky Pharmaceuticals, Inc.	0	$0.00	no
Kryosphere, Inc.	n/a	n/a	no
Laamscience, Inc.	2	$110,000.00	no
Learning Management Systems, Inc.	1	$36,000.00	no
Liquidia Technologies, Inc.	19	$88,400.00	no
Listingbook, LLC	34	$72,223.00	no
Live Cargo, Inc.	3	$166,667.00	no
Longfiber Cotton Gins, Inc.	n/a	n/a	no
Magnus Health Technology, Inc.	3	$14,931.00	no
Mediplay, Inc.	1	$100,000.00	no
MD Scientific, LLC	3	$105,000.00	no
MediWave Star Techology Inc.	4	$38,864.00	no
Microphase Coatings Inc.	4	$78,000.00	no
Modality, Inc.	11	$43,850.00	no
Moving Midway, LLC	4	$4,613.00	no
MyBode, Inc.	6	$70,000.00	no
Near-Time, Inc.	n/a	n/a	no
New Direction Biofueols, LLc	n/a	n/a	no
Novan, Inc.	n/a	n/a	no
Oncoscope, Inc.	2	$34,000.00	no
Patriot Software Systems, Inc.	0	$0.00	no
Paula Lee Haller Productions LLC	0	$0.00	Yes
Piedmont Angel Network LLC	0	$0.00	no
Piedmont Angel Network TWO LLC	n/a	n/a	no
Piedmont Global Solutions, Inc.	4	$75,000.00	no
Piedmont Pharmaceuticals LLC	n/a	n/a	no
Pogo Health LLC	n/a	n/a	no
Qualyst, Inc.	2	$57,500.00	no
Quartek Corporation	2	$30,000.00	no
RadarFind Corporation	7	$71,571.00	no
Realserv, LLC	1	$40,000.00	no
Regado Biosciences, Inc.	10	$96,250.00	no
Remedease, Inc.	n/a	n/a	no
Renewable Fibers, LLC	n/a	$0.00	no
Resource4Realtors, LLC	n/a	n/a	no
Respirics, Inc.	0	$0.00	no
R Path	10	$105,000.00	no
Scion Neurostim, LLC	n/a	n/a	no
Semma Enterprises, Inc.	0	$0.00	no
Sequentric Energy Systems, LLC	0	$0.00	no
Sharedvue, Inc.	0	$0.00	no
Sicel Technologies, Inc. Changed from QGB to QBV	n/a	n/a	no
Slate Pharmaceuticals, Inc.	4	$150,000.00	no
Southern Capitol Technology Fund II, LP	2	$20,000.00	no
Southeast Techinventures, Inc. (From QBV to QGB)	1	$80,000.00	no

Specialty Wood Components, Inc.	0	$0.00	no
Synermed Select Partners, Inc.	3	$45,000.00	no
Textile Film Initiative L.L.C.	n/a	n/a	no
The List Productions, LLC	10	$12,455.80	no
The Sacrifice Productions, LLC	n/a	n/a	no
The Venue Network, Inc.	n/a	n/a	no
Trana Discovery, Inc.	0	$0.00	no
Transenterix, Inc.	0	$0.00	no
Tri-State Investment Group IV, LLC	n/a	n/a	no
Triad Specialty Products LLC	0	$0.00	no
U.S. Environmental Protection Service, LLC	5	$49,400.00	no
Versatile Premium Products, LLC	11	$12,299.50	no
Vtflex, Inc.	0	$0.00	no
Yap, Inc.	10	$36,737.37	no
ZellComp, Inc.	0	$0.00	Yes
Zenph Studios, Inc.	1	$30,000.00	no
ZyCare, Inc.	6	$75,000.00	no

6	Minority	
706	# of Jobs Created	
$4,715,574.43	Wages divided by Co.	Reporting
$31,228.96	Average Wages	

Business Name	Brief Description of Business Activity
A Bunch of Us Productions, LLC	Engaged in the development, financing, production, distribution, and exploitation of motion pictures.
AC-2, LLC	Development and commercialization techonoligies in the fields water supply, wastewater treatment, bio-energy, green structural material and enzymes.
Addrenex Pharmaceutical, Inc.	The business is engaged in the development and commercialization of pharmaceuticals.
Advanced Digital Systems, Inc.	Provide personal information management software by developing a pen-on-paper-based user-interface.
Advanced Liquid Logic Inc.	The company is in the business of design, development, manufacture and sale of equipment to manipulate fluids at the nanoscale.
Affinergy, Inc.	The company has developed the innovative technology of "interfacial biomaterials" or IFBMs.
Aldagen, Inc.	The company is engaged in the development, the manufacture, and the distribution of a series of proprietary medical device products designed to improve therapeutic transplantation of adult hematopoetic stem and progenitor cells.
Alpha Theory, LLC	Engaged in financial software who use the application to manage portfolio for investments.
Arbor Pharmaceutical, Inc.	The company is primairly focused on commercialization of pharmaceutical and related technology and intellectual property.
Arbovax, Inc.	An early stage research and development company that will commercialize a vaccine targeting mosquito-borne diseases.
ArtusLabs, Inc.	Technology company providing scientific data mamagement software and service for research based businesses.
Asklepios Biopharmaceutical, Inc.	Development and production of vector based delivery vehicles for genes and gene products for therapeutic applications.
Atomfan . Com, Inc.	Receiving editing, modifying, storing and distributing content to computers and mobile web devices.
Aurora Enrichment Fund, L.L.C.	The company operates as a venture capital fund formed to invest in early and later stage investments in existing informatio technology and life science companies located in N.C. and the Southeastern U.S.
Aurora Ventures IV, L.L.C.	The company will operate as a venture capital fund formed to invest primarily in seed and early stage investments.
Aurora Ventures V, L.P.	The company will invest primarily in seed, and early stage and follow on investments in information technology and life sciences .
AvidXchange, Inc.	Provides software that lets organizations know how bills are electronically routed for approval within the company.
Beroe, Inc.	It researches commodities and analyzes their performance worldwide using proprietary software.
BioMarck Pharmaceuticals, Ltd.	R&D directed to the discovery and preclinical development of new drugs for the treatment of diseases such as asthma, chronic bronchitis, and cystic fibrosis.
Biotechnology Research & Development, LLC	Development and commercialization techonoligies in the fields water supply, wastewater treatment, bio-energy, green structural material and enzymes.
Bioptigen, Inc.	Bioptigen is developing Optical Coherence Tomography instrumentation for imaging of humans and small animals for pre-clinical research .
BioResource International, Inc.	Research and development of industrial enzymes for animal feed applications.
Blue Ridge Analytics, Inc.	Provide a new Internet based outsourcing option for employers.
Blue Ridge BioFuels, LLC	Waste oil is converted into biodiesel fuel at production facility.
Bright Door Systems, Inc.	Developing and marketing software and web-based software applications.
Bright View Technologies, Inc.	Development of technology permitting creation and replication of complex microstructures over large areas and application of this technology to design and production of new products.
BUILDERadius, Inc.	Develops and markets software for building departments and building contractors.
BuildLinks, Inc.	Provider of integrated web-based and wireless/mobile software applications for the homebuilding industry.
Carolina Warehousing & Transportation Group, Inc.	CW & TG offering Core service in trucking and warehousing.
Charlotte Angel Partners, LLC	Venture capital investments.
Chesson Laboratory Associates, Inc.	Decover, develop and commercialize therapeutic pharmaceutical systems and products.
Civatech Oncology, Inc.	Will develop and manufacture a medical device which will allow radiation therapy for the treatment of cancer.
Clean Burn Fuels, LLC	Process for the production of ethanol - dry milling.
CleanTechnics International, Inc.	Sell, market, manufacture, warehouse & distribute technology in fluid filtration.
ClickBrick, Inc.	Will manufactory and distribute a thin brick panel assembly panelof brick and plastic componants.
Clinical Ink, LLC	Clinical Ink. Will develop data capture software for use in clinical trials.
Columbia Life Systems, Inc.	Design and Manufactory a medical device that will allow a physicilan to delivery supplemental oxygen to newboms in need of oxygen therapy.
Companioncabinet Software, LLC	This is a software package for the cabinet industry.
Consolidated Asset Recovery Systems, Inc.	Consolidated Asset Recovery Systems operates an internet portal for industry for the financial service industry to reduce cost.
Edgewater Movie, LLC	To develop financing, production and explitation of a feature-length motion picture.
Effectur, Inc.	Effectur is a venture-backed software as service formed to streamline and automate the irs collections process for tax debtor.
Electronic Document Logistics, Inc.	To provide online software applications to automated real estate transactions for mortgage lending industry.
Endacea, Inc. (fka Link Technology, Inc.)	Business intends to develop the endotoxin detection kit first for industrial use and subsequently for clinical diagnostic use, developing a drug for asthma
Entegrion, Inc.	Entegrion, Inc. is engaged in the research & development of biological products for the treatment of blood or other conditions.
EnSolve Biosystems, Inc.	Ensolve Biosystems develops bioremediation treatment systems for the maritime industry.
Eqmentor, Inc.	Based mentoring service delivered over the internet needs of the working professional.
ESP Systems LLC (Now INC.)	The ESP Systems has patented, pioneered and commercialized a state of the art wireless system for technology.
Eyeborgs, LLC	A North Carolina based corporation specializing in the production of an original feature film for motion pictures.
Field2Base, Inc.	Offers a highly mobile communications solution to its end users via use of the Tablet PC and certain proprietary software.
Family Linen Productions LLC	Was formed to participate in financing, production and exploitation of a feature length motion picture.
FirstString Research, Inc.	Is organized to develop research of therapeutics. Includes research and drug testing in animals and Humans for FDA approval.
FloLogic, Inc.	Directs the design, development, manufacture and markets an automatic fluid shutoff valve for installation.
Focus 3, Inc.	Development and sales of web-based customer relationship management application for real estate sales and marketing businesses.
F-Origin, Inc.	Engages in research, development and commercialization of software and hardware relating to portable handheld devices.
Foundery Pictures 1, LLC	To develop, produce and subsequently arrange distribution of a motion picture based on the true story of John Wesley.
Freedom Shopping, Inc.	The company provides affordable and secure RFID solutions to the consuming public technology.
Gentris Corporation	Engaged in the R & D and commercialization of proprietary clinical pharmacogenomic product and services.
Get Interactive, Inc.	Develops product placement in the television show and then promotes that placement in the pages of GET magazine and on-line at GetTV,tv, connecting the viewer to their favorite content.
Greatwall Systems, Inc.	Research and development of network security products.
GoGo Baby . Com LLC	A net working website.
Going Again Productions I, LLC	Business was formed to participate in the financing, production and exploitation of a featured length motion picture.
Hatteras Venture Affiliates III, LP	Intended to be a venture capital fund to invest primarily in companies engaged in the biotechnology, medical device and similar related industries.
Hope Stout, LLC	The applicant business engages in the financing, production, distribution and exploitation of motion pictures.
Horticultural Asset Management, Inc.	Develop a custom horticultural software product that will enable professionals to evaluate the installed landscape and to produce a product that predicts the replacement value of horticultural assets and provides a horticulturally correct specimen and care guide.
Huemetrix	Develop a dye exhaustion monitoring control and adaptive technology with future applications in waste water treatment industries.

Inception Micro Angel Fund LLC	Angel investor investment fund focusing on the Piedmont triad area.
Idea Fund 1. L.P.	Idea fund 1, is an early-stage venture capital fund that will invest in other companies.
IFAN Corporation	Manufacture and Distribution of electronic sports related merchandise in this marketing area.
IFAN Health Products, Inc.	The company plans to distributea microbial trademarked (Bacorbial) that fights superbugs.
Inception Micro Angel Fund, LLC	A investor investment fund which will invest in growth companies for technology opportunities.
IMAF-East, LLC	A investor investment fund which will invest in growth companies for technology opportunities.
IMAF- Kannapolis, LLC	The applicant is a structured investment fund which will invest in capital stock or other equity interests.
IMAF - West, LLC	The applicant is a structured investment fund which will invest in capital stock or other equity interests.
ImagineOptix Corporation	A technology development company. Commercializing technology that will double the efficiency of video projector divices.
InfoStrength, Inc.	Produces software for life science companies to manage their intellectual property, key processes, quality and regulatory needs
3-C Institute For Social Development, Inc.	A research and development company devoted to promotion positive mental health and adaptive functions of children and families through evidence based on educational materials.
Inneroptic Technology, Inc.	Inneroptic is engaed in the research and development of advanced visualization product for minimally-invasiver surgery.
Intercede, Inc.	Corporate human resources consulting, software development and training.
Intersouth Affiliates V, L.P.	Venture capital firm focusing on early stage investments in the high technology and life sciences industries.
Intersouth Partners V, L.P.	Venture capital firm focusing on early stage investments in the high technology and life sciences industries.
Intersouth Partners VI, L.P.	Venture capital firm focusing on early stage investments in the high technology and life sciences industries.
Intersouth Partners VII, L.P.	Venture capital firm focusing on early stage investments in the high technology and life sciences industries.
Intervolve, Inc.	Development, marketing and sale of customized solutions for the information technology needs of the beverage.
Joseph Charles, LLC	The company is engaged in the business of arranging for the design and production of various products and services.
Jute Networks, LLC	Software as a service application that supports management and analysis of complex social data for personal and professionl relationships.
KeraNetics, LLC	A continuous program of research, development, production & commercialization in the fields of Biotherapeutics.
Klein Decisions LLC	Engaged in the manufacture, production, sales and service of web-based decision software for the financial services industry.
Krenitsky Pharmaceuticals, Inc.	Engaged in the discovery and early development of drugs that provide new therapies or improve existing ones and lower overall medical costs.
Kryosphere, Inc.	Kryosphere is engaged in the business of long term refrigerated facilities for the storage of biological specimens.
Laamscience, Inc.	Research/development of innovative technology of applying materials to substances, surfaces and the like to achieve antibiological activity to destroy microscopic, ultramicroscopic or infectious agents, etc.
Learning Management Systems, Inc.	Provides distance learning technology and professional services.
Liquidia Technologies, Inc.	Research and development of chemical compounds
Listingbook, LLC	Software solutions for real estate agents and their customers.
Live Cargo, Inc.	A Secure Messaging software company that provides products and services to transfer, store, and ensure secure delivery of digital documents.
Longfiber Cotton Gins, Inc.	The principal business is product development, manufacturing & whole sale distribution of cotton gins.
Magnus Health Technology, Inc.	The business is developing a system for the organization, storage and distribution of health records.
Mediplay, Inc.	Providing digital marketing solutions for health care professionals.
MD Scientific, LLC	Engaged in research and development to improve healthcare through commercialization of medical innovations developed by physicians.
MediWave Star Techology Inc.	Research and development of technology and devices which incorporate such technology, for use in the field of medical diagnostics.
Microphase Coatings Inc.	Engaged in marine vessel coating development.
Modality, Inc.	Modality is the developer of technology used to transform and distribute handheld devices, allowing mobile access to trusted content.
Moving Midway, LLC	The applicant business is engaged in the financing,production,distribution and explitation of a motion picture.
MyBode, Inc.	Developing, marketing, and selling proprietary Internet applications to the real estate industry.
Near-Time, Inc.	Near-Time is a software development and sales company committed to delivering the best systems available to businesses.
New Direction Biofueols, LLc	Our primary purpose will be the transesterfication of vegetable oil to produce fuels or fuel additives.
Novan, Inc.	Biotechnology pharmaceutical research and development company.
Oncoscope, Inc.	The business activity in which the corporation is engaged is the research and development of optical biopsy systems.
Patriot Software Systems, Inc.	Engaged in research and development of computer software.
Paula Lee Haller Productions LLC	The business is engaged in the development, financing, production, distribution and exploitation of motion pictures.
Piedmont Angel Network LLC	Invests in capital stock or debt instruments of growth companies, including but not limited to, early stage privately-held companies.
Piedmont Angel Network TWO LLC	Will invest in capital stock or debt instruments of growth companies, including but not linited to early stage, privately-companies.
Piedmont Global Solutions, Inc.	Develop, manufacture, market and sell hospital beds.
Piedmont Pharmaceuticals LLC	Pharmaceutical research & development
Pogo Health LLC	Primarily engaged in providing a service & products business to business getting them to offer as part of companies hmo's.
Qualyst, Inc.	Creates and develops medium-and high-throughput admet assays for the pharmaceutical industry.
Quartek Corporation	Quartek is a corp. that uses nanotechnology a combination for research and technology to create the use of structures and devices to measure distance,
RadarFind Corporation	Developing an asset tracking system for hospitals and care centers. "Indoor GPS system" for mobile medical devices used in hospitals (beds, infusion pumps, incubators).
Realserv, LLC	To gather data, process, then evaluate,package and sell this data to businesses.
Regado Biosciences, Inc.	Is a biopharmaceutical company developing antidote-controlled therapeutics, focusing on the acute care antithrombotics market.
Remedease, Inc.	Offer a patented method and device for a new and novel treatment for nosebleeds,
Renewable Fibers, LLC	To develop and commercialization of state-of-the-art technologies of wastewater treatment, using the vehicle therefor the Hibiseus cannabinus plant (Kenaf).
Resource4Realtors, LLC	Engaged in the research and development of internet-based software applications to assist agents and buyers in the real estate industry.
Respirics, Inc.	Respirics is a respiartory drug delivery and development company serving pharmaceutitial biotechnology and diagnostic industries.
R Path	Provides application (software) companies the opportunity to reduce developmental, installation/operational costs of installing and maintaining enterprise software applications as well as custom OS platforms.
Scion Neurostim, LLC	To research, develop, manage, license and market medical technology, devices and treatments.
Semma Enterprises, Inc.	The corporation is engaged in manufacturing, processing and wholesale distribution of specialty food products.
Sequentric Energy Systems, LLC	Sequentric Energy Systems has developed and has a patent for management control system for business customers.
Sharedvue, Inc.	Programs are designed to provide a direct connect to a web server containing products content. This is updated on a regular basis.
Sicel Technologies, Inc.	A medical device company focused on systems, monitors, and software for cancer treatments.
Slate Pharmaceuticals, Inc.	Research and development of pharmaceuticals.
Southern Capitol Technology Fund II, LP	Venture capital investments.
Southeast Techinventures, Inc.	They are a technology accelerator focused on migrating technologies from universities into commercial marketplace.
Specialty Wood Components, Inc.	Research, development, manufacturing and marketing of treated wood products.

Synermed Select Partners, Inc.	Refurbish medical equipment and instruments.
Textile Film Initiative L.L.C.	Engages in the financing, and exploitation of motion pictures.
The List Productions, LLC	Formed to participate in the financing, production, distribution and exploitation of a feature-length motion picture.
The Sacrifice Productions, LLC	Formed to participate in the financing, production, distribution and exploitation of a feature-length motion picture.
The Venue Network, Inc.	The Venue Network creates easily accessible internet-based rented 3D environments suitable for conducting training classes online.
Trana Discovery, Inc.	The company is engaged in research and development drug discovery technology.
Transenterix, Inc.	Research and development of medical devices.
Tri-State Investment Group IV, LLC	Acquires capital stock or debt instruments of growth companies, including but not limited to early stage privately-held companies.
Triad Specialty Products LLC	Will function as an animal pharmaceutical company.
U.S. Environmental Protection Service, LLC	Develops and produces proprietary erosion controlled processes, products, and systems.
Versatile Premium Products, LLC	Engages in the manufacturing of a Facia System known as Clip-Eze for commercial and other applications.
Vtflex, Inc.	Design, enginer, manufacture, market VT Flex therapeutic exercise devices for consumers, hospitals, and physical therapy clinics.
Yap, Inc.	Develops and markets speech and voice-enabled mobile software.
ZellComp, Inc.	Researching, developing. manufacturing and commercializing innovative fiber-reinforced products for a variety of uses.
Zenph Studios, Inc.	Development of software to create, analyze and record music.
ZyCare, Inc.	Engages in research and development with a primary focus in cost effective clinical management of insulin-requiring diabetes mellitus.

North Carolina Department of Revenue

Beverly Eaves Perdue
Governor

Kenneth R. Lay
Secretary

January 27, 2009

Report to

The Revenue Laws Study Committee

Amount of Corporate Income Tax Revenue Generated by the Requirement that Captive REITS Add Dividends Paid to Taxable Income

Tax Year 2007

As required by Section 31.18.(d) of Session Law 2007-323, this is to report that the amount of corporate income tax revenue generated in the 2007 taxable year by the addition of dividends paid by captive REITs to taxable income required by G.S. 105-130.5(a)(19) is $ 12,805,806.

P.O. Box 871, Raleigh, North Carolina 27602-0871
State Courier 51-71-00
Website: www.dornc.com
An Equal Opportunity Employer

North Carolina Department of Revenue

Beverly Eaves Perdue
Governor

Kenneth R. Lay
Secretary

January 27, 2009

MEMORANDUM

TO: The Honorable Marc Basnight
President Pro Tempore

Senator John H. Kerr, III
Revenue Laws Study Committee Chairman

The Honorable Joe Hackney
Speaker of the House

Representative Paul Luebke
Revenue Laws Study Committee Chairman

FROM: Kenneth R. Lay
Secretary of Revenue

SUBJECT: Customer Service Initiatives

This report is prepared pursuant to Session Law 2008-107, Section 28.16(i) and addresses customer service initiatives undertaken by the Department of Revenue. The report covers five specific reporting requirements contained in the statute.

The Department has taken a comprehensive approach to customer service improvement. Delivering quality service to taxpayers and other constituents is a key strategic objective of the agency. The Department, in an effort to focus attention on this strategic objective, conducted service excellence training sessions in the fall of 2008. Over 1,400 agency personnel attended a total of 57 training sessions. This training emphasized the need to provide quality customer service in all instances, equipped employees with several tools and techniques for providing such service, and provided feedback on additional training and quality improvement issues to be considered in future efforts made by the agency regarding this important issue.

The agency also crafted a service excellence vision and nine guiding principles supporting this vision. This information became a focal point of the training efforts and other discussions about customer service improvement.

The remainder of this report provides specific information related to the five reporting requirements contained in Section 28.16(i):

P.O. Box 25000, Raleigh, North Carolina 27640
Phone (919) 733-7211
State Courier 51-71-00
Website: www.dornc.com
An Equal Opportunity Employer

1. *Efforts to ensure that inquiries on complicated tax matters are handled or reviewed by appropriate personnel within the Department.*

Standard operating procedures for taxpayer inbound calls have been reviewed and enhanced. The procedures cover agency employees located at our Taxpayer Assistance and Call Center (TACC) and Taxpayer Assistance personnel located in Raleigh and in our service centers across the state. These procedures insure that employees with the requisite technical knowledge address complicated tax matters for various tax types.

The improved procedures also addressed several relevant points:

(a) Additional and frequent training for personnel
(b) Development of frequently asked questions with periodic updates
(c) Enhancement and evaluations of the competency level of personnel responding to tax matters
(d) Improved internal communication flow for complex tax matters
(e) Consultation with Tax Administration divisions on complex tax issues

At each service center location across the state, Taxpayer Assistance managers serve as the primary contact for complicated tax matters. The managers address tax matters in consultation with administrative officers with this division based in Raleigh.

2. A review of the Department's efforts to provide accurate and timely information regarding changes in tax law resulting from legislative changes, court decisions, or revised interpretations.

The Department's efforts to provide accurate and timely information are noted in the following actions:

(1) The 2008 Tax Law Changes publication was placed on the DOR website on September 12, 2008. The publication documents the law changes enacted in 2008 and laws changes enacted in prior legislative sessions that affect 2008 tax returns. (applies to all tax schedules)

(2) The Corporate, Excise and Insurance Tax Division published a 2008 Supplement to the 2007/2008 Rules and Bulletins that modified the sections of the Rules and Bulletins that were affected by law changes enacted during the 2008 legislative session. The supplement was posted to the Department's website on September 26, 2008.

(3) Our Corporate, Excise and Insurance Tax Division developed a document titled "Important Notice Regarding Requirement for Licensed Home Inspectors to Obtain a State Privilege License" which was sent via e-mail to the North Carolina Home Inspector Licensure Board. The Board subsequently distributed the document to all of its licensed home inspectors. Form B-202A, Application for State Privilege License, was revised to include home inspectors in the list of occupations that requires a license.

(4) Created and added to the Department's website a Hot Topic titled "Internet Resale of Admission Tickets". Form TR-110, Internet Resale of Admission Tickets Report, was developed and added to the website.

(5) Refund of Unsaleable Other Tobacco Products - Form B-A-101R, was renamed and revised to reflect that the refund provision is no longer limited to cigars.

(6) Tax forms and instructions are revised each year to reflect law changes. The instructions include a section titled "Important Legislative Changes for 2008" that addresses law changes.

(7) The Department maintains on its website information about the tax credit allowed to a film production company in the form of frequently asked questions. That information was revised on August 22, 2008 to reflect legislative changes in 2008 and other policy changes.

(8) The Corporate, Excise and Insurance Tax Division published two Directives during 2008, both of which are available on the Department's website. Directive CD 08-1, dated January 23, 2008, addressed the allocation of premium income from group life insurance policies. Directive CD 08-2, dated September 15, 2008, revised the Department's guidelines for renewable energy tax credit

(9) The Personal Taxes Division revised the Individual Income, Gift, and Estate Tax Bulletins to reflect all law and administrative tax changes and posted the info to the website, including a special notice about the new earned income tax credit.

(10) All general information for Personal Taxes schedules on the website has been updated to reflect any law or administrative changes.

(11) The 2008 individual income tax return instructions include language on the front of the booklet highlighting the law changes.

(12) Personal Taxes posted a notice to the website on Jan. 6, 2009 regarding the administrative position on the addback treatment for bonus depreciation.

(13) Motor Fuels provides all licensed taxpayers with an annual notice of tax law changes. This is usually mailed to the taxpayer in the Fall. We also send these notices to the NC Petroleum Marketers Association and the NC Trucking Association to be included in their monthly newsletters. All correspondence is placed on the web for further reference.

3. A review of the Department's outreach efforts designed to assist taxpayers, particularly small business taxpayers, in complying with the State's tax laws.

The Department's outreach efforts to small businesses fall into two primary categories:

- Creating new communications and outreach channels to small business owners and entrepreneurs
- Improving the Department's existing outreach and education efforts

New Communication and Outreach Channels

The Department established a partnership with the Community College System in August 2008 in an effort to assist small businesses to better under tax laws by providing free seminars at each of the 58 community college locations across our state. The seminars continue in 2009 and cover five key topics:

1. Tax implications for starting a business
2. Tax implications for growing a business
3. The basics of sales and use tax
4. The basics of withholding taxes
5. Dealing with the N.C. Department of Revenue.

In the first four months of the program, more than 250 small business owners and entrepreneurs attended tax seminars at the community colleges. Feedback from the attendees has been very positive, with most of the seminars rated as excellent or very good.

The N.C. Community College System Small Business Center Network also launched a website, www.sbcn.nc.gov, with a section dedicated to tax information provided by the Revenue Department. The site is a one-stop resource for small business owners and offers a variety of helpful information such as entrepreneurship training, guides and tools for starting a business, information on government contracts and business publications. Small business owners can sign up for confidential one-on-one counseling through the website.

The site also features a section from the Department of Revenue that focuses specifically on tax issues for small business owners. The key items are tax obligations, current announcements from the Department, a tax checklist for starting a business, a guide for getting tax assistance and a list of helpful links for small businesses. The tax section is located at: www.sbcn.nc.gov/taxInfo/default.aspx

The Department has also begun issuing "plain-English" announcements about topics such as tax law changes, new electronic services, compliance issues and new reporting and filing requirements. Some of these announcements are more general and others are targeted at specific types of businesses. The announcements are similar to news releases and are designed for organizations to use in newsletters or on websites. They offer easy-to-understand explanations of complex tax issues and links to the Department's website for additional information. They are specifically designed for small business owners who operate without the help of accountants, attorneys or tax preparers.

The announcements that apply to most businesses are sent to a network of organizations that include the North Carolina Chamber of Commerce, the North Carolina Retail Merchants Association (more than 25,000 members), local chambers of commerce across the state, business incubator organizations like the Upper Coastal Plains Council of Governments and the Rural Center. They have been sent by these organizations to members in e-mails, have appeared on websites, been published in newsletters and have gone out in broadcast faxes. The announcements have covered topics including:

1. The introduction of the new online file and pay system for businesses.
2. The introduction of the new online business registration system.
3. The introduction of the partnership with the Small Business Center Network.
4. The sales tax holiday.
5. A change in reporting for alcoholic beverage excise tax returns.
6. The phase-out of the excise tax on piped natural gas.

Many of these same announcements are also sent to tax preparer organizations like the N.C. Association of CPAs and the N.C. Society of Tax Professionals. These organizations also use the announcements frequently, which helps the Department reach businesses that employ professional tax preparation assistance.

Improving Existing Outreach Efforts

Department representatives have always been available to speak to groups of taxpayers about tax issues. This year the Department began offering public speaking training to its tax experts to improve the quality of its outreach efforts. This training covers the basics of public speaking, translating tax jargon into plain language and answering questions effectively in light of the Small Business Protection Act. It also includes a practical exercise in which the attendees make a presentation to their colleagues and receive feedback. Approximately 50 people have gone through the training and the feedback has been tremendous. Many of the attendees have reported back on how their presentations have improved and on the positive responses from their audiences.

The Department offers a comprehensive website as an information resource for taxpayers (including small business owners). Newcomers to the site often report that it is difficult to navigate and that they don't know which tax laws apply to them. In one of the first steps toward improving the site, the Department launched a Taxpayer Education section on the site. This new section helps taxpayers (including small business owners) navigate the site and find the information they need. It provides shortcuts to:

- Information about Tax Seminars and Presentations offered by the Department
- Current Tax Announcements
- Technical Bulletins, Directives and Notices
- Brochures and other Publications

This section was just launched recently. The Department will continue adding more content to make the section more robust and useful for small business owners.

Our Motor Fuels Division conducts annual motor carrier seminars throughout the State, usually during the month of August. In 2008, we conducted 2 seminars in Hickory, 1 in

Charlotte, 1 in Asheboro, 1 in Greenville, 1 in Wilmington, and 1 in Cary. There was 56% attendance based on registration forms. Approximately 400 taxpayers attended the seminars. We have been conducting motor carrier seminars since 1999.

4 A review of the Department's efforts to ensure that taxpayers are informed of their rights to request written advice from the Department upon which they may reasonably rely.

The Department maintains a website section entitled "Verbal Advice" that addresses both verbal and written advice. It explains how a taxpayer can request written advice, as well as when and how the Department will document verbal advice given to a taxpayer.

This information is also included in the Department's 2008 Tax Law Change document. It was included in the sales and use tax law change information sent to all registered taxpayers.

Our tax seminars conducted at the Small Business Centers also include information on how to get help and information from the Department. Most of the instructors cover written advice regardless of the seminar topic. The seminar on Dealing with the Department covers the common interactions small business owners have with the Department. It includes specific information on how a taxpayer can request written advice.

5. A review of the Department's plan to record telephone calls at the Department's Taxpayer Assistance Center.

The Department has evaluated call recording software for the TACC. A Service Level Request for call recording will be submitted after a final price quote is provided by ITS.

KRL/at

North Carolina 911 Board

Biennial Report to the
Governor
Joint Legislative Commission on Governmental Operations
Revenue Laws Study Committee
Joint Legislative Utility Review Committee

February 2009

Table of Contents

Executive Summary.....3

I. ***Background of the North Carolina 911 Board***.....6

II. ***Purpose of the North Carolina 911 Board***.....8

III. ***Accomplishments***.....15

IV. ***Action Plan for 2009***.....20

V. ***Addendum 1 / Use of 911 Fund***.....22

VI. ***Addendum 2 / FCC Non-Service Initialized Filing***.....27

VII. ***Addendum 3 / Intrado Findings & Recommendations***.....32

North Carolina 911 Board
Biennial Report to the
Governor
Joint Legislative Commission on Governmental Operations
Revenue Laws Study Committee
Joint Legislative Utility Review Committee
February 2009

Executive Summary

Background of the North Carolina 911 Board

On August 19, 2007, SL 2007-383 was enacted creating the 911 Fund and the North Carolina 911 Board ("Board") to administer that fund. Members of the Wireless 911 Board created under Article 2 of Chapter 62A serve as the initial twelve members to the seventeen member 911 Board. The remaining five members were appointed by the Governor, President Pro Tempore of the Senate, and the Speaker of the House of Representatives. Seven Board members represent the public sector of local government, nine members represent the private sector of the telecommunications industry and the chair of the Board is the State Chief Information Officer or the State Information Officer's designee.

Prior to the enactment of SL 2007-383, wireline 911 fees were established and collected by the governing authority of any local government. As of December 31, 2007, the 911 fee being collected by 122 local governments ranged from $ .25 to $ 3.00 per telephone connection.

The wireless 911 fee was established at $ .70 per with SL 2005-439 and was collected from all wireless (ie:cellphones) devices with remittance to the Wireless 911 Board.

SL 2007-383 created a single 911 fee for all telecommunication devices capable of accessing the 911 system at the rate of $ .70 beginning January 1, 2008. This fee is collected by all voice communication service providers (wireline, wireless & VoIP) and remitted to the North Carolina 911 Board. (§62A-43)

A PSAP Grant Fund is to be established for the purpose of making grants to PSAPs in rural and other high-cost areas. Funds for these grants are to come from excess amounts in the wireless carrier cost recovery fund and in 911 Fund designated for PSAPs. (§62A-47)

Funds distributed for wireless carrier cost recovery may only be used for the reimbursement for the compliance with the requirements of enhanced 911 services.

Funds distributed to primary PSAPs may be used only for the costs of establishing a 911 emergency telephone system. Also included are expenditures for in-State training of 911 personnel.

Section 7 of SL 2007-383 provided a moratorium on the collection of the 911 fee on prepaid wireless telephone service until December 31, 2008. Also, the Joint Legislative Utility Review Committee was directed to determine the best method for collecting the 911 fee from prepaid wireless telephone subscribers. SL 2008-134, enacted July 28, 2008, extended the moratorium until September 30, 2009.

Purpose of the North Carolina 911 Board

- To develop a 911 State Plan. In developing and updating the plan, the 911 Board must monitor trends in voice communications service technology and in enhanced 911 service technology, investigate and incorporate GIS mapping and other resources into the plan, and formulate strategies for the efficient and effective delivery of enhanced 911 service.
- To administer the 911 Fund and the monthly 911 service charge authorized by §62A-43.
- To distribute revenue in the 911 Fund to CMRS providers and PSAPs and advise CMRS providers and PSAPs of the requirements for receiving a distribution from the 911 Fund.
- To establish policies and procedures to fund advisory services and training for PSAPs and to provide funds in accordance with these policies and procedures.
- To investigate the revenues and expenditures associated with the operation of a PSAP to ensure compliance with restrictions on the use of amounts distributed from the 911 Fund.
- To accept gifts, grants, or other money for the 911 Fund.
- To undertake its duties in a manner that is competitively and technologically neutral as to all voice communications service providers.

Accomplishments

✓ The Board met eleven times during 2008 with focus on PSAP Fund distribution, use of 911 funds by PSAPs, establishing rules for the Board and work towards the Comprehensive Statewide 911 Plan

✓ Created new North Carolina 911 Board web page with content rich data for public access

- ✓ Created "Eligible Use of Fund " list to assist PSAPs to easily determine eligible uses of 911 fees
- ✓ Transitioned through funding issues with primary and secondary PSAPs
- ✓ Filed comments with the Federal Communications Commission (FCC) regarding Non Service Initialized Phones (wireless)
- ✓ Received legislative approval through technical corrections granting the Board the ability to adjust percentage allocations of funds received from wireless carriers.
- ✓ Recommended and received legislative approval through technical corrections to resume 911 funding to the Eastern Band of the Cherokee Indians
- ✓ Created a 911 funding seminar "The NC 911 Board: The Next Generation" for presentation to County/City Managers, Finance Directors and PSAP Directors.
- ✓ Completed the data gathering phase of the Comprehensive Statewide 911 Plan
- ✓ Created policies and procedures for the PSAP Grant Account

Action Plan for 2009

- Complete the Comprehensive Statewide 911 Plan
- Initiate the PSAP Grant Account program and award grants
- Continue the rulemaking process
- Explore new wireless carrier and PSAP funding model
- Provide at least one training program available to all PSAPs

North Carolina 911 Board
Biennial Report to the
Governor
Joint Legislative Commission on Governmental Operations
Revenue Laws Study Committee
Joint Legislative Utility Review Committee
February 2009

I. Background of the North Carolina 911 Board

On August 19, 2007, SL 2007-383 was enacted creating the 911 Fund and the North Carolina 911 Board ("Board") to administer that fund. Members of the Wireless 911 Board created under Article 2 of Chapter 62A serve as the initial twelve members to the seventeen member 911 Board. The remaining five members were appointed by the Governor, President Pro Tempore of the Senate, and the Speaker of the House of Representatives. Seven Board members represent the public sector of local government, nine members represent the private sector of the telecommunications industry and the chair of the Board is the State Chief Information Officer or the State Information Officer's designee.

Prior to the enactment of SL 2007-383, wireline 911 fees were established and collected by the governing authority of any local government. As of December 31, 2007, the 911 fee being collected by 122 local governments ranged from a low of $ .25 in Wake County and the Town of Cary to $ 3.00 in Washington County for each telephone connection.

The wireless 911 fee was established at $ .70 with SL 2005-439 and was collected from all wireless (ie:cellphones) devices with remittance to the Wireless 911 Board for distribution based on Article 2 of Chapter 62A-25(b) to 128 Primary Public Safety Answering Points (PSAPs). Wireless Primary PSAPs are defined as the PSAP receiving the initial wireless 911 call. The use of the wireless 911 fund by local governments was monitored by the Wireless 911 Board staff through their annual revenue/expenditure reports.

There are over 400 Voice over Internet Protocol (VoIP) providers operating in North Carolina. As of December 31, 2007 less than five were remitting a 911 fee back to a local government.

SL 2007-383 created a single 911 fee for all telecommunication devices capable of accessing the 911 system at the rate of $ .70 beginning January 1, 2008. This fee is collected by all voice communication service providers (wireline, wireless & VoIP) and remitted to the North Carolina 911 Board. (§62A-43)

All voice communication service providers are entitled to retain 1% of the collected fee as an administrative allowance. The Board may retain up to 1% of the remitted fees as an administrative allowance. Only funds received from wireless carriers (Commercial Mobile Radio Service or CMRS) are divided, 52% designated for wireless carrier cost recovery and 48% designated for distribution to PSAPs. Funds from wireline and VoIP providers in addition to the 48% designation from wireless carriers are allocated for distribution to primary PSAPs. (§62A-44(b))

Monthly distributions to primary PSAPs are based on a two part method. The "base" amount is based on deposits in the Emergency Telephone System Fund by the local governing entity as reported to the State Treasurer's Office, Local Government Division for the fiscal year ending June 30, 2007. The second method is a "per capita" distribution based on a primary PSAP's estimated population from a total amount designated by the Board of funds not needed to make the base amount distribution. (§62A-46(a) - (b))

A PSAP Grant Fund is to be established for the purpose of making grants to PSAPs in rural and other high-cost areas. Funds for these grants are to come from excess amounts in the wireless carrier cost recovery fund and in 911 Fund designated for PSAPs. (§62A-47)

Funds distributed for wireless carrier cost recovery may only be used for the reimbursement for the compliance with the requirements of enhanced 911 services. Costs of complying include costs incurred for designing, upgrading, purchasing, leasing, programming, installing, testing, or maintaining all necessary data, hardware, and software required to provide service as well as the recurring and nonrecurring costs of providing the service.

Funds distributed to primary PSAPs may be used only for the lease, purchase, or maintenance of emergency telephone equipment, including necessary computer hardware, software, and database provisioning, addressing, and nonrecurring costs of establishing a 911 system. Also included are expenditures for in-State training of 911 personnel regarding the maintenance and operation of the 911 system and charges associated with the service supplier's 911 service and other service supplier recurring charges.

Section 7 of SL 2007-383 provided a moratorium on the collection of the 911 fee on prepaid wireless telephone service until December 31, 2008. Also, the Joint Legislative Utility Review Committee was directed to determine the best method for collecting the 911 fee from prepaid wireless telephone subscribers. SL 2008-134, enacted July 28, 2008, extended the moratorium until September 30, 2009.

II. Purpose of the North Carolina 911 Board

The North Carolina 911 Board was created in January 2008 as mandated by §62A-41. Members of Board, their appointing authority, organization represented and term expiration are:

Board Member	*Appoint Authority*	*Organization Represented*	*Term Expires*
Jason Barbour	Governor	National Emergency Number Association (NENA) (Johnston County 911)	2012
Wayne Bowers	Governor	North Carolina League of Municipalities (Greenville)	2014
Frank Cairon	Speaker of the House	CMRS Provider (Verizon)	2012
Robert Cherry	Senate Pro-Tem	Chief of Police (Tarboro)	2012
Alan Cloninger	Speaker of the House	Sheriff (Gaston County)	2014
David Corn	Senate Pro-Tem	Local Exchange Carrier with less Than 200,000 Lines (Yadkin Valley Telephone)	2014
Bill Craigle	Speaker of the House	CMRS Provider (Alltel)	2014
Christi Derreberry	Senate Pro-Tem	CMRS Provider (Sprint-Nextel)	2014
David Dodd	Speaker of the House	Association of Public Safety Communications Officials (APCO) (Cleveland County 911)	2014
Joe Durham	Governor	North Carolina Association of County Commissioners (Wake County)	2012
Margie Fry	Governor	Voice over Internet Protocol Provider (Time-Warner)	2012
Jerry Jones	Speaker of the House	Local Exchange Carriers (ATT)	2012

Wesley Reid	Senate Pro-Tem	National Emergency Number Association (NENA) (Guilford Metro 911)	2014
Slayton Stewart	Senate Pro-Tem	CMRS Provider (Carolina West Wireless)	2014
Laura Sykora	Senate Pro-Tem	Local Exchange Carrier (Embarq)	2012
Jean Thaxton	Speaker of the House	Local Exchange Carrier with Less than 50,000 Lines (Randolph Telephone)	2012
Billy Willis	Statutory	State Chief Information Officer's Designee	n/a

The Board is housed in the Office of Information Technology Services and is staffed by three full-time staff members and receives legal counsel from the Department of Justice. Staff members and counsel are:

Ron Adams	Network Technician
Richard Bradford	Legal Counsel
Marsha Tapler	Accountant
Richard Taylor	Executive Director

Funding for the administration of the 911 Board comes completely from a 1% fee deducted from the total revenues remitted to the Board by the Voice Communication Providers. For the period ending December 31, 2008, total revenues for the 911 Board Administrative Fund were $ 846,134.57. Budgeted expenses for the fiscal year 2007-2008 were $ 1,093,600.00. The approved administrative budget for the 2008-2009 year is $ 584,254.00. As of December 31, 2008, the available 911 Board Administrative Fund balance was $ 1,576,840.43.

- To develop a 911 State Plan. In developing and updating the plan, the 911 Board must monitor trends in voice communications service technology and in enhanced 911 service technology, investigate and incorporate GIS mapping and other resources into the plan, and formulate strategies for the efficient and effective delivery of enhanced 911 service.

In October 2007, the Wireless 911 Board entered into a contract with Intrado, Inc. of Longmont, CO. to perform in-depth data gathering from over 120 primary PSAPs located in the 100 counties of North Carolina including the Eastern Band of the Cherokee Indians to develop the 911 State Plan. The contract is for an eight month period at a price of $ 708,000.00 with an option of a one year renewal.

To date, the data gathering phase of the project has been completed. A draft document detailing the data collected and the findings based on that data was presented to the 911 Board at their November 21, 2008 meeting. The Intrado team, based on comments received from Board members at that meeting, is conducting further analysis of the data and presented a draft plan (Addendum 3) at the Board's January 16, 2009 meeting.

- To administer the 911 Fund and the monthly 911 service charge authorized by §62A-43.

The 911 Board employs one fulltime accountant responsible for the bookkeeping of the revenues and expenditures of the Board. In September 2007, letters were mailed to all wireline providers operating in North Carolina (based on information from the North Carolina Utilities Commission) and all known Voice Over Internet Protocol (VoIP) providers operating in North Carolina (based on information from the Federal Communications Commission) informing them of the legislative change in the amount of the 911 fee and the new remittance requirements.

Remittances are monitored on a weekly basis to ensure all providers are in compliance. There have been only minimal instances of delinquent remittances and each has been satisfactorily resolved.

Revenues received from Voice Communications Providers are classified into three categories, Wireless, Wireline and VoIP. For the twelve month period ending December 31, 2008, total revenues received from the total number of providers in each category are:

48	Wireless providers remitting	$ 50,910,242.92
103	Wireline providers remitting	29,959,846.91
7	VoIP providers remitting	3,743,581.90

Total 911 Revenues for the calendar year 2008 $84,613,671.73

Also for the period ending December 31, 2008, all Voice Communication Providers are current with their remittances.

- To distribute revenue in the 911 Fund to CMRS providers and PSAPs and advise CMRS providers and PSAPs of the requirements for receiving a distribution from the 911 Fund.

Cost recovery for Commercial Mobile Radio Service (CMRS) providers (wireless carriers) per §62A-45 continued from policies and procedures instituted by the Wireless 911 Board based on cost recovery plans filed by each carrier. Carriers are required to submit sworn invoices for eligible recurring and nonrecurring costs for complying with the requirements of enhanced 911 services in order to receive reimbursement.

Of the 48 wireless providers remitting the 911 fee, nine are seeking cost recovery from the 911 fund. For the calendar year 2008, $ 16,953,787.54 was paid to CMRS providers for cost recovery.

The following wireless carriers are receiving cost recovery funds:

Alltel
ATT
Atlantic Telephone Membership
Carolina West Wireless
Cricket
North State Communications
Sprint-Nextel
SunCom (discontinued reimbursement requests July 1, 2008 after merger with T-Mobile)
US Cellular

As of December 31, 2008, the funds available in the CMRS Cost Recovery Fund, with interest, were $ 21,702,972.48.

The PSAP Fund is disbursed based on two statutory amounts and one qualifying requirement. The qualifying requirement is that a PSAP must be a primary PSAP. The definition of a primary PSAP is the first point of reception of a 911 call by a public safety answering point (§ 62A-40.16). The monthly distribution to a primary PSAP is the sum of 1) PSAP base amount which is the amount the PSAP received in fiscal year ending June 30, 2007 and reported to the State Treasurer's Office, Local Government Division, and 2) the PSAP per capita amount which is the PSAP's share of the amount designated by the Board for per capita distribution.

The State Treasurer's report to the Board dated April 16, 2008 reflected 140 PSAPs receiving 911 funds (only wireline, only wireless or both) in fiscal year 2006-2007. Of the 140 PSAPs reporting, Board staff determined that only 126 were primary PSAPs and eligible to receive 911 funds.

The following primary PSAPs received funding from the 911 Board in calendar year 2008:

Alamance County Central Communications
Alexander County Communications
Alleghany County E911
Anson County Emergency Communications
Ashe County Communications
Avery County Communications Center
Beaufort County Communications Ctr
Bertie County Sheriff's Communications
Bladen County Sheriff's Communications
Brunswick County 9-1-1
Buncombe County Emergency Communications

Burke County Emerg. Communications
Cabarrus County Sheriff Communications
Caldwell County Communications
Carteret County Communications
Caswell County 911 Communications
Catawba Co Communications Center
Chatham County Emergency Operations Center
Cherokee County 911
Chowan Central Communications
Clay County E911 Communications
Cleveland County Communications Center
Columbus Central Communications
Craven County Sheriff Communications
Cumberland County Communications
Currituck Central Communications
Dare Central Communications
Davidson County 911
Davie County Communications
Duplin County/Kenansville PSAP
Edgecombe County E911
Forsyth County 911 Communications
Franklin County Sheriff Communications
Gaston County Communications
Gates County Communications
Graham County Communications
Granville County Emergency Communications
Greene County Communications
Guilford Metro 911
Halifax County Central Communications
Harnett County Communications
Haywood County 911
Henderson County Communications
Hertford County Communications
Hoke County Emergency Communications
Hyde County Emergency Management
Iredell County Emergency Communications
Jackson County Emergency Communications
Johnston County Communications
Jones County Sheriff Communications
Lee County Emergency 911 Center
Lenoir County Communications
Lincoln County Communications Center
Macon County Communications
Madison County EOC
Martin County Communications Center
McDowell County Sheriff's Communications
Mitchell County Central Communications
Montgomery County Communications
Moore County Emergency Communications
Nash County Central Communications
New Hanover County Sheriff Communications
Northampton County E-911
Onslow County Communications
Orange County Emergency Communications
Pamlico County Communications
Pasquotank/Camden Central Communications
Pender County Sheriff Communications
Perquimans County Communications
Person County Communications
Pitt County 911 Communications
Polk County Communications
Randolph County Emergency Communications
Richmond County Emergency Comm.
Robeson County Communications
Rockingham County 911 Communications
Rowan County Telecommunications
Rutherford County Communications
Sampson County Sheriff Communications
Scotland County Emergency Communications / Laurinburg Police

Stanly County Emergency Communications
Stokes County Emergency Communications
Surry County Communications Center
Swain County 911 Dispatch
Transylvania County Communications
Tyrrell County
Union County
Vance-Henderson 911 Center
Warren County Sheriff Comm.
Washington County Communications
Watauga County Sheriff Communications
Wayne County Central 911
Wilkes County Sheriff Communications
Wilson County Emergency Communications
Yadkin County Emergency Communications
Yancey County Sheriff Comm.
Ahoskie Police Department Communications
Beech Mountain Police Dept
Boone Police Department 911
Cary Police Dept
Charlotte-Mecklenburg Police Department
Cornelius-Huntersville Police Communications
Dunn Police Communications**
Durham Emergency Communications
Eden Police Communications
Fayetteville City Communications
Havelock Public Safety Comm.
High Point Police/Fire Communications
Holly Springs Public Safety Center
Jacksonville E-911
Kings Mountain (City of)
Lumberton Emergency Comm.
Mount Holly Police Department
Murfreesboro
New Bern Communications Center
Oak Island (Town of)
Pineville Police Comm. Center
Raleigh Wake 911 Center
Reidsville Police Communications
Rocky Mount Police Communications
Shelby Police Communications
Tarboro Police Communications
Winston Salem Police/Fire Communications

** Dunn PD is a primary PSAP but did not report revenues to the State Treasurer in the April 16, 2008 report

The following PSAPs reported 911 wireline funding to the State Treasurer Local Government Division as shown on the April 16, 2008 report but are not primary PSAPs and have not received 911 funds from the 911 Board:

Davidson, Town of
Erwin
Grifton
Harrells
Kernersville
Lenoir, City of
Raeford
Spring Hope
Stoneville
Washington, City of

As of December 31, 2008, $ 60,422,033.82 has been disbursed to the 122 primary PSAPs.

As of December 31, 2008, the funds available in the PSAP Fund, with interest, were $ 10,215,996.63.

- To establish policies and procedures to fund advisory services and training for PSAPs and to provide funds in accordance with these policies and procedures.

As of December 31, 2008, the 911 Board had not established policies and procedures to fund advisory services and training. However, this is included as part of the Board's action plan for 2009.

- To investigate the revenues and expenditures associated with the operation of a PSAP to ensure compliance with restrictions on the use of amounts distributed from the 911 Fund.

The 911 Board adopted the policies and procedures used by the Wireless 911 Board for investigating PSAP revenues and expenditures. Reporting is done on a fiscal year basis to coincide with local government operations. Reporting by finance officers is done on a simple form which requests the name of each vendor, product or service purchased and the amount paid from 911 fees.

Revenue/Expenditure report requests were mailed to the 122 finance officers on October 15, 2008 for the reporting period of January 1, 2008 through June 30, 2008. As of December 31, 2008, 16 reports have been returned and approved by 911 Board staff. 62 reports have been returned and are still in the staff review process. 44 finance officers have not filed a Revenue/Expenditure Report with the 911 Board.

- To accept gifts, grants, or other money for the 911 Fund.

As of December 31, 2008, the 911 Board has not accepted any gifts, grants or other money for the 911 Fund. The National 911 Implementation Coordination Office under the auspices of the US Department of Transportation, National Highway Traffic Safety Administration and Department of Commerce, National Telecommunications and Information Administration is currently developing rules to awards grants totaling over $ 41,000,000. The grants will be awarded to a single state officer or governing body that can certify that 911 funds have not been diverted to other uses. The grants must be used for the deployment of Phase 2 Enhanced 911 services or migration to an IP enabled network.

In order to apply for grants, a State 911 plan must be in place. As of December 31, 2008, the North Carolina Comprehensive 911 plan was in development and based on the contents of the final plan, may or may not satisfy the requirements. The State 911 plan referred to in the grant process is a plan toward migration of the 911 system in the state to an IP network.

III. Accomplishments

✓ The Board met eleven times during 2008 with focus on PSAP Fund distribution, use of 911 funds by PSAPs, establishing rules for the Board and work towards the Comprehensive Statewide 911 Plan. The meeting dates for 2008 were:

January 18, 2008	February 8, 2008
March 14, 2008	April 11, 2008
May 9, 2008	June 20, 2008
July 28, 2008	August 8, 2008
September 26, 2008	October 24, 2008
November 21, 2008	

Meetings were held at the Governor's Crime Commission with one at the Wake County Commons and one web conference. All meetings were open to the public and the approved minutes of each meeting have been posted to the 911 Board website, www.nc911.net.

✓ Created new North Carolina 911 Board web page with content rich data for public access. The website, www.nc911.net, features three defined areas of interest, "911 Board, Voice Communications Service Providers and PSAPs". In each of the three sections, detail information regarding each can be located. Also, the site features an "Events Calendar" and "Newsroom" for easy access to upcoming and recent activities.

Agendas with accompanying documentation for past and upcoming Board meetings are accessible to the public. Downloadable forms used for reporting by PSAPs and Voice Communications Providers are available through the website. Training programs, schedules and public presentations are posted to the website for public access.

Grant applications and a new training video are currently under construction and will be web accessible when completed.

✓ Created "Eligible Use of Fund" list to assist PSAPs to easily determine eligible uses of 911 fees (Addendum 1). This list was created at the request of the North Carolina chapter of the National Emergency Number Association (NENA) and the North Carolina Chapter of the Association of Public Safety Communications Officers (APCO) at the first meeting of the 911 Board, January 18, 2008.

The request was generated from the fact that previous expenditures from wireline 911 fees received no oversight while expenditures from wireless 911 fees were monitored by the Wireless 911 Board and that local

interpretation may not be in line with the 911 Board's interpretation of the statute.

The Board chair appointed a committee of both the public and private sector Board members who spent many hours constructing the list. The initial list was approved by the Board at their February 8, 2008 meeting and has been amended four times in 2008.

✓ Transitioned through funding issues with primary and secondary PSAPs Based on the statutory requirements of §62A-46, only Primary PSAPs, defined as the PSAP that is the first point of reception of a 911 call, are eligible to receive 911 funding. Prior to the enactment of this legislation, there were a myriad of funding configurations between Primary and secondary PSAPs.

This issue was extremely sensitive given that changes were being made in the middle of a fiscal year and that replacing funding for secondary PSAPs would cause undue financial harm on the affective entities.

While trying to adhere to statutory directives and at the same time not cause harm, the Board has handled the secondary PSAP funding issue case by case. As of December 31, 2008, an agreement has been reached between the Town of Kernersville and Forsyth County. The 911 Board staff is currently working on agreements with the City of Washington and Beaufort County and with multiple secondary PSAPs in Robeson County.

✓ Filed comments with the Federal Communications Commission (FCC) regarding Non Service Initialized (wireless) Phones (Addendum 2).

The original Federal Communications Order (FCC) 94-102 which governs wireless 911, permitted cellphones that did not have active service to access the local 911 network. These phones, referred to as Non Service Initialized (NSI) phones did not provide a telephone number for a 911 center to call back if needed nor do they provide location information of the caller.

The phones have been used in many positive ways nationwide by such groups as battered women's shelters as a safety tool for their clients. They have also been used by many individuals to place false 911 calls. These false calls have caused the unnecessary dispatch of police, fire and EMS resources.

The FCC sought comments regarding NSI phones and any data available that could help in their consideration process.

The 911 Board requested available 911 call data from the 126 Primary PSAPs in the state. Data collection of this type is very burdensome and was collected by 25 PSAPs for the period May 15, 2008 – June 15, 2008. Thee findings were as follows:

NSI calls for May 15 – June 15, 2008	159,129	Percentage of total
Emergency NSI calls	14,849	9.33%
Non- Emergency NSI calls	132,885	83.51%
Malicious Non- Emergency NSI calls	11,395	7.16%

As of December 31, 2008, the FCC has not taken any formal action on the NSI issue. A complete copy of the 911 Board's filing with the FCC can be found in the Appendices.

✓ Received legislative approval through technical corrections granting the Board the ability to adjust percentage allocations of funds received from wireless carriers.

In April of 2008, 911 staff advised the Board of a potential shortfall in revenues for the PSAP fund due to the transition from a local collection to a state collection of wireline 911 fees. Unfortunately, SL-2007-0383, did not allow for a method to account for a cash shortfall.

The Board determined that the CMRS cost recovery fund was operating with a surplus of funds. The Board recommended a legislative change through a Technical Corrections bill that would allow the Board to adjust the percentage allocations of wireless carrier remittances between the wireless carrier cost recovery fund and the PSAP fund. SL 2008-134, Section 1(a) and (b) authorized the Board to adjust the allocations as necessary to allow for full cost recovery for CMRS providers and to meet the base amount for PSAP fund distribution.

The Board exercised this option at the July 28, 2008 meeting adjusting the percentage allocation to 99.5% for PSAP Base fund and .5% for CMRS cost recovery. The allocation change was effective immediately and set to revert back to the original percentages December 1, 2008.

The allocation change was successful allowing the Board to meet PSAP base fund requirements for the fiscal year ending June 30, 2008. At the November 21, 2008 meeting, the Board changed the wireless remittance

percentage allocation, to be effective December 1, 2008, to 48% for the PSAP fund and 52% for the CMRS cost recovery fund.

✓ Recommended and received legislative approval through technical corrections to resume 911 funding to the Eastern Band of the Cherokee Indians

Prior to the enactment of SL 2007-383, the Eastern Band of the Cherokee Indians received wireline 911 remittances from the Local Exchange Carriers and wireless 911 funds from the Wireless 911 Board. SL2007-383 permitted funding only to PSAPs that reported revenue to the State Treasurer, Local Government Division. The Eastern Band of the Cherokee Indians are not required to report revenues to the North Carolina State Treasurer and thus not eligible to receive 911 funds from the 911 Board.

The Board recommended changes through Technical Change legislation that would permit funding to the ECBI after verification of PSAP base amount and population data. This recommendation was adopted in SL 2008-134 and provided for funding to the ECBI retroactive to January 1, 2008.

✓ Created a 911 funding seminar "The NC 911 Board: The Next Generation" for presentation to County/City Managers, Finance Directors and PSAP Directors.

The enactment of SL 2007-383 brought about a complete change in how 911 funds were collected, remitted and accounted for by local governments. It was normal and somewhat expected that such a transition would create many questions with local governing officials. The Board produced a two hour presentation that focuses on the history of the 911 fee in North Carolina, the purpose behind SL 2007-383, the responsibilities of the 911 Board and how the Board will carry out those responsibilities.

The program is scheduled to be presented in each of the seventeen Council of Government regions plus in one dissolved region for a total of eighteen presentations across the state. As of December 31, 2008, six presentations had been completed in the western area of the state. The remaining twelve regional presentations are scheduled to be completed by February 20, 2009.

One presentation, conducted in Charlotte, was videotaped complete with audience questions and staff answers. This video will be edited and "chaptered" for easy reference through the 911 Board's website.

✓ Completed the data gathering phase of the Comprehensive Statewide 911 Plan (Addendum 3)

As part of the statement of work the 911 Board required of the vendor contracted to work on the Statewide 911 Plan, was the requirement to collect detail data from each of the PSAPs in North Carolina. The survey instrument had over 400 questions inquiring about network connectivity, technical equipment, operational procedures, physical facilities, staffing levels, statistical data and financial data.

The surveys were conducted with 128 Primary PSAPs, 53 secondary PSAPs and 5 military PSAPs. Data was also gathered from each of the colleges and universities that receive emergency calls.

With the collection of data complete, the analytical phase can now begin with the goal of understanding exactly how the 911 system in North Carolina functions including technically, operationally and financially.

✓ Created policies and procedures for the PSAP Grant Account

§ 62A-47 states that a PSAP Grant Account is to be established for the purpose of making grants to PSAPs in rural and other high-cost areas. The Board Chair established a Grant Committee to develop the policies and procedures necessary to implement the PSAP Grant program.

The Grant Committee presented draft policies to the 911 Board at the November 21, 2008 meeting.

The committee recommended that the grant program be established with two categories of grants. These are the E-911 Continuity and Consolidation Program and the E-911 Enhancement Program.

The purpose of the Continuity and Consolidation Program is to provide funding to primary PSAPs for projects designed to replace or upgrade E-911 equipment and services that are out of service, without vendor support, technically outdated, or can no longer perform at an established minimum functional standard to sustain an acceptable level of service to the public.

The purpose of the Enhancement Program is to provide funding to primary PSAPs for projects designed to strengthen, broaden or increase the current E-911 operations through equipment, PSAP staff development, or service beyond that PSAP's current capabilities.

The Board approved the procedures and staff is currently working with web development to make the entire grant application process web based. It is

anticipated that the actual grant application process for PSAPs will begin in February 2009.

IV. Action Plan for 2009

- Complete the Comprehensive Statewide 911 Plan

  With the completion of the data gathering phase, the presentation of findings and recommendations from the vendor, the 911 Board will immediately begin work to develop the 911 Plan. With the amount of data collected, the plan will be established based on the priorities established by the Board. The first stage of priority will be to establish a comparison of the level of 911 services available in North Carolina, the cost of providing the levels of service, potential for developing uniform costs and cost savings, and migration to an IP based 911 system(s) for access of next generation 911 technology.

- Initiate the PSAP Grant Account program and award grants

  With the completion of the PSAP Grant Program policies and procedures, the next step will be to implement the program and award the grants. It is anticipated that 911 Staff will have the web based application process completed in early 2009. Once the availability of the web application is ready, the 911 Board will begin accepting PSAP applications. It is anticipated that grant awards will be announced in the last quarter of FY 2008-2009 and the actual monetary awards made after July 1, 2009.

- Continue the rulemaking process

  The 911 Board will complete the draft rules in early 2009 and will take the next step in rulemaking process with the adoption by the Office of Information Technology (where the 911 Board is housed) of the Board's rules. Once ITS has adopted the rules, they will be submitted to the Rules Review Commission for approval.

- Explore new wireless carrier and PSAP funding model

  Wireless carrier cost recovery was established in 1998 with SL 1998-158. Since that time, the initial cost of implementing 911 services by wireless carriers has been completed and now it is more in the maintenance mode of providing services.

  The Board will review the current cost recovery program to determine if the requirements for cost recovery should be modified.

SL 2007-383 changed the process for remitting and distributing 911 fees to local governing authorities based on funding levels of fiscal year 2006-2007. Based on the limited amount of information already received by the Board, those funding levels provided what appears to be a surplus of funds for some PSAPs and a need for additional funds for other PSAPs to provide a minimum level of service.

The Board will begin a thorough analysis of the cost data provided by the PSAPs to determine what an adequate funding level should be for each PSAP and determine how that funding will be equitably distributed.

- Provide at least one training program available to all PSAPs

  Working with the PSAP community, the 911 trade associations of NENA and APCO, the Board will determine the greatest training need for 911 personnel. With the need identified, the Board will then move towards providing the necessary resources affording the greatest number of personnel receiving training.

Addendum 1

BY WAY OF EXAMPLE, BUT NOT LIMITATION, THE FOLLOWING COSTS ARE 911 FUND ELIGIBLE (as approved by the North Carolina 911 Board on 2/08/2008):

IF YOU HAVE QUESTIONS ABOUT EXPENDITURES NOT LISTED, PLEASE CONTACT THE 911 BOARD STAFF

ELIGIBLE 9-1-1 FEE EXPENDITURES

Revised April 11, 2008
Revised May 9, 2008
Revised September 26, 2008
Revised November 21, 2008

Phone Systems:

911 trunks and one administrative line per answering position in a primary PSAP

Telephones sets used to answer 911 calls, including CPE equipment, headsets, monitor, keyboard, mouse and servers used exclusively for telephone sets; when servers host both 911 eligible and ineligible applications, only the percentage of the cost of the server representing the 911 eligible use is allowable

Call Detail Printer or Call Detail Record (CDR) which provides the historical list of 911 calls, this is not a CAD printer

TDD/TTY (Telecommunications Device for the Deaf/Telephone Typewriter)

Automatic Call Distributions Systems (ACD) whether facilities based or premise based

Interpretive Services (e.g. Language Line or Omni Lingual)

Service provider selective routing and ALI provisioning charges

A percentage of FTE (full time equivalent) or contractual costs to provide telephone system maintenance until June 30, 2008 *(May 9, 2008)*

The costs for functions implemental to receiving and utilizing voice and data at the appropriate PSAP be considered as an eligible 911 system expense. Any

PSAP must provide adequate documentation upon request indicating the appropriate statutory authority supporting the cost of providing those functions *(May 9, 2008)*

Furniture:

Cabinets, tables or desks that actually hold eligible 911 equipment; when non-eligible 911 equipment is also being used on the cabinets, tables or desk, then a percentage of the 911 eligible portion is applied to the total cost

Software:

Computer Aided Dispatch (CAD) system modules that are part of the call taking process only. Some CAD systems will include many additional modules that are not a part of the 911 process and are not eligible

Geographic Information Systems (GIS) that are used to create and display the base map showing street centerlines

Photo Imagery used for maintaining mapping systems such as Ortho or Oblique images. Either imagery solution is acceptable but only one is permissible in a four year cycle

Voice logging recorder software

Law enforcement, fire and medical protocols including software & flipcards *(April 11,2008)*

Quality assurance software used for the training program of law enforcement, fire and medical call taking protocols
(November 21, 2008)

ALI database software

Software licensing costs

A percentage of FTE (full time equivalent) or contractual costs to provide software maintenance until June 30, 2008 *(May 9, 2008)*

The costs for functions implemental to receiving and utilizing voice and data at the appropriate PSAP be considered as an eligible 911 system expense. Any PSAP must provide adequate documentation upon request indicating the appropriate statutory authority supporting the cost of providing those functions *(May 9, 2008)*

Hardware:

Servers used exclusively for Telephone, CAD, voice logging recorder, and GIS software systems.

When servers host both 911 eligible and ineligible applications, only the percentage of the cost of the server representing the 911 eligible use is allowable

Computer work stations used exclusively for Telephone, CAD, voice logging recorder, and GIS software systems. *(September 26, 2008)*

When computer work stations host both 911 eligible and ineligible applications, only the percentage of the cost of the work station representing the 911 eligible use is allowable *(September 26, 2008)*

Uninterrupted Power Supply (UPS) for 911 only related equipment. If a UPS serves more than 911 equipment, then only a percentage of 911 eligible equipment served is allowable

Emergency Power Generator that serves the 911 center. If a generator serves more than the 911 center, then only a percentage of the total cost that serves the 911 center is allowable

A percentage of FTE (full time equivalent) or contractual costs to provide hardware maintenance until June 30, 2008 *(May 9, 2008)*

The costs for functions implemental to receiving and utilizing voice and data at the appropriate PSAP be considered as an eligible 911 system expense. Any PSAP must provide adequate documentation upon request indicating the appropriate statutory authority supporting the cost of providing those functions *(May 9, 2008)*

Addressing:

Street sign installation and street sign infrastructure maintenance until June 30, 2008 *(May 9, 2008)*

A percentage of FTE (full time equivalent) or contractual costs to provide addressing maintenance until June 30, 2008 *(May 9, 2008)*

The costs for functions implemental to receiving and utilizing voice and data at the appropriate PSAP will be considered as an eligible 911 system expense. Any PSAP must provide adequate documentation upon request indicating the

appropriate statutory authority supporting the cost of providing those functions
(May 9, 2008)

Training:

911 funding is allowed for individual class registration for maintenance and operation of the 911 system and specific 911 intake and related call taking training

Allowable travel expenses shall not exceed the local government or State of North Carolina per diem rates

Out of state training will be considered permissible if the class is not offered in North Carolina six months prior to, or six months after the scheduled out of state class.
(April 11, 2008)

Addendum 2

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition for a Notice of Inquiry	)	PS Docket No. 08-51
Regarding 911 Call-Forwarding	)	
Requirements and Carriers'	)	
Blocking Options for Non-Initialized Phones	)	

COMMENTS OF THE NORTH CAROLINA 911 BOARD

I. Introduction

The North Carolina 911 Board (NC Board) responds to a Notice of Inquiry, FCC 08-95, in which the Federal Communication Commission ("Commission") seeks comment on issues regarding 911 calls made by means of non-service initialized (NSI) telephones. The FCC released the Notice of Inquiry on April 11, 2008.

II. North Carolina 911 Board

The North Carolina 911 Board was created by the North Carolina General Assembly in 2007, and began operating on January 1, 2008. The Board's predecessor (North Carolina Wireless Board) was created by the North Carolina General Assembly in 1998. The NC Board was formed to provide a single agency to administer the State's 911 service fee. The NC Board comprises 17 members: two representatives from local governments, two representatives from local government law enforcement, four representatives from commercial mobile radio service ("CMRS") providers, four representatives from local exchange carriers, two

representatives from the North Carolina chapter of the National Emergency Number Association ("NENA"), one representative of a Voice over Internet Protocol (VoIP) provider and one representative from the North Carolina chapter of the Association of Public Safety Communications Officials ("APCO"). The NC Board is chaired by the State Chief Information Officer or his designee.

III. Survey and Data Collection

The Commission specifically requested comments and relevant information on the nature and extent of fraudulent 911 calls made from NSI devices. North Carolina is a diverse state comprised of 100 counties in which 127 primary PSAPs operate. Upon review of the Notice of Inquiry, the Board contacted the PSAPs and requested information relating to the use of NSI phones. Such information cannot be collected automatically. This necessitated manual notation by telecommunicators. As one would reasonably anticipate, collection of such data imposes a significant burden upon individual telecommunicators. Data was collected and submitted by 25 primary PSAPs. These PSAPs form a representative sample of all PSAPs within the State: whether examined by size, number of calls, population served or other measure. Hence, the NC Board believes the data offers a reasonable estimate of NSI call information.

PSAPs were asked to collect data comprising the number of NSI calls, the number of emergency calls from NSI phones, the number of non-emergency calls from NSI phones and the number of malicious calls from NSI phones. Data was collected during a one month period: May 15 – June 15, 2008. Based upon the

collected data, calculations were made to extrapolate the data to all PSAPs across the State. These calculations provide estimates as follows:

NSI calls for May 15 – June 15, 2008	159,129	Percentage of total
Emergency NSI calls	14,849	9.33%
Non- Emergency NSI calls	132,885	83.51%
Malicious Non- Emergency NSI calls	11,395	7.16%

The NC Board recognizes potential ambiguities associated with "malicious" and how telecommunicators and other PSAP personnel may have interpreted this category.

North Carolina provides criminal sanctions for abuse or misuse of a 911 system, whether (GS §14-111.4). Violations are misdemeanors, and may be prosecuted by the District Attorney having jurisdiction over the location of the call.

IV. Conclusion

The NC Board appreciates the opportunity to provide data to the Commission relating to this very important issue. North Carolina PSAPs have consistently reported problems arising from the use of NSI phones. While such reports are anecdotal, they are echoed across the country in reports from other PSAPs. The data collected clearly demonstrates a significant negative impact from the use of NSI phones.

Respectfully submitted this 27th day of June 2008,

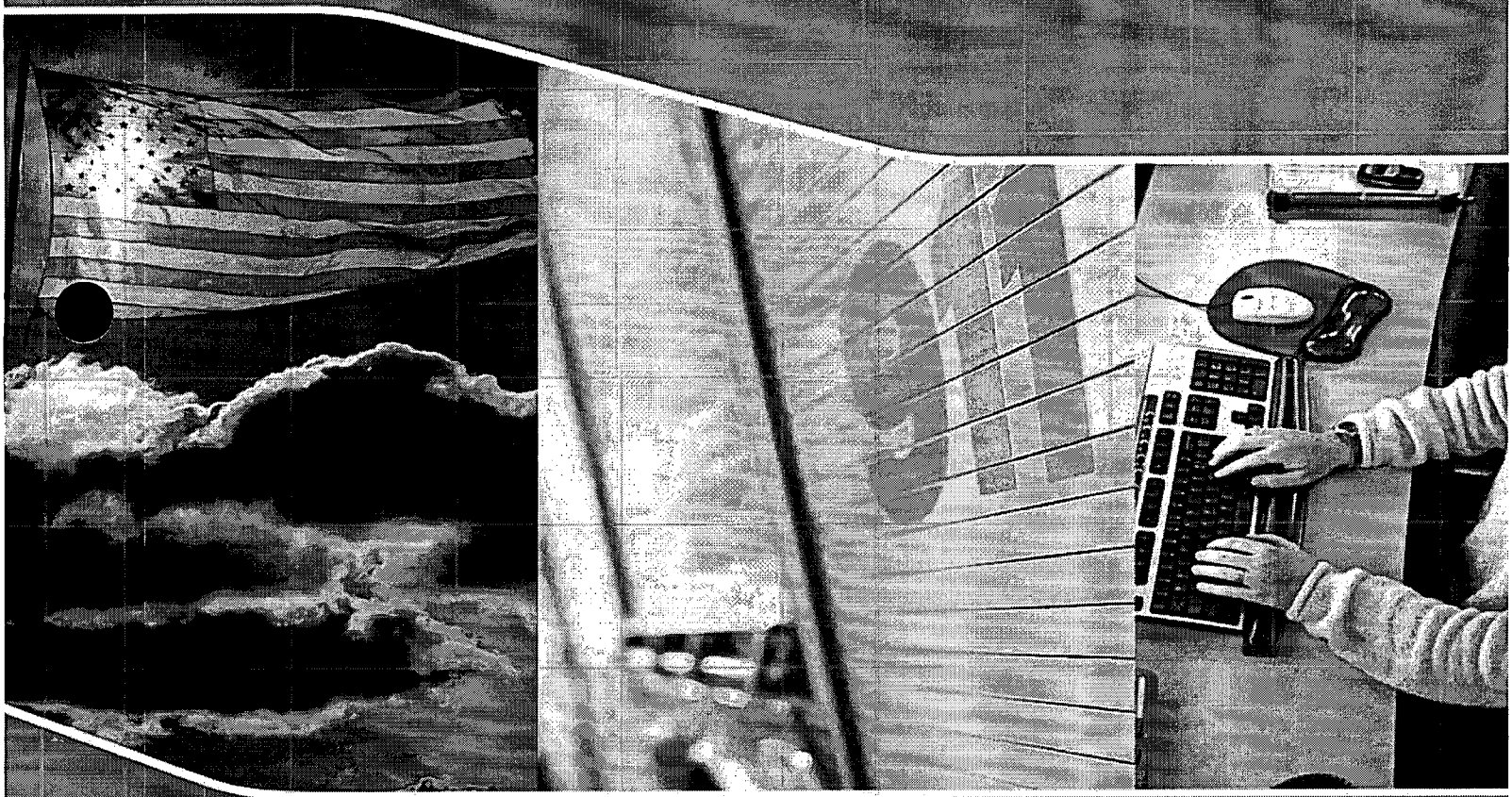
William Willis, Chair
North Carolina 911 Board
Post Office Box 17209
Raleigh, North Carolina 27619-7209

By: Richard H. Bradford,
Assistant Attorney General
Counsel for the North Carolina 911 Board

Addendum 3

VOLUME IV:
Comprehensive Statewide E9-1-1 Telecommunications Plan

North Carolina 911 Board



intrado

Intrado®

VOLUME IV: Comprehensive Statewide E9-1-1 Telecommunications Plan

prepared for

North Carolina 911 Board

January 6, 2009

west Intrado Inc. is a Subsidiary of West Corporation

Trademark Ownership

All trademarks used herein are the property of their respective owners.

Corporate Ownership

Intrado is a wholly owned subsidiary of West Corporation.

Contents

INTRODUCTION **3**
THE PLAN **4**
PURPOSE AND SCOPE OF STUDY 4
FINDINGS AND RECOMMENDATIONS **5**
UNDERSTAND THE ACTUAL COSTS FOR PROVIDING 9-1-1 SERVICE IN NORTH CAROLINA 5
IMPLEMENT STRATEGIC PLANNING PROCESS 5
UNDERSTAND THE DESIGN OF EXISTING NORTH CAROLINA 9-1-1 SYSTEMS 7
ESTABLISH A CONSISTENT AND COMPREHENSIVE TRAINING CURRICULUM 8
DESIGN, IMPLEMENT AND MAINTAIN A STATEWIDE 9-1-1 GIS/MAPPING SYSTEM AND DATABASE 8
DEVELOP AND MAINTAIN A CENTRALIZED STATE REPOSITORY FOR INFORMATION ABOUT 9-1-1 AND THE COMMUNICATIONS INDUSTRY 8
PROVIDE 9-1-1 TECHNICAL AND OPERATIONAL EXPERTISE AND PROJECT MANAGEMENT ASSISTANCE 9
ALIGN 9-1-1 FUNDING ACROSS COMMUNICATIONS PROVIDERS AND COVER ALL 9-1-1 SYSTEMS EXPENSE ITEMS 10
ASSESS AND CORRECT PSAP SPACE AND ENVIRONMENTAL DEFICIENCIES TO MEET MINIMAL REQUIREMENTS FOR THE TRANSITION TO NG9-1-1 10
ESTABLISH INTER-SELECTIVE ROUTER TRANSFER CAPABILITIES AND ALI DATABASE NODE INTEROPERABILITY 11
DEPLOY A CENTRALIZED ALI DATABASE 12
DEVELOP A STATEWIDE PROCUREMENT PROCESS AND CATALOG OF 9-1-1 SERVICES AND EQUIPMENT 13
DEVELOP 9-1-1 OPERATIONAL AND TECHNICAL REQUIREMENTS FOR MULTI LINE TELEPHONE SERVICES (MLTS) 14
RESEARCH, EVALUATE, AND COORDINATE DEPLOYMENT OF APPLICATIONS TO BE INTEGRATED INTO NG9-1-1 14
IMPROVE WIRELESS E9-1-1 CONFIDENCE AND UNCERTAINTY FACTORS 16
PROPOSED PROJECT PLAN **18**
PRIORITIZATION OF RECOMMENDATIONS **19**
PRIORITIZATION PROJECT PLAN **20**
RESOURCES TO IMPLEMENT THE PLAN **21**

INTRODUCTION

The statewide 9-1-1 challenges facing North Carolina as well as the nation are aptly described in a recent study commissioned by the 9-1-1 Industry Alliance[1]:

> Our nation's emergency system is getting left behind by technological change. The original provision of 9-1-1 arose in a world where a single carrier... provided service to customers using analog voice connections from fixed locations. Today, by contrast, there are a multiplicity of providers, almost all of which use digital technology and many of which offer "nomadic" or mobile services. In response to technological innovation, our current 9-1-1 infrastructure is a clever but "jury-rigged" system that uses yesterday's technology to provide service in a world very different for which it was designed. Indeed, the limits of the legacy technology used in emergency communications can be best understood by viewing today's 9-1-1 system as an analog island in a digital sea. To be sure, the ingenuity of the engineers who have stretched the current system to accommodate wireless telephony and other services is admirable. But policymakers must recognize that the system is stressed to its limits and change is required.[2]

In response to NC G.S. 62A-42. (a)(1)[3], which specifies that the North Carolina 911 Board (the Board) has a duty to develop a 9-1-1 state plan, the Board engaged Intrado to investigate, document, and assess the current emergency communications infrastructure in North Carolina, report trends in the 9-1-1 and telecommunications industry, and make recommendations that will allow the Board to develop and execute a comprehensive Enhanced 9-1-1 telecommunications plan. This plan is a result of the contract between the Board and Intrado.

Taking into account the challenges discussed in the 9-1-1 Industry Alliance study, Intrado developed this *Comprehensive Statewide E9-1-1 Telecommunications Plan* (plan) to foster the development of a statewide inter-networked 9-1-1 system allowing for Enhanced 9-1-1 (E9-1-1) call information to be communicated across networks and between Public Safety Answering Points (PSAPs) in North Carolina.

---

[1] The mission of the 9-1-1 Industry Alliance is to "represent the emergency communications industry in the development of emergency technology infrastructure and policy, for the good of public safety and the public it serves." See http://www.911alliance.org. Retrieved October 13, 2008.

[2] The 9-1-1 Industry Alliance 2008 Study on the Health of the United States Emergency Network: A Call to Action by the ColoComm Group, LLC. December 8, 2007.

[3] NC G.S. 62A-42.(a)(1) specifies that the North Carolina 911 Board has a duty to "develop the 911 State Plan. In developing and updating the plan, the 911 Board must monitor trends in voice communications service technology and in enhanced 911 service technology, investigate and incorporate GIS mapping and other resources into the plan, and formulate strategies for the efficient and effective delivery of enhanced 911 service." http://www.ncleg.net/enactedlegislation/statutes/html/bysection/chapter_62a/gs_62a-42.html. Retrieved October 9, 2008.

THE PLAN

Purpose and Scope of Study

In preparing its report, Intrado conducted interviews and collected information from North Carolina PSAPs as well as other entities that interact with 9-1-1 call flow, analyzed the findings, assessed industry trends, and developed the recommendations according to a short term (3 year) and long term (5 year and more) plan. The recommendations represent actions intended to address each of the 9-1-1 system areas assessed in the course of the project.

FINDINGS AND RECOMMENDATIONS

Understand the actual costs for providing 9-1-1 service in North Carolina

Finding:

Board staff currently collects 9-1-1 expense information from counties. For this assessment, PSAPs were asked to provide various 9-1-1 costs, and in many cases, PSAPs provided actual bills or budget documents to substantiate their costs. In addition, Intrado developed a baseline cost model as part of this assessment. It calculates the going-forward cost for 9-1-1 based on county populations, tariffs, and estimated costs for 9-1-1 system components. The going-forward costs represent the cost liability the 9-1-1 fund may need to bear as the actual costs change over the short and long term.

Recommendation:

Intrado recommends that the Board staff continually collect information from North Carolina PSAPs with which to forecast the cost for providing 9-1-1 service. The costs that are currently collected represent the historical costs PSAPs have incurred and may not accurately reflect all of the going-forward costs that will be incurred as 9-1-1 systems need to be replaced or upgraded. As counties and PSAPs submit their actual costs, the Board staff should update the model to continually reflect the new information. Other impacts to actual costs may occur as PSAPs purchase from the proposed statewide 9-1-1 catalog, realize that additional items are allowed, utilize newly offered common/shared resources, or implement next generation 9-1-1 technology.

Implement Strategic Planning Process

Finding:

Intrado's plan represents a 'point in time' analysis and plan for the Board to help coordinate activities to be performed by multiple parties throughout the state. By necessity, subsequent actions will need to be identified and taken based on the results of these initial recommendations.

Recommendation:

Intrado recommends that the Board implement an ongoing strategic planning process. As further described in this plan, this process would:

- Assess the current operational measures collected as part of this study (augmented with additional data collection or data validation as specified below) and the going-forward cost for providing 9-1-1 service in North Carolina;
- Determine whether the current operational measures and existing 9-1-1 funding is optimally aligned with statewide 9-1-1 system goals and going-forward costs;
- Investigate opportunities to gain efficiencies, leverage common resources, and implement new capabilities including next generation 9-1-1 technology;

- As necessary, propose system improvements, reconfigurations, or new funding models that more closely align system goals and the going-forward costs to provide 9-1-1 service.

Finding:

The North Carolina 9-1-1 system consists of diverse facilities, equipment, network, and software components. Prior to this assessment, there was no single or comprehensive source describing all of the various components statewide. The Board will require accurate and timely information regarding North Carolina 9-1-1 systems in order to plan for its ongoing development and funding, as well as assess the state's progress in migrating to Next Generation 9-1-1.

Recommendation:

Intrado recommends that the Board establish a process for PSAPs to continually submit, update, and validate 9-1-1 system information so the Board always has a reasonably accurate view of current 9-1-1 deployments. In the short-term, this process can be built upon the PSAP survey that was performed in support of the development of this plan. In the long-term, the Board staff should work with the North Carolina Office of Information Technology Services to augment the 911 Board web site by creating a repository and secure methods for PSAPs to maintain their information online. This will facilitate the updating of information by the PSAPs as well as provide management reports and data query capabilities to the Board.

Finding:

In the course of this assessment, it was observed that North Carolina county 9-1-1 system components are continually changing as PSAPs, carriers, and vendors upgrade or modify their services and configurations. The assessment performed in support of this plan provides a "snapshot" in time of the current system configurations for each county. A statewide inventory of 9-1-1 systems quickly becomes obsolete if not maintained and kept in alignment with those changes as they occur.

Recommendation:

The Board should specify a schedule for PSAPs to update or validate their data. Ideally, data updates would occur whenever there is a significant change in a county's 9-1-1 system, but not less than twice per year. In addition, as next generation systems are implemented, new data requirements corresponding to next generation equipment types and information categories will be identified. These new data requirements should be added to the data collection process.

Finding:

During the PSAP survey process, some North Carolina PSAPs indicated they do not routinely collect certain operating statistics that were requested by the Board such as 9-1-1 call volumes and dispatch intervals. Other PSAPs indicated they do not know how to extract the statistics from their call taking and dispatch systems.

Recommendation:

Intrado recommends that the Board communicate the need for PSAPs to work with their vendors to implement management information system (MIS) reporting capabilities, or understand how to use existing tools, in order to respond to requests for 9-1-1 call

statistics from the Board and be able to participate in the data collections process outlined above.

Finding:

According to Intrado's research and interviews performed in support of this study, communication services are now broader than phone calls over a standard telephone instrument. They are voice and text, wired and wireless, and are being delivered in a multi-tiered, multi-vendor market structure. There are retail providers and wholesale providers of communication service and infrastructure. And the evolution of IP-enabled communications service is changing the way people communicate with each other. From the perspective of the general public, the transition to next generation communications technologies has been underway for years. Although some of these technologies have been integrated into the existing 9-1-1 network through various means, the solutions are neither complete nor able to offer the level of functionality expected by the public. Because the existing 9-1-1 network is based solely on voice delivery, integration of new technologies like text messaging, telematics, data services, and images is not possible.

Recommendation:

Migration to Next Generation 9-1-1 technology is not only essential to provide citizens of North Carolina with complete integration of their existing communications means, but also provides a forward-looking, progressive path for integrating new technologies as they become adopted by the public. This will entail making sure current infrastructure truly meets existing needs for the short term, investigating and assessing new 9-1-1 service platforms, developing migration strategies, and executing them effectively to assure there is no degradation of services. Intrado recommends the Board take an aggressive role to lead, coordinate, and facilitate these activities across the 100 counties.

Understand the design of existing North Carolina 9-1-1 systems

Finding:

Intrado's report indicates that the number of PSAP positions per capita per county varies markedly across the state, as do certain other measures and operating statistics, even when controlled for population differences. Many of these variances are identified in Volume I; Section 3.2 of the report.

Recommendation:

Intrado recommends that the Board work with PSAPs to understand the cause for the variability of certain measures and operating statistics as identified in the report. In many cases, there may be local factors that reasonably contribute to the differences. In other cases, counties may recognize an opportunity for regionalizing 9-1-1 service to increase efficiency or jointly implement next generation system capabilities. The proposed ongoing collection of statewide 9-1-1 data can support the development of "what-if" scenarios or ad hoc business cases for estimating potential benefits associated with regionalizing service in different configurations.

Establish a consistent and comprehensive training curriculum

Finding:

As indicated by the PSAP surveys, the amount and type of new and ongoing call-taker and dispatcher training varies from location to location throughout North Carolina. A standard curriculum has been adopted by the North Carolina Sheriffs' Association for the training of sheriff department personnel.

Recommendation:

Intrado recommends that all PSAPs adopt a consistent and comprehensive minimum training curriculum for 9-1-1 call takers and dispatchers. Leveraging the North Carolina Sheriffs' Association call-taker training, PSAP managers should ensure that the scope of training represents a minimum recommended 9-1-1 curriculum as specified by standards bodies and associations such as APCO, NENA, and CALEA[4].

Design, Implement and maintain a statewide 9-1-1 GIS/Mapping system and database

Finding:

According to PSAP survey results, North Carolina counties and PSAPs maintain discrete geographic information systems (GIS). As a result, data collection, validation, maintenance, and storage are conducted by each county. The availability of North Carolina county GIS resources varies, as does the software employed, sources of information, and scheduling and method for updates. Volume I, Section 5 of this report provides a detailed assessment of the current use of GIS by PSAPs, as well as an inventory of North Carolina GIS resources.

Recommendation:

Intrado recommends that the Board Staff designate a program manager responsible for tasks specifically associated with assessing options for implementing a centralized statewide GIS database based on the conceptual architecture presented in the report. Tasks would include the issuance of requests for information and proposals for implementing the hardware, network, software, and procedures for establishing and maintaining a statewide GIS resource. To augment this capability and leverage existing resources, the program manager should represent 9-1-1 stakeholders in statewide GIS initiatives such as NC OneMap.

Develop and maintain a centralized state repository for information about 9-1-1 and the communications industry

Finding:

Rapid changes in communications technology, a shifting regulatory climate, and national efforts to deploy next generation 9-1-1 systems is creating large amounts of information

[4] The Communications Assistance for Law Enforcement Act of 1994.

regarding the public safety environment. The North Carolina 911 Board web site can be an effective method for sharing information with PSAPs. Almost every North Carolina PSAP indicated that they currently have internet access.

Recommendation:

Intrado recommends that the Board continue and expand use of the 911 Board web site as a centralized repository for ancillary information about 9-1-1 and the communications industry. Working with the North Carolina Office of Information Technology Services, Board staff can maintain a "public library" that would allow the Board, PSAPs, and 9-1-1 professionals to post documents and create links to various industry forums and standards bodies such as NENA, APCO, and Emergency Services Interface Forum (ESIF). The sharing of such resources will most likely become even more crucial as features for next generation 9-1-1 systems are defined and standards evolve.

Finding:

As part of its assessment, Intrado identified that the technical standards for next generation 9-1-1 systems are still evolving in standards bodies such as the Emergency Services Interconnection Forum and various NENA technical subcommittees. In its report, Intrado identified various reference models for NG9-1-1 that are being promoted by government as well as public and private entities.

Recommendation:

Intrado recommends that the migration to next generation 9-1-1 systems in North Carolina follow guidelines so that the easy inter-operation of 9-1-1 systems is assured. The Board should monitor PSAP trials of next generation 9-1-1 technologies (both within North Carolina and elsewhere), compile information, and assemble "lessons learned" to facilitate the propagation of approaches that are deemed successful and the efficient application of replicable processes. In addition, the Board's statewide knowledge of 9-1-1 systems can provide the North Carolina Utilities Commission with a valuable resource to establish service standards for next generation 9-1-1 systems that more readily accommodate IP-based technologies such as Telecommunications Relay Service (TRS), Video Relay Service (VRS), text messaging, and video.

Provide 9-1-1 technical and operational expertise and project management assistance

Finding:

There is an ongoing need at the PSAP and local-government level for 9-1-1 technical and operational expertise, as well as project management. This was made evident by PSAPs reporting that some systems did not work properly or at all, that some PSAPs could not access information from their systems, and that some equipment vendors were not responsive to repeated requests for assistance. Project management for upgrade to systems is conducted largely on a standalone county and PSAP basis.

Recommendation:

Intrado recommends that additional technical expertise be made available to PSAPs that may not have their own experts. Project plan templates and checklists for tasks should be developed for replicable activities to ensure that all issues are addressed. PSAPs

should be encouraged to share 'lessons learned' and identify instances where vendors are not responsive or systems do not work as expected. Specific attention will be required to coordinate tasks with neighboring PSAPs who may have inter-local agreements.

Finding:

Some PSAP representatives are not knowledgeable regarding the network configurations implemented by their 9-1-1 service providers and therefore were not able to provide specific information to the Board regarding abilities or constraints to transfer 9-1-1 calls.

Recommendation:

Intrado recommends that the Board communicate the need for there to be a coordinated effort between the PSAPs, LECs, and 9-1-1 service providers to validate or update the information representing each county's 9-1-1 system configuration including trunks, selective routers, and ALI database, as well as the PSAPs' ability to transfer 9-1-1 calls with data. When validated and kept current, such information can provide the Board with additional insight into jurisdictional border areas that may be experiencing chronic misroutes and explain why some North Carolina counties can transfer 9-1-1 calls with ANI/ALI and 9-1-1 call priority to certain counties while others cannot.

Align 9-1-1 funding across communications providers and cover all 9-1-1 systems expense items

Finding:

County 9-1-1 systems are funded from statewide 9-1-1 revenues at a "locked in" rate. The current method for allocating 9-1-1 funds to counties in North Carolina is based on a historic level that may not accurately represent future funding requirements. Many 9-1-1 components have a fixed lifespan after which they must be replaced. The need to implement new systems (including next generation 9-1-1), population growth and demographic shifts, as well as inflation may impact future costs. Additionally, there is an ongoing nation-wide trend for consumers to consolidate their telecommunication services which is resulting in a decrease in overall 9-1-1 revenues.

Recommendation:

Intrado recommends that the Board continually assess whether existing 9-1-1 funding and revenue allocation is appropriate to support the statewide 9-1-1 system and to meet the expenses associated with cost recovery for PSAPs, wireless carriers, and communication service providers while simultaneously planning for growth and enhancements.

Assess and correct PSAP space and environmental deficiencies to meet minimal requirements for the transition to NG9-1-1

Finding:

According to PSAP survey results, and as observed and documented during onsite PSAP visits, some PSAP facilities have deficiencies for housing and operating current 9-1-1 communications equipment or will be deficient for housing and operating next

generation 9-1-1 equipment. Deficiencies were noted in environmental conditions, wiring, and space. In general, the PSAPs were aware that such deficiencies existed. Although the onsite assessment was not intended to expertly assess all building systems, both notes and photographs were recorded where older structures or specific areas of PSAP facilities may be inadequate to appropriately house and operate the type of equipment necessary to implement next generation technology.

Recommendation:

Intrado recommends that the Board communicate the need for counties and PSAPs to address space, wiring, and environmental deficiencies. A compilation of equipment vendor environment, power, and space requirements provides a baseline set of recommended guidelines that should be adhered to by all PSAPs. Failure to address such issues may degrade system performance or cause systems to fail, invalidate system warrantees, and increase operating expenses

Establish inter-selective router transfer capabilities and ALI database node interoperability

Finding:

As described in detail in Volume I; Section 4 of the report, some PSAPS are unable to transfer emergency calls with ANI to other PSAPs in their surrounding areas. The caller's identifier, the ANI, must be sent with the voice path over the PSAP emergency trunks to the second (transferred-to) PSAP to enable that PSAP to retrieve an ALI record for the caller[5]. Challenges that prohibit the ability to transfer an emergency call with ANI include:

- PSAP's served by different service provider's selective routers
- PSAPs served by same 9-1-1 service provider but different selective routers

Without the activation of special software on the selective router, inter-selective router transferred calls will include the PSAP's phone number instead of the caller's ANI as the caller identifier in the voice path. This prohibits the PSAP receiving the transferred call from receiving the caller's ANI as part of the incoming call and thus the PSAP is unable to retrieve the ALI record.

The E9-1-1 Tandem-to-Tandem feature is a software package that enables the ANI, instead of the PSAP phone number, to be preserved and presented with the transferred call as part of the voice call. The feature package is currently available on all the DMS switches acting as selective routers serving North Carolina. Use of this feature requires that the 9-1-1 service provider purchase the right-to-use license from Nortel and then activate the software on the selective router.

Recommendation:

Intrado recommends:

- The Board should request the ongoing periodic submission of inter-selective router call transfer statistics from all primary PSAPs to include the volumes and

[5] To maintain the status of an emergency call, the transferred call must come in over the PSAP emergency trunks, the same trunks used for 9-1-1 calls.

types of calls transferred between PSAPs: wireline, wireless, VoIP (see 9-1-1 System Data Collection).

- Based on its evaluation of the PSAP call transfer statistics, the Board should assess the need for additional inter-selective router trunks to support transfers and prioritize which selective router switches may require activation of the E9-1-1 Tandem-to-Tandem feature based on a higher volume of transferred calls.
- The Board should request from 9-1-1 service providers price quotations and ordering procedures for activation of the E9-1-1 Tandem-to-Tandem feature including any implementation considerations or constraints.
- Focusing initially on counties where call statistics indicate a high volume of transferred calls, the Board should share the information with PSAPs and governing authorities regarding availability of the E9-1-1 Tandem-to-Tandem feature, benefits, ordering procedures, and any implementation considerations or constraints so that PSAPs can assess the information and follow up with their 9-1-1 service provider.
- The Board should establish a method to pay for use of the E9-1-1 Tandem-to-Tandem feature. As a common resource that by definition will be used by multiple counties and PSAPs to provide E9-1-1 service throughout the state, and in order to encourage efficient implementation statewide, Intrado recommends the Board pay for use of the feature from 9-1-1 funds.
- Based on the ongoing evaluation of PSAP call transfer statistics, the Board should continually assess the need for additional selective routers to have the E9-1-1 Tandem-to-Tandem feature activated and/or additional inter-selective router trunks.
- The Board should continue to identify candidate PSAPs and selective router switches (those with progressively lower volumes of transferred calls) that would still benefit from activation of the E9-1-1 Tandem-to-Tandem feature for call transfers.

Deploy a centralized ALI database

Finding:

North Carolina PSAPs are served by multiple 9-1-1 service providers: AT&T, Embarq, Verizon, Citizens Telephone, and Windstream. AT&T and Embarq have regional ALI databases for wireline and wireless ALI records. Verizon is in the process of establishing a regional database for wireless ALI record access for PSAPs in their service areas. The current deployment of multiple ALI database nodes in North Carolina precludes delivery of ALI subscriber data records between 9-1-1 service providers when 9-1-1 calls are transferred.

Recommendation:

Intrado recommends:

- The Board Staff should designate a program manager responsible for tasks specifically associated with assessing options for resolving the ALI database

challenges including potential implementation of a centralized statewide ALI database as well as common data format (see below).

- Acting on behalf of the Board, the program manager should issue a request for information (RFI) to solicit input regarding potential benefits, implementation options, estimated costs, and policy issues associated with establishing a centralized statewide ALI database. The results of the RFI will provide the Board with potential design and implementation options for providing a centralized statewide ALI database.

Finding:

A second challenge for delivering consistent data for transferred calls arises from the fact that North Carolina PSAPs utilize different data formats. This is not a problem when PSAPs operate independent of each other utilizing standalone ALI (SALI) systems. However, in order to be able to transfer calls and share data, the data format issue needs to be addressed so that the call information is displayed appropriately for each PSAP.

Recommendation:

Intrado recommends:

- The Board should appoint a task force consisting of PSAP representatives, 9-1-1 service providers, the ALI database program manager, and other interested North Carolina 9-1-1 stakeholders to determine the benefits, costs, and procedures necessary for PSAPs to agree on a standard ALI data format with a focus on supporting converged technology – wireless, VoIP. The task force should consider the experience of other states that have standardized their ALI record formats. California is an example of a state where standard formats have been agreed upon for all PSAPs and used for access to wireless records.

Develop a statewide procurement process and catalog of 9-1-1 services and equipment

Finding:

Currently, procurement of 9-1-1 products and services in North Carolina is executed largely on an individual county and PSAP basis. Duplicate requests for proposal (RFP) processes are conducted and different terms and conditions are negotiated by each agency.

Recommendation:

Intrado recommends that the Board establish a voluntary statewide procurement process and compile a catalog of 9-1-1 services and equipment. This would relieve local governments of the need to conduct individual competitive bids, while assuring them of quality products and services that meet basic technical, operational, and interoperability requirements. As demonstrated by other states that have established 9-1-1 catalogs, the use of "bulk" purchasing should reduce costs and help stretch public safety dollars.

Develop 9-1-1 operational and technical requirements for Multi Line Telephone Services (MLTS)

Finding:

Currently, North Carolina does not have legislation requiring 9-1-1 for users of Multi Line Telephone Service (MLTS). As discussed in Volume I; Section 6 of the report, MLTS creates unique issues for enhanced 9-1-1 systems due to challenges in delivering the calling parties' telephone number and specific location for 9-1-1 calls made within a business or residential tenant facility. This information is critical when attempting to locate callers who are unable to provide accurate location information. The lack of specific location information can have dire consequences if the caller is disconnected, because there is no call back number to reach the person who placed the call.

Considering the growth of VoIP-type multiline telephone systems for businesses and the mobility these systems provide for "soft phone"[6] users, plus the integration of wireless calling devices with MLTS systems, public safety services have a growing dependency on states to provide legislative directives for businesses to implement MLTS E9-1-1 solutions.

Recommendation:

Intrado recommends that the Board communicate to the North Carolina legislature the need for MLTS 9-1-1 legislation to cover businesses and residential tenant facilities. Furthermore, the Board should encourage North Carolina state and local governments to lead by example and implement MLTS 9-1-1 for all agencies currently not covered by such service. This is especially crucial for North Carolina university campuses that provide telephone services for residential housing facilities for students.

The current status of MLTS rules is discussed in detail in Volume I; Section 6.1.7 of the report regarding federal regulatory mandates. A copy of NENA's sample MLTS legislation is included in Appendix Q.

Research, evaluate, and coordinate deployment of applications to be integrated into NG9-1-1

Finding:

Current 9-1-1 network and equipment and associated PSAP operations are designed to be discretely provisioned for or conducted by each PSAP. A recurring theme addressed in the report is the benefit associated with greater integration, inter-operation, and sharing of resources, much of which will be made possible by next generation technology. Many NG9-1-1 systems will be IP-based and will have the ability to support other applications on data networks that can serve multiple purposes for public safety.

[6] The term "soft phone" generally refers to a software program for making telephone calls over an IP network like the Internet or a private managed IP network using a computer instead of a dedicated telephone instrument. A soft phone is often designed to look like a standard telephone and has buttons that represent the standard functions that are often found on telephone sets.

Recommendation:

With the advent and deployment of this new technology, there will be a need to research and evaluate these applications and to coordinate deployment across systems statewide. For example, a single data network could hypothetically be used for Radio over IP (RoIP) applications that resolve inter-jurisdictional radio interoperability issues, emergency event management, E9-1-1 call delivery, and access to centralized GIS resources.

Finding:

According to survey results, 97 North Carolina PSAPS currently have access to a citizen notification "call-out" system while 64 indicated that they would be interested in having such a capability. In North Carolina, the Emergency Management Division of the North Carolina Department of Crime Control and Public Safety[7] is the central organization for Emergency Alerting Systems. Currently there are several methods for outbound emergency notification and various systems to support them including:

- Emergency Alert System (EAS)—Standard method used to disseminate information via television and radio media broadcasters to the public.
- Call-Out Phone Systems—Calling home phones to alert residences in particular areas
- Text Message (Short Message Service (SMS)—Useful for notification on college campuses and relaying brief information about an emergency
- Broadcast Email—Requires email lists to alert individuals with email access
- Siren Systems—Community-wide notification of impending emergency situations. Some systems include voice audible explaining the type of emergency along with the siren.
- Web Sites—Posting of emergency situations on web sites to allow global communication
- Instant Messaging—Another means of sending messages within a designated group of recipients
- Electronic Billboards—Posting of emergency situations on highways, evacuation routes, etc.

None of these emergency notification systems interface directly with the physical 9-1-1 system. The only emergency notification system that may have an operational relationship to the 9-1-1 system is an outbound notification phone system. Outbound call notification systems often utilize standard directory white page listing information, but this information may be inadequate for emergency notifications. Standard white page listing data does not include non-published numbers or many business non-listed numbers, thereby not fully representing the contact area.

[7] NC Department of Crime Control & Public Safety: http://www.nccrimecontrol.org. Retrieved September 10, 2008.

Recommendation:

Intrado recommends that the Board encourage PSAPs and Emergency Management to adopt a consistent set of guidelines if they choose to use ALI database data as part of their emergency call-out systems. Using the 9-1-1 database to support emergency call-out systems would ensure that all numbers in a target area are available for notification messages. A common set of guidelines would control the use and access to the data for this purpose. Additionally, authorized agencies could negotiate a common set of terms and conditions with service providers for use of the data.

Improve Wireless E9-1-1 Confidence and Uncertainty Factors

Finding:

Confidence and Uncertainty are numeric representations that may be provided along with the latitude and longitude (x,y) coordinates associated with a Phase II wireless E9-1-1 call. The NENA master glossary defines the two terms as follows:

- Confidence—Mathematically derived statistical estimate indicating how sure the measuring system is that the wireless Phase II location data estimate is accurate, within the bounds defined by the Uncertainty value. This is expressed as a percentage, such as 90% or 45%, etc. The specific value is not representative of the accuracy of the Position Determining Entity (PDE).
- Uncertainty—Mathematically derived statistical estimate, expressed in meters, indicating the size of the area used in the calculation of the Confidence. The specific value is not representative of the accuracy of the PDE location system.

FCC requirements for wireless Phase II E9-1-1 calls (FCC Docket Number 94-102) state that the wireless carriers provide longitude and latitude within certain accuracy requirements. However, federal requirements for Phase II location data do not mandate the delivery of confidence and uncertainty data. These supplemental data fields are most useful when the PSAP displays the longitude and latitude coordinates as a point on a map. The confidence and uncertainty data can be used in an algorithm in the mapping software to produce a visual representation of the probable range of location of an emergency call.

When surveyed, many North Carolina PSAPs indicated that they either do not receive confidence and uncertainty information with the latitude and longitude, or do not believe it is reliable, or do not know how to use it appropriately.

Recommendation:

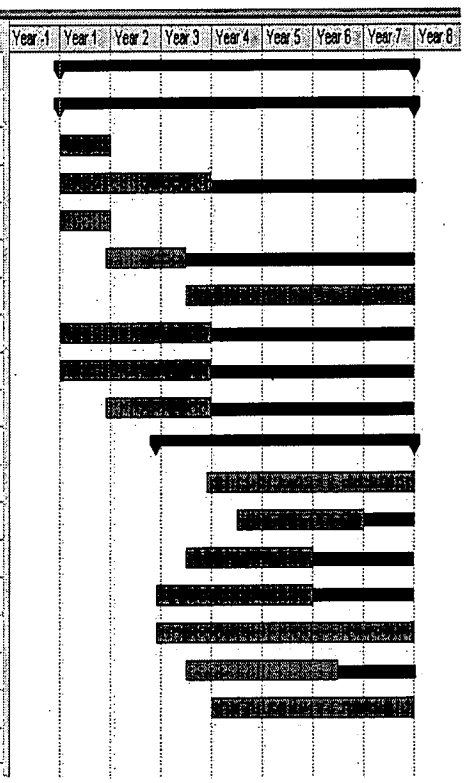
Intrado recommends that the Board share with agencies the need for PSAPs to work collaboratively with wireless carriers to do regular and random field testing of wireless 9-1-1 calls. The purpose of this collaborative testing is to help PSAPs assure the quality of information being presented to call takers. The field testing of wireless carrier location accuracy for mapping validation requires that the PSAPs have access to GPS units and wireless services from the wireless carriers in their area. Some wireless carriers provide service and handsets at no charge to the PSAP testing personnel. Alternately, Intrado recommends that such equipment be an allowable expense under Board guidelines. Additionally, PSAPs will need to dedicate trained personnel to the task. Appropriate training regarding mapping software, GIS, wireless 9-1-1 call routing, and the

appropriate use of confidence and uncertainty information should be funded under current guidelines.

Given these requirements and the replicable nature of this testing, the Board (or a contracted 3rd party) may be better positioned to administer the logistics of wireless field testing for mapping validation on behalf of North Carolina PSAPs. There would be certain economies of scale and a concentration of expertise if a single party performed regular and random testing on behalf of PSAPs throughout the state.

PROPOSED PROJECT PLAN

	Task Name
1	**Comprehensive Statewide 9-1-1 Plan**
2	**Three-Year Plan**
3	Understand the actual costs for providing 9-1-1 service
4	Implement Strategic Planning Process
5	Understand the design of existing North Carolina 9-1-1 systems
6	Establish a consistent and comprehensive training curriculum
7	Design, implement and maintain a statewide 9-1-1 GIS/Mapping system and database
8	Develop centralized 9-1-1 information repository
9	Provide 9-1-1 technical and project management assistance
10	Improve Wireless E9-1-1 Confidence and Uncertainty Factors
11	**Five Plus Year Plan**
12	Align 9-1-1 funding
13	Assess and correct PSAP deficiencies for transition to NG9-1-1
14	Establish inter-selective router transfer and ALI database interoperability
15	Deploy a centralized ALI database
16	Develop a statewide procurement process and 9-1-1 catalog
17	Develop 9-1-1 for Multi Line Telephone Services (MLTS)
18	Coordinate deployment of applications to be integrated into NG9-1-1



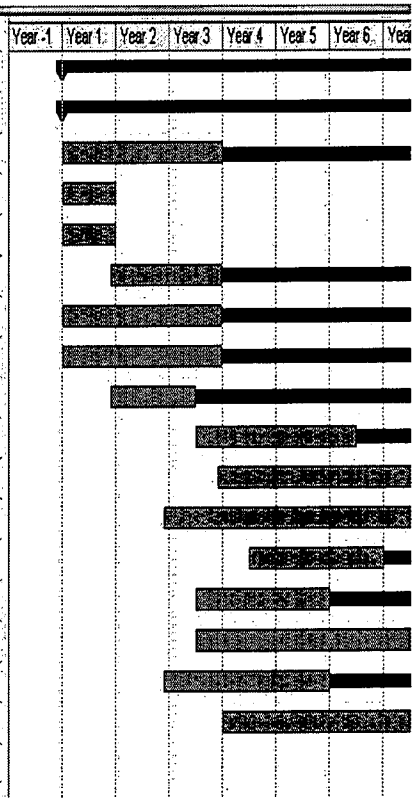
PRIORITIZATION OF RECOMMENDATIONS

The following table represents another view of the recommendations detailed above, listing them in order according to priority for improving 9-1-1 services in North Carolina.

Recommendation Prioritization Plan
1. Implement Strategic Planning Process
2. Understand the design of existing North Carolina 9-1-1 systems
3. Understand the actual costs for providing 9-1-1 service
4. Improve Wireless E9-1-1 Confidence and Uncertainty Factors
5. Provide 9-1-1 technical and project management assistance
6. Develop centralized 9-1-1 information repository
7. Establish a consistent and comprehensive training curriculum
8. Develop 9-1-1 for Multi Line Telephone Services (MLTS)
9. Align 9-1-1 funding
10. Develop a statewide procurement process and 9-1-1 catalog
11. Assess and correct PSAP deficiencies for transition to NG9-1-1
12. Establish inter-selective router transfer and ALI database interoperability
13. Develop, implement, and maintain a statewide 9-1-1 GIS/Mapping system and database
14. Deploy a centralized ALI database
15. Coordinate deployment of applications to be integrated into NG9-1-1

PRIORITIZATION PROJECT PLAN

	Task Name
1	**Comprehensive Statewide 9-1-1 Plan**
2	**Recommendation Prioritization Plan**
3	Implement Strategic Planning Process
4	Understand the design of existing North Carolina 9-1-1 systems
5	Understand the actual costs for providing 9-1-1 service
6	Improve Wireless E9-1-1 Confidence and Uncertainty Factors
7	Provide 9-1-1 technical and project management assistance
8	Develop centralized 9-1-1 information repository
9	Establish a consistent and comprehensive training curriculum
10	Develop 9-1-1 for Multi Line Telephone Services (MLTS)
11	Align 9-1-1 funding
12	Develop a statewide procurement process and 9-1-1 catalog
13	Assess and correct PSAP deficiencies for transition to NG9-1-1
14	Establish inter-selective router transfer and ALI database interoperability
15	Design, implement and maintain a statewide 9-1-1 GIS/Mapping system and database
16	Deploy a centralized ALI database
17	Coordinate deployment of applications to be integrated into NG9-1-1
18	



RESOURCES TO IMPLEMENT THE PLAN

Intrado recognizes that implementation of all of the recommendations included in this plan would stretch the 9-1-1 Board Staff. Therefore, recommended incremental staffing needs for accomplishing the plan are as follows.

- Research for Centralized ALI Database (1 FTE)—This is an initial one-time task (12 months) to lead a taskforce, issue an RFI, and coordinate interested stakeholders in researching issues associated with the potential design and implementation of a centralized ALI database and agreement on a common data format. This task may spawn subsequent project design, implementation, and deployment phases which would require ongoing support of the resource.
- 9-1-1 Information Repository—Development and maintenance of 9-1-1 information repository (.25 FTE). Ongoing task to develop, acquire, research, and maintain the documents and information that will be made available related to the design, implementation, and operations of 9-1-1 services.
- 9-1-1 Network Configuration—Development and maintenance of 9-1-1 network schematics. A one time task to develop and publish the initial network schematics and then provide updates as changes in 9-1-1 systems occur. This could be performed by the same FTE required for the information repository as defined above.
- 9-1-1 Training Curriculum Development (1 FTE)—Create an ongoing project to research, develop, and publish 9-1-1 training curriculum. Project should include the coordination of training programs with other stakeholders and the various 9-1-1 agencies.
- Research for GIS and Mapping (1 temporary FTE)—This is a one-time task that could take 8-12 months to research, develop, and provide initial coordination of GIS systems and data in support of 9-1-1 systems and mapping. Should the state determine to continue with the mapping project and provide ongoing GIS and mapping support services, the position would require a permanent FTE.