1998 Tax Law Changes

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S.L. 1998-1 Extra Session (Senate Bill 2, Senator Rand)

AN ACT TO ESTABLISH THE HEALTH INSURANCE PROGRAM FOR CHILDREN AND TO AUTHORIZE A TAX CREDIT FOR CERTAIN PURCHASERS OF DEPENDENT HEALTH INSURANCE.

Section 5 of this act creates a refundable individual income tax credit for certain taxpayers who purchase health insurance for their dependent children. The credit is equal to $300 for those taxpayers with incomes below 225% of the Federal Poverty Level and $100 for those taxpayers above the 225% threshold. Taxpayers who have their health insurance premiums deducted from their income before it is taxed do not qualify for the credit. Taxpayers whose adjusted gross income is higher than the threshold amount set by the act do not qualify for the credit. The threshold amount for married filing jointly is $100,000 and the threshold amount for head of household is $80,000. The credit is effective for taxable years beginning on or after January 1, 1999, and it expires on the effective date of an act repealing the Heath Insurance Program for Children established by this act. It is estimated that the tax credit will produce a General Fund revenue loss of $64.5 million in FY 1999-2000.

Governor Hunt convened the General Assembly in an extra session beginning March 24, 1998, to address the issue of uninsured children. In 1998, there were more than 71,000 uninsured children in North Carolina whose parents made too much money to qualify for Medicaid but who could not afford to purchase health insurance for their children. Under Title XXI of the Social Security Act, North Carolina had the opportunity to receive $79.9 million in federal money in order to provide health care for children if the State established a Health Insurance Program for Children that met federal guidelines.

This act establishes a Health Insurance Program for Children. To be eligible for the program, the person must be ineligible for other government-sponsored health insurance, be under the age of 19 and enrolled in school, be uninsured for six months prior to application, be in a family that meets the income requirements, be a State resident, and pay the required premium amount. The premium amounts vary depending upon the family's income from zero to $5 per child per month with a $15 per month family unit cap to $10 per child per month with a $28 per month family unit cap. A family who loses

coverage under the Program due to an increase in income may purchase extended coverage through the Program for one year by paying the full premium costs.

In addition to creating a Health Insurance Program for Children, the General Assembly enacted a tax credit for taxpayers who purchase health insurance for their children to help bridge the gap between assisted health insurance costs under the Heath Insurance Program and unassisted health insurance costs as a family begins earning too much income to qualify for the Program. The credit is not allowed for the reduced premiums paid under the Program; it is allowed for premiums paid to purchase extended coverage under the Program.

The amount of the credit differs depending upon the taxpayer's adjusted gross income, stated as a percentage of the applicable federal poverty level, based upon the taxpayer's family size. For purposes of the credit, a taxpayer's family size is the number of persons for whom the taxpayer may deduct a personal exemption on the taxpayer's tax return. This qualification means that a non-custodial parent who pays health insurance premiums for a child will not qualify for the credit if the parent cannot claim the child as a dependent on the parent's return. Under federal law, the custodial parent is entitled to claim the child as a dependent on the parent's income tax return unless the custodial parent signs a written declaration that the parent will not claim the child as a dependent for that taxable year.

To prevent a double tax benefit, the tax credit may not be claimed if the amount paid by the taxpayer for insurance coverage is deducted from or not included in the taxpayer's gross income for income tax purposes. If a taxpayer claimed a deduction for health insurance costs of self-employed individuals for the taxable year, the amount of credit otherwise allowed is reduced by the amount of the deduction. In 1999, a self-employed individual may deduct 45% of health insurance costs from income tax. This percentage increases to 100% by the year 2007. If a taxpayer claims a deduction for medical care expenses, the taxpayer is not allowed a credit. Lastly, if a taxpayer uses "pre-tax" dollars to pay the health insurance premiums through a cafeteria plan, the taxpayer is not allowed a credit. Roughly 40% of the parents now paying health insurance premiums for their children do so with "pre-tax" dollars and, therefore, are not eligible for the credit.

The tax credit may not exceed the amount of health insurance premium the taxpayer paid during the taxable year that provided insurance coverage for the taxpayer's dependent children. However, the amount of the credit may exceed the amount of tax owed by the taxpayer. If the credit allowed exceeds the

amount of tax imposed, the excess is refundable to the taxpayer. In computing the amount of tax against which multiple credits are allowed, nonrefundable credits are subtracted before refundable credits. This credit is North Carolina's first refundable tax credit. To claim the credit, approximately 20,000 families that do not currently have to file a State income tax return will have to file a tax return to receive this refundable credit. Many low income families do not currently file income tax returns because their personal exemptions and standard deductions exceed their tax liability.

The ability of the Department of Revenue to ensure compliance with this credit will be difficult. The Department does not currently require a taxpayer to include a copy of the taxpayer's federal return with the State return. However, the Department will need this information to ensure that the taxpayer did not claim a self-employed health insurance deduction or a medical expenses deduction for the premiums. The Department will probably require the federal return to be attached if the credit is claimed. How to determine whether premiums were paid with "pre-tax" dollars is more difficult since the wage and tax statement does not state whether health insurance premiums were paid with pre-tax dollars. To help the Department ensure compliance with the law, the act states the General Assembly's intent to appropriate funds to the Department for the 1999-2000 fiscal biennium to cover the costs of auditing 10% of the tax credits claimed for child health insurance premiums. The Department believes it will need 10 auditors and two clerical support positions to monitor 10% of the tax credits claimed.

S.L. 1998-22 (Senate Bill 1327, Senator Dalton)

AN ACT TO PRESERVE THE TAX-EXEMPT STATUS FOR PIPED NATURAL GAS SOLD BY MUNICIPALITIES, TO MAKE THE TAXES ON OTHER SALES OF PIPED NATURAL GAS MORE UNIFORM, TO ADJUST THE CITIES DISTRIBUTION OF THE TAX PROCEEDS UNTIL JUNE 30, 2000, TO DIRECT THE REVENUE LAWS STUDY COMMITTEE TO DETERMINE THE IMPACT OF THE TAX ON THE DISTRIBUTION TO CITIES, AND TO DIRECT THE UTILITIES COMMISSION TO STUDY THE ISSUE OF TRANSPORTATION RATES.

This act combines the current gross receipts and sales taxes on piped natural gas into a single, per therm excise tax and applies the tax uniformly to all sales of piped natural gas not exempt from the tax, effective July 1, 1999. The act also preserves the tax-exempt status for piped natural gas sold by the eight municipalities that operate their own piped gas system, by exempting them from

the excise tax. The act is expected to reduce General Fund revenues by about $3.6 million a year.

There are three types of sellers of piped natural gas: a utility company, a gas marketer, and a gas city. A utility company is a utility regulated by the Utilities Commission. A gas marketer is a person who sells piped natural gas but is not a regulated utility. Gas marketers use the pipeline infrastructure of the utilities to deliver the gas they sell and they pay a transportation charge to the utilities for this service. Piped natural gas is increasingly sold by persons who are not utilities. A gas city is a city that operates its own piped gas system. Eight cities in the State have done this since at least the 1950s: Bessemer City, Greenville, Kings Mountain, Lexington, Monroe, Rocky Mount, Shelby, and Wilson.

Before enactment of this act, two taxes applied to piped natural gas, franchise gross receipts tax and sales tax. The applicability and rate of each tax varied depending upon both the identity of the seller and the identity of the consumer. The franchise gross receipts tax was imposed at the rate of 3.22% of the gross receipts derived by a utility from the business of furnishing piped natural gas. The tax applied only to the receipts of a regulated utility. This gross receipts tax on piped natural gas was enacted in the 1920s, when only regulated utilities could sell piped natural gas. Federal and state regulation of the piped natural gas industry has changed. Now, persons who are not utilities are allowed to sell piped natural gas. The gross receipts tax was not extended to these new sellers, however. Thus, gas marketers and gas cities were not subject to the tax, except to the extent the tax was imposed on the transportation charges paid by gas marketers or was embedded in the price paid for gas bought from a utility for resale to customers.

A special sales tax of 3% also applied to utilities' retail sales of piped natural gas. This tax was imposed in 1985, when the General Assembly split the existing 6% franchise gross receipts tax into a 3% sales tax and a 3.22% gross receipts tax, to make the sales tax portion deductible by individuals on their federal income tax returns. Although the federal tax law changes in 1986 removed this deduction, North Carolina did not change its taxation of utilities. Like the franchise gross receipts tax, this special sales tax did not apply to sales by gas marketers or gas cities because, by its terms, it was limited to sales by utilities.

The act eliminates bifurcated taxation of piped natural gas and applies a uniform excise tax to all piped natural gas consumed in this State. The excise tax exempts gas distributed to or by a gas city but does not otherwise distinguish between sales by utilities and sales by others. The tax is due monthly and is

payable, generally, by the company that delivers the gas to the end-user. The tax rate is structured as a "declining block" that decreases as the amount of therms of piped gas consumed in a month increases.

A declining block tax rate is used to preserve the prior allocation of the tax burden among the three classes of piped gas customers: residential, business, and industrial. The sales and gross receipts taxes were a percentage of price; residential prices are the highest, business prices are in the middle, and industrial prices are the lowest. The combination of price and tax rate therefore resulted in a higher effective rate of tax on residential customers and a lower rate on business and industrial customers. The new tax preserves this differential in the burden by applying a lower tax rate to those who use higher volumes

The only sales tax exemption applicable to piped natural gas under prior law was the "products of the mine" exemption. Under that exemption, the sale of piped gas by the producer of the gas, in the producer's capacity as a producer, was exempt from sales and use tax. Few consumers of piped natural gas buy their gas directly from the producer. This act does not, therefore, retain this exemption in the new excise tax imposed in lieu of the franchise gross receipts tax and sales tax.

Under prior law, a percentage of the franchise gross receipts tax on piped natural gas service provided inside municipalities was distributed to the municipalities. This act preserves the distribution by providing that 50% of the new excise tax on piped gas service provided within a municipality will be distributed to that municipality. To minimize the difference between the former distribution amounts and the new distribution amounts, the tax provides that the amount distributed to cities will be adjusted for the first year, fiscal year 1999-2000. Any distribution adjustments will be made within the monies distributed to the cities. No State money is involved. The act directs the Revenue Laws Study Committee to look at the distribution formula and recommend to the General Assembly any changes it believes are necessary.

For several years before 1998, the Department of Revenue did not impose the general 4% State and 2% local sales and use tax on the sale of piped natural gas. However, upon reexamination of the law, the Department determined that piped natural gas is tangible personal property as that term is defined in the sales and use tax statutes and all sales of piped natural gas are, therefore, subject to tax. Based on this determination, therefore, all retail sales of piped natural gas would have become subject to the general sales and use tax effective July 1, 1998, if they had not been exempted by this act.

The sale of piped gas by a gas city or by a gas marketer would not have been exempt from sales and use tax. Therefore, the retail sale of piped gas by these sellers would have been subject to a 6% State and local sales and use tax unless a lower rate applied. The law provided a lower rate of 3% for all sales made by regulated utilities and a lower rate of 2.83% for sales made to farmers, manufacturers, and laundries. Piped natural gas taxed at the State rate of 3% or 2.83% was not subject to the 2% local sales and use tax. The use tax would have applied to a person who purchased piped natural gas from a seller who was not required to collect North Carolina sales tax.

S.L. 1998-24 (Senate Bill 124, Senator Odom)

AN ACT TO REDUCE THE WHITE GOODS DISPOSAL TAX RATE TO ONE RATE FOR ANY WHITE GOOD REGARDLESS OF WHETHER THE WHITE GOOD CONTAINS CHLOROFLUOROCARBONS, TO EXTEND THE WHITE GOODS DISPOSAL TAX SUNSET, TO ALTER THE DISTRIBUTION OF THE TAX PROCEEDS FROM THIS TAX, TO CLARIFY HOW THE COUNTIES MAY USE THE TAX PROCEEDS, AND TO LIMIT THE AMOUNT OF SURPLUS A COUNTY MAY ACCUMULATE BY HOLDING FURTHER TAX DISTRIBUTIONS UNTIL THE SURPLUS IS REDUCED.

This act reduces the white goods tax rate, delays the sunset of the tax, changes the formula for distributing the tax proceeds, clarifies the purposes for which counties may use the proceeds of the tax, and provides for detailed reporting on counties' white goods management programs, effective July 1, 1998. The act also provides that counties that have excess tax proceeds may not receive additional distributions until they have spent the excess tax proceeds, effective January 1, 1999. The act does not affect the General Fund.

The white goods tax was imposed effective January 1, 1994. The purpose of the tax is to provide a source of revenue for the proper disposal of discarded white goods. A white good is a domestic or commercial large appliance, such as a refrigerator, a water heater, an air conditioner unit, or a dishwasher.

The white goods tax was scheduled to sunset July 1, 1998. This act extends the sunset three years, to July 1, 2001. The tax is a flat rate charged on every new white good purchased in this State or brought into this State for storage or use. The former tax rates were $10.00 for white goods that contain chlorofluorocarbon refrigerants and $5.00 for white goods that do not contain chlorofluorocarbon refrigerants. This act reduces the tax to $3.00 per white good, whether or not it contains chlorofluorocarbon refrigerants. The reduction of the tax rate will reduce revenues by about one-half.

Under prior law, the tax proceeds were distributed as follows: 5% to the Solid Waste Management Trust Fund, 20% to the White Goods Management Account, and 75% to counties on a per capita basis. This act changes the formula so that 8% of the tax proceeds will be distributed to the Solid Waste Management Trust Fund and 72% will be distributed to counties. The 20% allocation to the White Goods Management Account does not change.

Counties may use the white goods tax proceeds distributed to them only for the management of discarded white goods. This act clarifies that expenditures of the tax proceeds must be related directly to the management of discarded white goods. It also specifies that authorized uses include capital improvements for infrastructure to manage discarded white goods, operating costs associated with managing discarded white goods, and cleanup of illegal disposal sites that consist of more than 50% discarded white goods. If an illegal disposal site consists of 50% or less discarded white goods, the tax proceeds may be used only to clean up the discarded white goods portion of the site.

The act limits the amount of surplus white goods disposal tax proceeds that a county can accumulate. Counties receive their distributions of white goods tax proceeds on a quarterly basis. Effective January 1, 1999, this act provides that if, at the end of a fiscal year, the county has a surplus of white goods tax proceeds that equals or exceeds 25% of the amount it was eligible to receive for the fiscal year, it may not receive additional distributions until its surplus falls below that level. The amount that would have been distributed to a county will instead be credited to the White Goods Management Account.

Counties submit an annual financial information report to the Local Government Commission. This act directs the Local Government Commission to require counties to include in the reports information about their management of white goods and their receipt and expenditure of white goods tax proceeds and related revenues. This requirement will make counties more accountable for their white goods management programs. The annual financial information report must be certified by the county finance officer based on an independent audit by a certified public accountant.

The Department of Environment and Natural Resources reports annually to the Environmental Review Commission on the management of white goods. This act requires the Department to provide this report to the Revenue Laws Study Committee as well, and to include in the report a summary of the information about counties' white goods management programs provided in their annual financial information reports to the Local Government Commission.

S.L. 1998-55 (Senate Bill 1569 , Senator Hoyle)

AN ACT (1) TO ALLOW CERTAIN RECYCLING FACILITIES AN INVESTMENT TAX CREDIT, A REFUNDABLE INCOME TAX CREDIT, A SALES TAX REDUCTION FOR CRANES AND MATERIALS HANDLING EQUIPMENT, A SALES TAX REFUND FOR CONSTRUCTION MATERIALS, A SALES TAX EXEMPTION FOR ELECTRICITY, AND A PROPERTY TAX EXEMPTION FOR RECYCLING PROPERTY; (2) TO ALLOW AIR COURIERS A SALES TAX REDUCTION FOR MATERIALS HANDLING EQUIPMENT USED AT A HUB, A SALES TAX EXEMPTION FOR AIRCRAFT LUBRICANTS AND PARTS USED AT A HUB, AND A PROPERTY TAX EXEMPTION FOR AIRCRAFT USED AT A HUB; (3) TO EXPAND THE INDUSTRIAL DEVELOPMENT FUND AND UTILITY ACCOUNT TO INCLUDE THE SAME BUSINESSES AS THE WILLIAM S. LEE ACT, TO EXPAND THE UTILITY ACCOUNT TO TIER TWO COUNTIES, TO RAISE THE MAXIMUM GRANT UNDER THE INDUSTRIAL DEVELOPMENT FUND, AND TO ALLOW LOCAL GOVERNMENTS TO USE PART OF THE INDUSTRIAL DEVELOPMENT FUND GRANT FUNDS TO ADMINISTER THE GRANT; (4) TO PROVIDE FOR THE DESIGNATION OF STATE DEVELOPMENT ZONES, TO PROVIDE A LOWER WAGE STANDARD, A HIGHER WORKER TRAINING CREDIT, A ZERO THRESHOLD FOR THE INVESTMENT TAX CREDIT, AND AN ADDITIONAL JOBS TAX CREDIT WITHIN ZONES, AND TO GIVE ZONES PRIORITY FOR COMMUNITY DEVELOPMENT BLOCK GRANTS; AND (5) TO AMEND THE WILLIAM S. LEE ACT BY EXPANDING THE CENTRAL ADMINISTRATIVE OFFICE CREDIT TO GROSS PREMIUMS TAXES AND TO JOBS CREATED BEFORE THE PROPERTY IS CONSTRUCTED, BY PROVIDING THAT THE INVESTMENT TAX CREDIT THRESHOLD APPLIES ONLY ONCE FOR A TWO-YEAR PROJECT, BY EXPANDING THE INVESTMENT TAX CREDIT TO OPERATING LEASES FOR PROJECTS OVER ONE HUNDRED FIFTY MILLION DOLLARS, BY EXPANDING THE RESEARCH AND DEVELOPMENT TAX CREDIT, BY SIMPLIFYING THE WORKER TRAINING TAX CREDIT, BY IMPOSING A FEE FOR INCENTIVE APPLICANTS, BY EXTENDING THE CREDIT CARRYFORWARD PERIOD FOR PROJECTS OVER ONE HUNDRED FIFTY MILLION DOLLARS, BY PROVIDING FOR A SINGLE TIER DESIGNATION FOR TWO-COUNTY INDUSTRIAL PARKS, BY CLARIFYING THAT CREDITS ARE ALLOWED FOR BUSINESSES THAT ARE SOLD ONLY IF THERE IS

IMMINENT CLOSURE OR AN EMPLOYEE BUYOUT, BY CLARIFYING THE METHOD OF CALCULATING THE INVESTMENT TAX CREDIT FOR LEASES, AND BY CLARIFYING THE DEFINITIONS OF THE TYPES OF BUSINESSES ELIGIBLE FOR INCENTIVES.

The act is designed to promote economic development throughout the State in five ways:

1. It makes various amendments to the William S. Lee Act to encourage large investments and remove technical problems with the Act.

2. It authorizes enhanced incentives for development zones, which are economically distressed areas located within municipalities.

3. It expands and modifies the Industrial Development Fund to provide financial support for projects in rural and less prosperous areas of the State.

4. It provides sales tax and property tax reductions for air couriers and provides a temporary bidding law exemption for specific projects of the Piedmont Triad Airport Authority to encourage development of air courier hubs.

5. It provides an investment tax credit for large and major recycling facilities that locate in Tier One counties to encourage development of a recycling industry in Tier One counties. In addition, it provides a refundable reinvestment credit and sales tax reductions for major recycling facilities.

The act will reduce General Fund revenues by $2.22 million in fiscal year 1998-99, $1.21 million in fiscal year 1999-2000, $6.81 million in fiscal year 2000-01, $12.97 million in fiscal year 2001-02, and $16.33 million in fiscal year 2002-03.

William S. Lee Act Modifications. Part I of the act makes a number of technical and substantive changes to the William S. Lee Quality Jobs and Business Expansion Act. Unless a different date is given, these changes all become effective beginning with the 1999 tax year. The William S. Lee Act, enacted by the General Assembly in 1996, extended the jobs tax credit to all 100 counties, enacted a new tax credit for worker training expenses, enacted a new tax credit

for increasing research activities, and enacted two new tax credits for investing in machinery and equipment. In 1997, the General Assembly expanded the types of businesses eligible for the credits and created a new tax credit for taxpayers who purchase or lease real property to be used as central administrative office property.

The act makes two changes to the central administrative office credit that was enacted last year. First, it allows the credit to be taken against the insurance gross premiums tax. This change will permit insurance companies to qualify for the credit. Second, it clarifies that a central administrative office meets the requirements for creating new jobs if the jobs begin before the office property is in service but are located at a temporary facility that the business occupies while waiting for its office property to be completed.

It also makes two changes to the credit for investing in machinery and equipment. First, it provides that for projects that span two tax years, the threshold applies only once to the investment. Otherwise, a project put in service over several months within a calendar year would receive more benefit than a project put in service over several months starting in one calendar year and ending in the next. This change went into effect beginning with the 1998 tax year. Second, it expands the credit to include machinery and equipment the taxpayer uses under an operating lease, but only if the machinery and equipment are part of a project valued at $150 million or more.

The act expands the credit for research and development. This credit piggybacks the federal credit, allowing a State credit equal to approximately ¼ of the federal credit as it relates to North Carolina activities. In 1997, Congress enacted an alternative credit for research and development. The act modifies the State credit to also allow a credit equal to approximately ¼ of the federal alternative credit as it relates to North Carolina activities.

The act simplifies the credit for worker training by replacing the credit measured by costs of training with a credit for wages paid to workers while they are being trained (not including on-the-job training). The credit is restricted to employees for whom the taxpayer qualifies for the jobs tax credit and employees being trained to operate machinery and equipment for which the taxpayer qualifies for the credit for investing in machinery and equipment. In order to qualify under former law for this credit, the taxpayer was required to get its planned training certified in advance by the Department of Community Colleges. This requirement was difficult both for taxpayers and for the Department of Community Colleges.

Finally, Part I of the act makes a number of administrative and technical changes to the William S. Lee Act. First, it levies a $75.00 application fee on taxpayers who seek to qualify for a credit. The proceeds of the fee will help the Department of Commerce defray its costs in administering the credits. This fee becomes effective January 1, 1999. Second, the act extends the credit carryforward period for investments over $150 million. The act provides that for large investments, the excess may be carried forward for up to 20 years (was five years). Third, the act clarifies that credits are allowed only for new and expanding businesses, not for existing businesses that are sold to another taxpayer. An exception is made for a business that has closed, has filed a federally required notice that closure is imminent, or has been purchased in an employee buyout. In these cases, the business will be able to qualify for the credits to the same extent as a new business. Fourth, the act provides that if an industrial park is located in and owned by two counties who both contribute significantly to its development, the industrial park as a whole is considered to have the tier designation of the lower-tiered county. This change promotes regional cooperation in industrial development and avoids an industrial zone that is split into two tier designations. Fifth, the act clarifies and renumbers the definitions of the different types of businesses that are eligible for credits and clarifies the method of calculating the investment tax credit and the business tax credit for property acquired by a capital lease.

State Development Zones. Part I of the act provides for the designation of economically distressed areas located within municipalities as State development zones and authorizes enhanced incentives for businesses that locate in a development zone, effective beginning with the 1999 tax year. The act defines a development zone as an area that meets all of the following conditions: (1) consists of one or more contiguous census tracts, block groups, or both, (2) has a population of 1,000 or more, at least 20% of whom are below the poverty level, and (3) is located at least partly in a municipality with a population over 5,000. If a business locates in a development zone, the wage standard it has to meet is the same as for Tier One counties - slightly lower than the standard for other counties. In addition, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and there is no threshold for the credit for investing in machinery and equipment.

The Secretary of Commerce will designate development zones upon request of a taxpayer or a local government. The designation is effective for four years. The act provides that a development zone may qualify for priority in receiving community development block grants if the municipality's governing body adopts a strategy to improve the zone and establishes a committee to implement the strategy, in accordance with guidelines established by the Department of

Commerce. The Department of Commerce is required to report annually to the Department of Revenue and the General Assembly's Fiscal Research Division on the number of new jobs created within development zones and percentage of those jobs that were filled by residents of those development zones.

Infrastructure Funds. Part II of the act, effective July 1, 1998, states the intent of the General Assembly to appropriate funds to the Industrial Development Fund and the Utility Account of the Industrial Development Fund. The Governor's budget requested an appropriation of $18 million for the Fund and $14 million for the Utility Account. The Current Operations Appropriations and Capital Improvement Appropriations Act of 1998 provides nonrecurring funding of $1.5 million to the Utility Account for economic development grants for water and sewer infrastructure. Under prior law, money in the Utility Account could be used in Tier One counties for construction or improvements to new or existing water, sewer, gas, or electrical utility distribution lines or for existing, new, or proposed industrial buildings to be used in manufacturing and processing, warehousing and distribution, or data processing. The act expands the scope of the Utility Account to include Tier Two counties.

Under prior law, the Industrial Development Fund provided funding for manufacturing projects in Tier One, Two, and Three counties as well as in areas experiencing major economic dislocations. The funds could be used for equipment, capital improvements, and utility distribution lines. Projects in Tier Two and Three Counties were required to match the State funds on a $1/$3 basis. The funding was capped at $4,000 per job to be created and $400,000 per project. The act raises the per-job cap to $5,000 and the per-project cap to $500,000. The act also expands the industries covered by both the Industrial Development Fund and the Utility Account to include all of the following: manufacturing, central administrative offices, air courier services, data processing, and warehousing and wholesale trade.

Finally, Part II of the act amends the statute to allow local governments receiving industrial development funds to use up to 2% of these funds to verify that the funds are used as required by law and otherwise to administer the grant or loan.

Air Courier Hubs. Part III of the act provides sales tax and property tax reductions for interstate air couriers in order to encourage the development of air courier hubs in North Carolina. An air courier is an air carrier that delivers individually addressed letters, parcels, and packages. Effective January 1, 2001, the act provides that sales to an interstate air courier of equipment for handling and storing materials at its hub will be subject to a reduced sales tax of 1%, capped at $80 per item. In addition, the act provides a sales tax exemption for sales to an interstate air courier of aircraft lubricants, aircraft repair parts, and

aircraft accessories for use at the air courier's hub in this State. Effective beginning with the 2001 property tax year, the act provides a property tax exemption for aircraft owned by an air courier and apportioned for property tax purposes to the courier's hub in this State. A hub is the place in this State where the air courier allocates for property tax purposes more than 60% of its North Carolina aircraft value and where its primary function is to receive packages from consolidation locations for sorting and distribution, rather than to consolidate packages for delivery to another airport for sorting and distribution.

Part III of the act also grants a bidding law exemption for the Piedmont Triad Airport Authority. The exemption is effective for a five-year period beginning January 1, 1999, and applies to design and construction of an air freight distribution facility on airport property, and related supplies, equipment, and services.

Recycling Facilities. Part IV of the act provides tax incentives for "large" and "major" recycling facilities located in Tier One counties at the time of initial construction. A recycling facility is a plant that manufactures products, most of which are made from at least 50% post-consumer waste material. The facility also includes related infrastructure, buildings, and equipment on land near (and in the same county as) the plant. A large recycling facility is one that will involve at least $150 million in new investment and 155 new jobs within a two-year period. A major recycling facility is one that will involve at least $300 million in new investment and 250 new jobs within a four-year period. In order to qualify for the applicable tax incentives, the owner of the facility must obtain certification from the Department of Commerce that it will meet the minimum investment and new job requirements. If the facility fails to meet either requirement within the applicable time period, it forfeits any tax benefit it received as a result of being certified.

Part IV of the act provides an investment tax credit for both large and major recycling facilities, effective beginning with the 1998 tax year. This investment tax credit is in lieu of the investment tax credit provided in the William S. Lee Act. The recycling facility investment tax credit differs from the Lee Act credit in the following ways:

1. The Lee Act credit is equal to 7% of the cost of machinery and equipment, while the large recycling facility credit is equal to 20% of the cost and the major recycling facility credit is equal to 50% of the cost.

2. The credit is allowed at the time the owner of the recycling facility accrues expenses to purchase or lease

machinery and equipment, rather than at the time machinery and equipment are placed in service, as under the Lee Act. If the facility fails to put the machinery and equipment in service within 30 months after taking the credit, the credit is forfeited and must be repaid.

3. The credit is allowed against both the corporate franchise tax and the corporate income tax. The Lee Act allows the credit against either but not both taxes.

4. The credit may equal 100% of the tax due from the owner of the facility. The Lee Act limits the credit to 50% of tax due.

5. The excess credit may be carried forward for 25 years. Under the Lee Act, as revised by this act, the relevant carryforward period would be 20 years.

Part IV of the act also provides to major recycling facilities locating in Tier One counties a refundable corporate income tax "credit for reinvestment", effective beginning with the 1998 tax year. The credit applies if the major recycling facility is not accessible by ocean barge or ship and incurs additional expenses due to transporting its materials and products by alternative modes of transportation. The reinvestment credit is equal to the amount of these additional expenses, which must be documented annually to the Secretary of Commerce. The credit is subject to a dollar cap each year, in increasing amounts. In 1999, the cap is $640,000. In 2004, the cap levels off at $10.4 million a year. The act sunsets this reinvestment credit effective with the 2008 tax year. The act states the intent, however, to postpone the sunset if any major recycling facility can document that it is still experiencing additional expenses in 2008 due to its inability to use ocean barges or ships to transport materials and products.

The reinvestment credit is refundable. That means that if the amount of credit exceeds the major recycling facility's tax liability after all other credits are subtracted, the balance is paid out in cash. For the first ten years the reinvestment credit is in effect, a major recycling facility must use the amount received in credit to invest in rail and roads associated with the facility, in transportation infrastructure to reduce the expense of transporting materials and products to and from the facility, or in land and infrastructure for industrial sites, other than the facility itself, in the same county. If there are not enough reasonable opportunities for investments in those purposes in a given year, however, the major recycling facility may invest the amount of credit received in the facility itself, but only after it has made the minimum investment of $300

million required to qualify as a major recycling facility. The facility must document its compliance with this reinvestment requirement and it forfeits any part of the credit it spends for another purpose.

Part IV of the act provides several sales and use tax reductions for major recycling facilities located in Tier One counties, effective beginning July 1, 1998. First, it provides that a reduced sales tax rate of 1%, capped at $80 per item, applies to cranes, foundations, transportation equipment, and material handling equipment used at the major recycling facility. These items would otherwise be subject to 4% State sales tax and 2% local sales tax. Second, it exempts from sales tax lubricants and other additives for vehicles and machinery used at the plant, and other materials and supplies (not including machinery and equipment) that are used or consumed directly in the manufacturing process. These items would also otherwise be subject to a combined State and local rate of 6%. Third, it exempts from sales tax electricity purchased for use at the major recycling facility. This electricity would otherwise be subject to State sales tax at 3% or 2.83%. Fourth, it provides an annual sales tax refund for taxes a major recycling facility pays directly or indirectly on building materials, building supplies, fixtures, and equipment that become a part of the real property of the recycling facility located in a Tier One county.

Finally, Part IV of the act provides for major recycling facilities an expanded version of the existing property tax exemption for property used for recycling. Under general law, to qualify for exemption, the property must be used exclusively for recycling and have recycling as its primary purpose. Effective beginning with the 1999-2000 property tax year, the act provides that, for major recycling facilities only, the property must be used predominantly for recycling and have recycling as a purpose. The Department of Environment and Natural Resources determined that these changes would be necessary to prevent a major recycling facility from being disqualified because it adds fillers or other materials to the post-consumer waste material when manufacturing products.

S.L. 1998-67 (Senate Bill 186, Senator Foxx)

AN ACT TO PROVIDE THAT THE GOVERNING BODY OF A TAXING UNIT MAY DELAY THE ACCRUAL OF INTEREST ON CERTAIN UNPAID PROPERTY TAXES.

This act is a Statewide, public act that addresses a specific local problem concerning the payment of local property taxes for the 1997-98 fiscal year. The specific local problem is that after Gaston County conducted its octennial revaluation of property in 1997, 22,000 appeals were filed. This was many more appeals than had been anticipated. Although the statutory due date for the 1997

taxes was January 5, 1998, many of the appeals were still under consideration by the board of equalization and review at that time. Counties do not have the authority to release, refund, or compromise tax liabilities except as specifically provided by law.

This act allows the governing body of each affected taxing unit to adopt a resolution that waives interest on taxes paid between January 6, 1998, and March 7, 1998. The act is limited to taxing units whose tax receipts were not delivered to the tax collector before October 3, 1997. September 1 is the statutory due date for delivering tax receipts. The act applies to Gaston County and the units for which it collects taxes because the tax receipts were not delivered to the tax collector of Gaston County until October 3. Gaston County collects taxes for 13 of its 14 municipalities and for all of its 19 fire districts.

Generally, the law provides taxpayers two avenues to protest the amount of property tax due. A taxpayer may submit a written demand for a release of a tax claim any time prior to the payment of the tax. However, taxpayers who choose not to pay all or part of their taxes by the due date are subject to interest. Counties do not have the statutory authority to release taxpayers from the accruing interest, even if the taxpayers' appeals are under consideration. This is a rigid prohibition and failure to abide by it carries personal liability for each member of the board of commissioners. The rates of interest are 2% from January 6 to February 1 and ¾% for each month or part of a month after that. The second avenue to contest the payment of property tax is to pay the tax when due. If the tax is reduced on appeal, then the taxpayer receives a refund.

This act is a Statewide act rather than a local one because it must be Statewide to avoid conflicting with the prohibition in the North Carolina Constitution on certain local acts. Article II, section 24(1)(k) of the State Constitution prohibits local acts that extend the time for collecting taxes or otherwise relieve a tax collector from the performance of this duty. Although the act is nominally Statewide, it applies only to Gaston County because it applies only to units whose tax receipts were not delivered to the tax collector before October 3, 1997. Gaston County is the only taxing unit whose tax receipts were not delivered by that date. The General Assembly enacted a similar act for Beaufort County in 1995 and for Buncombe County in 1990.

S.L. 1998-69 (Senate Bill 1229, Senator Kerr)

AN ACT TO ABOLISH TAX WAIVERS FOR THE TRANSFER OR DELIVERANCE OF A DECEDENT'S PROPERTY.

This act repeals the provisions of the former inheritance tax law (which was itself repealed by S.L. 1998-212) that required an inheritance tax waiver before the property of a decedent could be transferred. The estate tax, known as the pick-up tax, which replaced the former inheritance tax effective January 1, 1999, has no inheritance tax waiver requirement. This act does not affect the General Fund.

Former law required that when a person died, the Department of Revenue had to be notified of any accounts, stocks, and bonds in the name of the decedent and of the contents in the decedent's safe-deposit box. The Department would then issue inheritance tax waivers authorizing the bank or financial institution in possession of the decedent's property to transfer or release the property. Accounts held by the decedent and spouse with right of survivorship did not require a waiver before transfer.

This act repealed the inheritance tax waiver requirement and related penalties for failure to obtain waivers and forms required for the waivers, effective August 1, 1998. The inheritance tax itself was repealed effective January 1, 1999. This act was a recommendation of the Revenue Laws Study Committee.

S.L. 1998-95 (Senate Bill 1252, Senator Hoyle)

AN ACT TO SIMPLIFY AND MODIFY PRIVILEGE LICENSE AND EXCISE TAXES AND RELATED PERMIT FEES.

This act incorporates two bills that the Revenue Laws Study Committee recommended to the 1998 General Assembly: Senate Bill 1252 and House Bill 1320. Senate Bill 1252 made numerous changes to the State privilege license taxes on amusements, professionals, installment paper dealers, banks, and alcoholic beverages. House Bill 1320 reduced the current 3% gross receipts tax on motion pictures to 1%.

Amusements. The former law imposed an annual $50 State privilege license tax and a 3% gross receipts tax on any form of entertainment not otherwise taxed or specifically exempted under Article 2 of Chapter 105 of the General Statutes. The State privilege license tax on amusements was treated as an advance payment of the corresponding gross receipts tax, and the license tax was applied as a credit upon the gross receipts tax. This act repeals the State privilege license taxes on amusements. Amusements will continue to pay a 3% gross receipts tax and any existing local license tax. This repeal simplifies the taxes assessed on amusements. It does not reduce revenues because the license tax was a credit against the gross receipts tax. This part of the act becomes effective July 1, 1999.

This act also reorganizes the list of amusements exempt from the tax so that all of the exemptions appear in one statute. The list includes those amusements that are currently exempt in Article 2, amusements that are listed as exempt in other sections of the statutes (the North Carolina Symphony Society and amusements organized under the Agriculture Chapter), and outdoor historical dramas that are described in Chapter 143 of the General Statutes and that have generally been exempt under the current definition for exemptions in G.S. 105-40. Exempt amusements set out in Article 2 are high school and elementary school athletic contests, teen centers, dances and amusements promoted and managed by a corporation that operates a center for the performing and visual arts when the dance or amusement is held at the center, and amusements on the Cherokee Indian reservation where the entity providing the amusement is authorized to do business on the reservation and pays the tribal gross receipts levy to the tribal council.

The act expands the exemption for elementary and secondary school dances and other amusements to include all such amusements. Former law exempted only the first $1,000 of gross receipts derived from dances and amusements actually promoted and managed by secondary schools when the proceeds were used exclusively for the school and not to defray expenses.

Motion Pictures. The act imposes a lower rate of tax on one form of amusements: motion picture shows. The act imposes a 1% gross receipts tax on this form of amusement, effective October 1, 1998, as opposed to the 3% gross receipts tax imposed on other forms of amusements. A 1% gross receipts tax on movie admissions is expected to generate $1.5 million in General Fund revenue in fiscal year 1998-99.

The act clarifies that if a taxpayer offers an entertainment or amusement that includes both a motion picture and an entertainment or amusement that is subject to the 3% gross receipts tax, then the higher rate applies. The act also clarifies the exemption of motion pictures that are shown at a center for the performing and visual arts that is promoted and managed by an organization organized for religious, charitable, scientific, literary, or educational purposes. The showing of the motion picture show may not be the primary purpose of the center. North Carolina's policy of taxing movie concessions is consistent with other states and the District of Columbia.

Prior to July 1, 1997, the State imposed a privilege tax on motion picture shows. Motion picture shows were not subject to the 3% gross receipts tax imposed on other forms of entertainment or amusement because it does not apply to amusements "otherwise taxed". During the Second Extra Session of the 1996 Session, the General Assembly repealed a number of State privilege license taxes,

including the privilege taxes on motion picture shows. When the privilege license tax was repealed, motion picture shows fell into the category of amusements not otherwise taxed and, therefore, became subject to the 3% gross receipts tax. The Department of Revenue chose not to assess this tax in fiscal year 1997-98 until the General Assembly clarified that the tax should be collected. The Department's uncertainty arose from the absence of debate by the 1996 General Assembly on the issue of imposing a gross receipts tax on movies.

The Revenue Laws Study Committee considered this issue at length and heard from several interested parties. The Committee learned that 27 states tax movie admissions in one fashion or another. Twenty-one states simply apply their sales tax to theater admissions. Alabama and Arkansas have a specific gross receipts tax on movie admissions, while Connecticut and South Carolina have a general admissions tax. Arizona has a transaction privilege tax on theaters and Indiana has a gross income tax on theaters. Twenty-five of these twenty-seven states have movie taxes higher than North Carolina's 3% gross receipts tax. Eleven of the states that tax movie admissions are members of the Southern Legislative Conference. After much debate, the Committee recommended imposing a 1% gross receipts tax on movies, as opposed to the 3% gross receipts tax imposed on other, similar forms of entertainment and amusements.

Professionals. The act makes several clarifying and technical changes to the statewide privilege license tax on persons practicing certain professions or engaging in certain businesses. It also reorganizes the existing exemptions from the tax found throughout the statutes so that all exemptions will appear in one place. Lastly, it ends the practice of charging half the privilege license tax to an individual who applies after the midpoint of the fiscal year. This part of the act becomes effective July 1, 1999, and is expected to generate $14,375 in General Fund revenues in fiscal year 1999-2000.

The statute exempts persons age 75 and over and certain persons practicing the professional art of healing from the privilege license tax. The act adds to this list blind persons engaging in a trade or profession as a sole proprietor. The exemption for blind persons was formerly set out in another section of Chapter 105, which this act repeals.

The act repeals an exemption from occupational license taxes for persons serving in the armed forces and replaces it with a general provision in Chapter 93B of the General Statutes that allows an individual who is serving in the armed forces of the U.S. an extension of time to pay any license fee charged by an occupational licensing board if the individual qualifies for the extension of time to file a tax return under G.S. 105-249.2. This statute provides that the Secretary of Revenue may not assess interest or penalty against a taxpayer for any period that is

disregarded under section 7508 of the Internal Revenue Code in determining the taxpayer's liability for a federal tax. This section of the Internal Revenue Code postpones tax liability for an individual serving in the armed forces, or serving in support of the armed forces, in an area designated by the President as a "combat zone". The period of service in such an area, plus the period of continuous qualified hospitalization attributable to an injury received while serving in that area, and the next 180 days thereafter, are disregarded in determining tax liability. The provision belongs in the Occupational Licensing Chapter, as opposed to the Chapter on Taxation, because it relates to occupational licensing, not to taxes.

Installment Paper Dealers. Installment paper dealers are persons engaged in the business of dealing in, buying, or discounting installment paper, notes, bonds, contracts, or evidences of debt, when at the time or in connection with the execution of these instruments, a lien is reserved or taken on personal property located in the State to secure the payment of the obligations. These dealers paid an annual $100 license tax and a quarterly tax of .275% of the total face value of the obligations within the preceding quarterly calendar months. This act repeals the $100 license tax and increases the quarterly tax of .275% to .277% to offset the loss of revenue from repealing the annual $100 license tax. According to the Department of Revenue, this increase in rate will cover $112,811 of the $123,800 loss. This provision becomes effective July 1, 1999.

Banks. Under former law, banks were issued a privilege license each year and paid a tax at the rate of $30 for each $1,000,000, or fractional part thereof, of total assets held. These assets were determined by averaging the total assets shown in the four quarterly call reports of condition (consolidation domestic subsidiaries) for the preceding calendar year as required by bank regulatory authorities. This act eliminates the license and requires the banks to submit instead an annual report to the Department of Revenue showing the average of their total assets. The privilege tax must be paid with the report by July 1. The submission of a report in lieu of issuing an annual license will relieve the Department of having to issue licenses that vary yearly for each bank. The Department's computer system has had difficulty issuing licenses that vary each year, and this problem will become even more difficult with the year 2000 changeover. Also, a report will assist the Department in auditing banks.

The act also repeals the $100 annual privilege tax for banks that have been in operation for less than a year. New banks will be required instead to pay a tax on the average of the total assets determined by the number of days in operation. These changes related to banks become effective July 1, 1999, and are expected to generate $1,400 in General Fund revenues.

Alcoholic Beverages. The act repeals annual privilege licenses on ABC permittees, raises the ABC permit fees by the corresponding amounts, and simplifies the tax rate on malt beverages. This part of the act becomes effective May 1, 1999, and is not expected to affect General Fund Revenues.

Under former law, a person had to obtain both a permit issued by the ABC Commission and a corresponding annual State license issued by the Department of Revenue to engage in a business involving alcoholic beverages. The person had to obtain the ABC permit before applying for the license. Upon payment of the State license tax, issuance of the license was mandatory if the applicant had the corresponding ABC permit. The information and qualifications required for the annual State license were the same as the information and qualifications required for the corresponding one-time ABC permit. The additional State license served no purpose other than to raise revenue. The act repeals these privilege licenses in order to eliminate the duplicate requirement of applying for a State privilege license and a corresponding ABC permit. The approximately $3.1 million revenue loss from the repeal of these privilege licenses is offset by an increase in the ABC permit fees set out in G.S. 18B-902(d), by repeal of the reduced fees for combined permits in G.S. 18B-902(e), and by an increase in the annual renewal fees for mixed beverage and guest room cabinet permits in G.S. 18B-903(b).

The act also simplifies the filing requirements for malt beverage taxpayers by setting a single rate of excise tax on malt beverages. Formerly, an excise tax of 48.387 cents per gallon was assessed against malt beverages in barrels holding at least 7¾ gallons and an excise tax of 53.376 cents per gallon was assessed against malt beverages in cans, bottles, barrels, or other containers holding less than 7¾ gallons. The act imposes an excise tax of 53.177 cents per gallon on the sale of any malt beverage, regardless of the container. Thus, the act simplifies the filing and reporting requirements for malt beverages by eliminating the requirement that vendors of these products specify the size and type of containers sold in their monthly reports to the Secretary.

S.L. 1998-96 (Senate Bill 1001, Senator Cochrane)

AN ACT TO PROVIDE AN AMUSEMENTS TAX EXEMPTION FOR CERTAIN NONPROFIT ARTS ORGANIZATIONS AND COMMUNITY FESTIVALS.

The State levies a 3% gross receipts privilege license tax on anyone engaged in the business of offering amusements, athletic events, dances, and entertainments for which an admission is charged. This act creates two new, narrow exemptions from this privilege license tax for nonprofit arts festivals and community

festivals that meet certain conditions. The act applies to events such as "First Night" of Raleigh and the Azalea Festival of Wilmington. The act became effective August 14, 1998. The Department of Revenue estimates that the revenue loss to the General Fund will be less than $25,000 a year.

Under the act, an arts festival is exempt from the privilege license tax if the person holding the festival meets all of the following conditions:

- The person holds no more than two festivals a year.
- Each of the festivals lasts no more than seven days.
- The arts festivals are held outdoors on public property and involve a variety of exhibitions, entertainments, and activities.
- The person is exempt from State income tax.

Under the act, a community festival is exempt from the privilege license tax if the person holding the festival meets all of the following conditions:

- The person holds no more than one community festival a year.
- The festival lasts no more than 7 days.
- The festival involves a variety of exhibitions, entertainments, and activities, the majority of which are held outdoors and are open to the public.
- The person is exempt from State income tax.

S.L. 1998-98 (Senate Bill 1226, Senator Cochrane)

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

This act makes numerous technical and clarifying changes to the revenue laws and related statutes as recommended by the Revenue Laws Study Committee. The following table provides a section-by-section analysis of the changes:

Section	Explanation
1	Recodifies the corporate income and franchise taxes on savings institutions. These entities currently pay tax under Article 8D of Chapter 105 of the General Statutes. The taxes are identical to the income and franchise taxes paid by other corporations, with two adjustments. This section moves the taxation of savings institutions from Article 8D to the regular corporate income and franchise taxes in Articles 3 and 4. The two adjustments are retained. In addition, a general exemption in Article 8D

has been transferred to the relevant privilege tax statutes: G.S. 105-83, G.S. 105-88, and G.S. 105-102.3. This technical change was reviewed and approved by the Bankers Association, which represents savings institutions.

2 - 3	Repeals obsolete provisions of the inheritance tax.
4	Conforms cross-reference to corporate tax credits to reflect that some credits are in other Articles of the Revenue Act.
5 - 8	Makes conforming changes to Subchapter S Corporation law to reflect the fact that trusts may now be shareholders.
9	Repeals an individual income tax definition for a term that is no longer used in the individual income tax law.
10	Adds cross-reference to two individual income tax credits that do not apply to estates and trusts.
11	Corrects grammar.
12 - 13	Clarifies that withholding is not required on payments to tax-exempt entities.
13.1	Removes cross-references to soft drink excise tax, which has been repealed effective July 1, 1999.
13.2	Removes reference to type of payment for food purchased under the Food Stamp Program, because counties are beginning to use a system in which a type of credit card will be used in lieu of food stamps or coupons.
14	Removes references to sales tax applying to two types of motor fuel for which motor fuel tax refunds are allowed, because refunds are not made on these types of motor fuel (accidental mixes and fuel sold to marinas).
14.1	Removes reference to type of payment for food purchased under the Food Stamp Program, because counties are beginning to use a system in which a type of credit card will be used in lieu of food stamps or coupons.
15	Modifies the definition of interstate carrier for purposes of sales tax refunds to reflect the deregulation of the industry.
15.1	Makes a conforming change to reflect a change under the Equitable Distribution Laws that now provides for the distribution of marital property and divisible property.

16	Provides that a gift tax return is not required for gifts that are exempt from tax: gifts to charity and gifts between spouses. The 1997 federal tax act made a similar change to the federal gift tax, which formerly required returns for gifts to charity above $10,000.
17	Removes incorrect language describing the calculation of the gross premiums tax.
18	Clarifies insurance company tax exemption language. G.S. 105-228.10 was enacted in 1945 to provide that local governments may not levy additional taxes on insurers and other entities subject to the gross premiums tax. This section rewrites the statute to state that cities and counties are prohibited from levying a privilege license tax or a gross premiums tax on entities subject to gross premiums tax. The vague language of the statute is rewritten to clarify that insurance companies are not exempt from local sales taxes, local meals taxes, and other similar taxes that the General Assembly has authorized for local governments since this statute was enacted in 1945. Insurance companies currently pay these taxes and the terms of the tax statutes make it clear that they are not exempt.
19	Deletes an individual income tax exemption that is no longer needed because federal law exempts the same income and our law piggybacks the federal law.
20	Provides that tax information may be shared on a reciprocal basis with tax officials from jurisdictions outside the United States, as required by the International Fuel Tax Agreement.
21	Clarifies that taxpayers may rely upon all interpretations published by the Department of Revenue to the same extent as provided under current law only for specified types of interpretations.
22 - 24	Remove ambiguities in the use value property tax law that were created unintentionally when these statutes were rewritten and reorganized in 1995. The rewrite created potential, although strained, interpretations that deferred taxes were no longer required to be paid in some or in many cases where the law has always intended for them to be paid. These sections clarify that the law with respect to "rollback" of deferred taxes was not restricted by the 1995 rewrite. They also make further clarifying changes to the language.
25	Revises definition of public service company to reflect deregulation of carriers and to conform to Institute of Government interpretation that regulation requirement applies only to catch-all category of "any other

company performing a public service."

26 - 27	Repeal two property tax provisions that have expired.
28	Clarifies that motor fuel sold to the federal government is exempt only if sold for use by the federal government.
29	Repeals a provision allowing refunds for motor fuel tax paid by marinas. Federal law no longer requires marinas to pay tax on motor fuel they purchase, so refunds are no longer necessary.
30	Corrects an incorrect cross-reference.
30.1	Removes reference to type of payment for food purchased under the Food Stamp Program, because counties are beginning to use a system in which a type of credit card will be used in lieu of food stamps or coupons.
31 - 32	Deletes provisions that have expired.
33 - 35	Corrects incorrect term describing short-term rental vehicles.
36	Reenacts a law modifying historic rehabilitation tax credits. The law was not roll called. Although the law expands the credits, in certain instances it could postpone part of the tax benefit allowed under prior law.
37	Repeals an obsolete tax on consigned candy products.
38	Amends the Setoff Debt Collection Act to reflect the new names given to public assistance programs by the 1997 welfare reform legislation, and to remove excess verbiage that resulted from a redlining error.
39	Conforms the structure of the Revenue Laws Study Committee statute to fit the requirements of the General Assembly's new computer system, and corrects gender-specific language.
40	Repeals list of cross-references to Highway Bond Acts. The list is incomplete and serves no purpose.
41 - 54	Change from "Division" to "Part" the name of the subdivisions within Articles of Chapter 105 of the General Statutes, in order to be consistent with all other General Statutes. The new computer statutory database software will function better with consistent nomenclature.
55 - 67	Eliminate the term "Schedule" used as an additional name for Articles in Chapter 105 of the General Statutes, in order to be consistent with all other General Statutes. The new computer statutory database software

will function better with consistent nomenclature.

68 - 113	Change cross-references to "Divisions" and "Schedules" to "Parts" and "Articles," respectively.
114	Provides that the act is effective when it becomes law, August 6, 1998.

S.L. 1998-100 (House Bill 1422, Representative C. Wilson)

AN ACT TO REMOVE UNCONSTITUTIONAL RESTRICTIONS ON INDIVIDUAL INCOME TAX CREDITS FOR CHILD CARE AND FOR

CONSTRUCTING DWELLINGS FOR THE HANDICAPPED.

This act amends two individual income tax credits to remove restrictions that prevent nonresidents from taking the credits. These restrictions are probably unconstitutional in light of a recent United States Supreme Court case. The act is effective for taxable years beginning on or after January 1, 1998. Its impact upon the General Fund is expected to be no more than $600,000 a year. This act is a recommendation of the Revenue Laws Study Committee.

On January 21, 1998, the United States Supreme Court held in Lunding v. New York that a state's tax laws must treat nonresidents on terms of 'substantial equality' with residents. The Court found that New York's individual income tax could not deny the alimony deduction to nonresidents while granting it to residents. The Court concluded that while the Privileges and Immunities Clause of the United States Constitution affords states considerable discretion in formulating their income tax laws, there must be a substantial reason for the difference in treatment of residents and nonresidents within a tax structure.

North Carolina has two individual income tax credits that only residents could claim: the credit for construction of dwelling units for handicapped persons and the credit for child care and certain employment-related expenses. As discussed below, there does not appear to be any reason, much less a substantial one, for prohibiting nonresidents from taking either credit. It appears, therefore, that the part of each credit limiting it to residents would likely have been ruled unconstitutional if challenged. This act removes the restriction of the construction credit to residents, and modifies the child care credit so that a nonresident may take a proportional amount of the credit based on the percentage of his or her income that is taxable to North Carolina.

G.S. 105-151.1 grants an individual income tax credit for construction of multi-family rental units that conform with mandatory building code requirements related to accessibility by the handicapped. The dwelling units must be located in North Carolina. The credit was limited to North Carolina residents. The residence of the owner bears no relation to the benefit to this State of having handicapped-accessible dwellings constructed. Furthermore, the same credit is allowed under the corporate income tax law, but without any restriction based on the residence or domicile of the taxpayer that constructs the dwelling units.

G.S. 105-151.11 grants an individual income tax credit for child care or similar expenses incurred so the taxpayer may be gainfully employed. The credit was not allowed to nonresidents. For nonresidents employed in North Carolina, the expenses would be directly related to the taxpayer's North Carolina income and thus there seems to be a substantial reason that the credit should be allowed rather than disallowed. In any case, legislative history of this credit shows that the provision preventing nonresidents from claiming the credit was retained in the law due to an oversight in 1981, when it should have been repealed.

The tax credit for child care expenses was formerly a deduction. On July 9, 1981, the General Assembly repealed the deduction and replaced it with a credit. At that time, nonresidents were not allowed to take income tax deductions that were not directly connected to their North Carolina income. Thus, in changing the deduction to a credit, the General Assembly retained the rule that nonresidents could not take advantage of the tax benefit. A few months later, however, the General Assembly abandoned its policy of disallowing nonresidents' deductions for expenses unrelated to North Carolina income and enacted a new law allowing a nonresident to take a proportional amount of these deductions. Through an oversight, the restriction that had been carried forward from the child care deduction to the child care credit was not similarly modified. Because this restriction remained in the law only because of an oversight, a court would have been unlikely to find the required substantial reason for it to be upheld in a constitutional challenge.

S.L. 1998-121 (House Bill 1367, Representative Hill)

AN ACT TO RAISE THE SALES TAX QUARTERLY THRESHOLD AND TO REPEAL THE ANNUAL WHOLESALE SALES TAX LICENSE.

This act makes three changes to the sales tax law, as recommended by the Revenue Laws Study Committee:

- It raises the sales tax quarterly threshold from $50 to $100, effective July 1, 1999.
- It repeals the annual wholesale sales tax license, effective July 1, 1998.
- It changes the name of the retail sales tax license to certificate of registration.

The act is expected to reduce General Fund revenues by about $1.3 million a year. It will also cause a one-time shift of about $2 million from the 1999-2000 fiscal year to the 2000-01 fiscal year.

Taxpayers that are consistently liable for at least $20,000 a month in State and local sales and use taxes must file sales and use tax returns and remit taxes on a semi-monthly basis. Under prior law, taxpayers that were liable for less than $50.00 a month in State and local sales and use taxes could file returns and remit the sales and use taxes owed on a quarterly basis. All other taxpayers would file returns and remit taxes on a monthly basis.

Section 1 of this act increases the sales tax quarterly threshold from $50 to $100, effective July 1, 1999. This change means that approximately 10,000 taxpayers that are now filing monthly sales and use tax returns will be able to file quarterly returns. The change will reduce the number of returns currently being filed by one-third. The threshold was last increased in 1991 from $25 to $50. This change in the law will mean that approximately $2 million that would have been collected in fiscal year 1999-2000 will not be collected until fiscal year 2000-01 because two months of collections are shifted into the 2000-01 fiscal year.

Under prior law, a wholesale merchant was required to obtain both a wholesale sales tax license and a certificate of registration, referred to in the statute as a retail sales tax license. The form for the two licenses was the same and the information necessary to obtain both of these licenses was the same. The only difference was that the wholesale sales tax license was an annual license that costs $25. The certificate of registration needs to be acquired only once and costs $15.

Section 2 of this act repeals the wholesale sales tax license, effective July 1, 1998. The Department of Revenue does not need the information from this license because the wholesale merchant has already provided the Department with the information it needs on the certificate of registration. The tax is also expensive to collect and document and is a nuisance tax for wholesale businesses to report and pay.

Section 3 rewrites the law to clarify that both wholesale merchants and retailers must obtain a certificate of registration before beginning business. Although the statute refers to the certificate as a "retail sales tax license", it must be obtained by both wholesale merchants and retailers because a privilege tax is imposed on both of them under the sales and use tax article. The act changes the name of the license to a "certificate of registration" because that more accurately reflects the nature of the document. It also corresponds to the name it is most commonly known as in the business community: a "Merchant's Certificate of Registration".

Unlike the annual wholesale sales tax license, the certificate of registration needs to be obtained only once. It is valid unless it is revoked because the retailer or wholesale merchant fails to comply with the sales and use tax law. In the case of a retailer, the certificate becomes void if the retailer does not make any sales for a period of 18 months. If the certificate is revoked or becomes void, the retailer or wholesale merchant must register with the Department and obtain a new certificate of registration before engaging in business.

S.L. 1998-132 (Senate Bill 1354, Senator Kerr)

AN ACT TO AUTHORIZE THE ISSUANCE OF GENERAL OBLIGATION BONDS OF THE STATE, SUBJECT TO A VOTE OF THE QUALIFIED VOTERS OF THE STATE, TO ADDRESS STATEWIDE CRITICAL INFRASTRUCTURE NEEDS BY PROVIDING FUNDS (1) FOR GRANTS AND LOANS TO LOCAL GOVERNMENT UNITS FOR WATER SUPPLY SYSTEMS, WASTEWATER COLLECTION SYSTEMS, WASTEWATER TREATMENT WORKS, AND WATER CONSERVATION AND WATER REUSE PROJECTS AND (2) FOR GRANTS, LOANS, OR OTHER FINANCING TO PUBLIC OR PRIVATE ENTITIES FOR CONSTRUCTION OF NATURAL GAS FACILITIES.

The act, known as the "Clean Water and Natural Gas Critical Needs Bond Act of 1998", authorizes the issuance of general obligation bonds in the amount of $1 billion. The issuance of these bonds, $800 million for water and sewer bonds and $200 million for natural gas bonds, was approved by a majority of the voters in the November, 1998 election. The act also increases the maximum principal amount of revolving loans and grants that may be made to local government units from the funds in the Clean Water Revolving Loan and Grant Fund. The maximum principal amount of grants made to any one local government unit during any fiscal year is increased from $1 million to $3 million. Finally, the act establishes a 19-member State Infrastructure Council within the Department of Environment and Natural Resources (DENR). The purpose of the Council is to

develop a State strategic plan that addresses the State's water supply and distribution and wastewater treatment needs.

Use of Clean Water Bond and note proceeds. The act provides for the issuance of $800 million of Clean Water Bonds. Public necessity and specific criteria listed in the act for various allocations of the Clean Water Bonds are the primary considerations in granting and loaning these proceeds. In addition, special emphasis is placed on the creation of efficient water supply and wastewater collection and disposal systems, sound fiscal policies, creative planning, efficient operation and management, development of a capital improvement plan, compliance with watershed protection requirements, and use of proceeds to address current critical infrastructure needs. None of the Clean Water Bond proceeds may be used for a low-pressure pipe wastewater system or for construction of a new water and sewer line to provide water and sewer connection in a designated watershed area.

$500 million of the proceeds of the Clean Water Bonds are to be issued as follows:

- $330 million are to be used by DENR to provide high-unit cost grants to local government units. These grants are for the purpose of paying the cost of water supply systems, wastewater collection systems and wastewater treatment works, water conservation projects, water reuse projects, and rural school water or wastewater projects. In order for a high-unit water supply or wastewater project to be eligible for a grant, the project must require estimated average household water and sewer user fees greater than 1 ½% of the median household income in the local government unit in which the project is located. S.L. 1998-212, enacted October 30, 1998, clarifies the statutory criteria used to determine eligibility of an applicant for a high-unit cost grant for a wastewater or water supply project. The amended definition clarifies that if an applicant is constructing its first utility or has only a single utility and is upgrading that utility, then the applicant's eligibility is determined by comparing the project's debt service, operation, and maintenance costs to ¾% of the median household income in the local government unit. The requirement that a project's debt service, operation, and maintenance cost be compared to 1 ½% of the median household income applies only when the applicant has two utilities (water and sewer).
- $35 million are to be used by DENR to provide State matching funds for federal wastewater or water supply funds.

- $20 million are to be awarded and administered by the Department of Commerce for the purpose of making grants to local government units to pay the cost of clean water projects in connection with the location of industry to, and expansion of industry, in the State. These grants may be made only for projects that are located in economically distressed counties, that will have a favorable impact on the State's clean water objectives, and that deal with manufacturing and warehousing and wholesale trade.
- $60 million are to be awarded and administered by the Rural Economic Development Center as supplemental and capacity grants to eligible local government units. Eligibility criteria include the requirement that an applicant be a rural county, a local government unit in a rural county, or a county applying for a grant on behalf of a rural school. Projects located within economically distressed counties receive priority. A grant awarded to a rural county that is not an economically distressed county must be matched by the county on a dollar-for-dollar basis.
- $55 million are to used for grants to local government units that are unsewered communities, that have a population of 5,000 persons or less, and that have a median household income that does not exceed 90% of the national median household income. To be eligible for a grant, a local government unit must agree to adopt a fee schedule that reflects at least the average annual water and wastewater cost per household calculated at 1 ½% of the median household income in the unit's jurisdiction. S.L. 1998-212, enacted October 30, 1998, clarifies that a local government unit that is constructing its first utility or that has only a single utility and is upgrading that utility, is eligible for these grants if it agrees to adopt a fee schedule that reflects at least the average annual water or wastewater cost per household calculated at ¾% of the median household income in the applicant's jurisdiction. These grants are to be awarded and administered by the Rural Economic Development Center. The act defines unsewered communities as "lacking centralized publicly owned wastewater collection systems and wastewater treatment works."

The remaining $300 million of the $800 Clean Water Bonds are to be used to provide loans to local government units to pay the cost of water supply systems, water conservation projects, water reuse projects, wastewater collection systems, and wastewater treatment works. A county may also apply for a loan for one of these projects on behalf of a rural school located in the county. DENR is to set the priorities for the loans. DENR and the Local Government Commission determine the eligibility of local government units for these loans. Each loan applicant must

demonstrate its financial capacity to repay the loan and agree to adopt and effect a schedule of fees and charges that will provide for proper operation, maintenance, and administration of the projects.

Use of Natural Gas Bond and note proceeds. The act provides that $200 million of Natural Gas Bonds are to be used for the purpose of providing grants, loans, or other financing to natural gas local distribution companies, persons seeking natural gas distribution franchises, State or local government agencies, or other entities for construction of natural gas facilities in unserved areas of the State. The following 22 counties are currently unserved: Alleghany, Ashe, Camden, Carteret, Cherokee, Chowan, Clay, Currituck, Dare, Gates, Graham, Hyde, Jackson, Jones, Madison, Pamlico, Pasquotank, Pender, Perquimans, Swain, Tyrrell, and Washington.

Reports required. The entities making grants or loans under the act must file a yearly report with the Joint Legislative Commission on Governmental Operations and the Fiscal Research Division. Each report must show the allocation and making of loans or grants authorized by the act for the preceding fiscal year. Entities making the grants must also monitor compliance with the statutory goals for participation in projects by minority businesses and report to the General Assembly annually regarding minority business participation.

S.L. 1998-134 (House Bill 1617, Representative Mitchell)

AN ACT TO EXTEND THE INCOME TAX CREDIT FOR POULTRY COMPOSTING FACILITIES TO CORPORATE ENTITIES AND TO REMOVE THE SUNSET FOR THE INDIVIDUAL INCOME TAX CREDIT.

This act removes the sunset from the individual income tax credit for constructing a poultry composting facility in this State for composting poultry carcasses resulting from commercial poultry operations. The credit would otherwise have expired in the 1998 tax year. The individual income tax credit was available only to individuals, shareholders in Subchapter S corporations, and other individual owners of pass-through entities. This act expands the credit to C corporations. The act will reduce General Fund revenues by approximately $30,000 a year.

The amount of the credit allowed is 25% of the installation, equipment, and materials costs of building the facility, not to exceed $1,000. The credit does not apply to costs paid with funds provided to the taxpayer by a State or federal agency. The amount of the credit allowed cannot exceed the amount of tax

imposed for the taxable year and any unused credit may not be carried forward to succeeding taxable years.

A poultry composting facility is a structure or an enclosure in which whole, unprocessed poultry carcasses are decomposed by a natural process into an organic, biologically safe byproduct that can be used for plant food. Every person engaged in raising poultry for commercial purposes who has a flock of at least 200 fowl is required to dispose of the poultry carcasses in a pit, an incinerator, or a poultry composting facility that has been approved by the Department of Agriculture. In the poultry business, the grower of a bird is often not the owner of the bird. The burden of disposing of poultry carcasses is usually on the grower of the bird.

The purpose of the credit is to encourage people who raise turkeys, chickens, or other poultry to compost the dead poultry rather than burn it or put it in a pit. By composting the poultry carcasses, the by-product can be converted into a useful product.

S.L. 1998-139 (House Bill 1489, Representative Neely)

AN ACT TO IMPROVE COLLECTION OF LOCAL TAXES BY ALLOWING CERTAIN GOVERNMENT OFFICIALS TO SHARE SPECIFIED TAX INFORMATION AND BY ALLOWING A TAXPAYER TO RECEIVE A RELEASE OR REFUND OF PRORATED VEHICLE PROPERTY TAXES IF THE TAXPAYER MOVES OUT-OF-STATE.

This act makes three changes relating to local taxes. The changes, which became effective September 14, 1998, relate to sharing of certain tax information and to property taxation of motor vehicles. First, the act authorizes the Department of Revenue and county tax officials to share information about the taxes paid on leased vehicles with each other and with a regional public transportation authority or a regional transportation authority. Second, it authorizes State tax officials to share information regarding sales and use taxes with city and county government representatives. Third, it also gives counties the specific authority to release or refund the taxes on a motor vehicle when the taxpayer moves out of state and surrenders his or her license plate. This last change was recommended by the Revenue Laws Study Committee.

Information sharing of taxes on leased vehicles by the Department of Revenue. The Department of Revenue collects the alternate highway use tax, which is a gross receipts tax on vehicle rentals. Regional transit authorities are authorized to levy gross receipts taxes on vehicle rentals. The act provides an exception to G.S. 105-259, which prohibits the Department of Revenue from

revealing confidential tax information. The act authorizes the Department of Revenue to provide regional transit authorities, on an annual basis, identifying information about the retailers from whom it collects the State vehicle rental tax. The compliance and audit information gathered by the Department of Revenue in collecting the State vehicle rental tax will assist regional authorities in enforcing their local vehicle rental taxes.

In 1997, the General Assembly enacted S.L. 1997-417, which authorized a regional transit authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting passenger motor vehicles and motorcycles. The tax applies only to short-term rentals, i.e., rentals for a period of less than one year. The tax is collected by the authority but is otherwise administered in the same way as the optional highway use tax on gross receipts from vehicle rentals. This optional highway use tax is 8% on short-term rentals, so the combined tax within the jurisdiction of the authority would be 13% if the authority levies the full 5%. Each authority may use the proceeds of the tax for its public transportation purposes. Before levying or increasing the tax, the authority must obtain approval from each county in the region.

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. Article 27 authorizes the creation of a regional transit authority for the Triad region. The counties served by the Authority would be Forsyth, Guilford, Randolph, Davidson, and Alamance. The four major cities involved in the Authority's creation are Greensboro, High Point, Winston-Salem, and Burlington.

Information sharing of sales and use taxes by the Department of Revenue. The Department of Revenue also collects sales and use taxes from retailers, including restaurants and other businesses that sell prepared food and beverages. Several local governments are authorized to levy local taxes on prepared food and beverages. They are Charlotte/Mecklenburg, Cumberland County, Dare County, Wake County, and the Town of Hillsborough. The act authorizes the Department of Revenue to provide counties and cities, on an annual basis, identifying information about the retailers from whom it collects sales and use taxes who might be engaged in the business of selling prepared food and beverages. This sharing of information will assist local governments in enforcing their local taxes on prepared food and beverages.

Information sharing of taxes by counties and regional transit authorities. Some counties audit vehicle rental dealers for property tax purposes and audit retailers

of prepared food and beverages for purposes of the local meals tax. G.S. 153A-148.1, however, prohibits counties from sharing tax information about a taxpayer's income or receipts. This information could assist regional transit authorities in enforcing their vehicle rental taxes and could assist the State in enforcing the sales and use tax it collects. The act adds two exceptions to the statute so that counties and regional transit authorities may (1) exchange tax information about vehicle rental dealers with one another when the exchange will aid either agency in fulfilling its duties, and (2) provide tax information to the Department of Revenue when the information will help the Department in its duties.

Property Taxation of Motor Vehicles. Since 1993, counties have taxed motor vehicles that are registered with the Division of Motor Vehicles (DMV) on a revolving, year-round basis. If the taxes remain unpaid for more than four months after they become due, the county places a block on the vehicle's registration with DMV. This block provides an incentive for taxpayers to pay the taxes. The block has no impact on a taxpayer who has moved out of the State during the tax year. In most instances the taxpayer is willing to pay the taxes on the part of the tax year that the vehicle was registered in North Carolina but does not want to pay the entire year's taxes. In the past, some counties have prorated the amount of taxes due in order to obtain part of the tax liability, although they did not have the statutory authority to do so. The act provides that authority, by requiring the partial release or refund of property taxes on a motor vehicle when the taxpayer surrenders the vehicle's registration plate to the DMV because the taxpayer has moved out of state and registered the vehicle in another jurisdiction. The taxpayer may apply for a release or refund of taxes on the vehicle for any full calendar months remaining in the vehicle's tax year after the date of surrender.

S.L. 1998-146 (Senate Bill 1230, Senator Kerr)

AN ACT TO CLARIFY THE TAXATION OF KEROSENE AND TO MAKE OTHER CHANGES IN THE MOTOR FUEL TAX LAWS.

This act makes changes in several different areas of the motor fuel tax laws that needed addressing. It clarifies the taxation of kerosene, provides automatic refunds to motor carriers, imposes a penalty for improper reporting, and makes several clarifying and conforming changes to the motor fuel tax laws.

As a means to address motor fuel tax evasion, the federal government in 1994 began requiring motor fuel to be dyed if it was non-tax-paid fuel. North Carolina passed a similar act in 1994. Under federal and State law, it is unlawful to use

dyed diesel fuel in a vehicle used on the highway because the dye indicates that fuel taxes have not been paid on that fuel. Effective July 1, 1998, the federal government began requiring kerosene to be dyed. This act conforms North Carolina's law with the federal law by amending the definition of the term "diesel fuel" to include kerosene. This change makes it a State violation, as well as a federal violation, to use dyed kerosene for a highway use.

This change in the law also means that undyed kerosene will be taxed at the rack. Prior to July 1, 1998, the taxation of kerosene occurred when it was blended with other fuel to be used for highway purposes. This part of the act applies to kerosene sold on or after July 1, 1998. To help the Department of Revenue track the path of kerosene that had been removed from the terminal transfer system prior to July 1, 1998, the act required retailers, distributors, importers, and suppliers who had kerosene on hand or in their possession as of 12:01 a.m. on July 1, 1998, to inventory the kerosene and report the results of the inventory to the Secretary of Revenue by July 15, 1998. Originally, the legislation required these people to pay tax on this kerosene. The act, however, does not require the tax to be paid, but it does require the inventory to be made and submitted to the Department of Revenue.

The act makes conforming changes to the motor fuel tax laws to provide the proper exemptions from, and refunds of, the excise tax on motor fuels for undyed kerosene used for non-highway purposes. It adds diesel fuel that is kerosene and that is sold to an airport to the list of fuels exempt from the motor fuels tax. It provides that a distributor will be allowed to obtain a refund of the tax paid on kerosene when it is sold to an end user for heating if the kerosene is dispensed into the end user's storage facility that contains fuel used only for heating. It also provides that a distributor will be allowed to obtain a refund of the tax paid on the kerosene when it is sold to a retailer for non-highway use if the kerosene is dispensed into a storage facility marked for non-highway use and the storage facility is equipped with a dispensing device that is not suitable to fuel highway vehicles. The act clarifies that kerosene sold for a non-highway use is subject to sales tax.

Effective July 1, 1998, the act provides for an automatic refund to a motor carrier whose credit exceeds its tax liability. A carrier operating in this State is taxed on the amount of motor fuel the carrier used in the State and is entitled to a credit for the motor fuels tax it paid on purchases made in this State. Under former law, a carrier had two years to request a refund when its tax credits exceeded its tax liability. If the motor carrier failed to request a refund within two years of tax payment, then the Department of Revenue kept the overpayment. From 1990 to 1996, the Department earned $6 million or approximately $83,300 per quarter from lapsed refunds. Since the complete implementation of the International Fuel

Tax Agreement in 1996, motor carriers have been more aggressive in seeking refunds owed to them. Based on a review of the second quarter of 1997, the amount of lapsed refunds was down to $60,000. Under this act, carriers will automatically receive refunds and the Highway Fund will no longer receive $240,000 in unanticipated revenues from lapsed refunds each year.

Effective January 1, 1999, the act imposes a penalty on a licensed distributor or licensed importer who deducts an exempt sale when paying the excise tax to a supplier and then fails to report the exempt sale when filing a reconciling return. The amount of the penalty is $250.00. The Department of Revenue anticipates a revenue gain from this penalty, but it cannot estimate the amount.

The act also makes the following changes to the motor fuel tax laws. With the exception of the first change listed below, the changes became effective when the act became law, September 18, 1998:

- It expands the definition of "two-party exchange" to include sales between suppliers to address buy-sell agreements. This change is effective for transactions occurring on or after January 1, 1999.
- It requires a carrier who denies liability for a penalty to pay the penalty under protest and then apply to the Department for a hearing.
- It gives the Secretary of Revenue the authority to send a letter of release instead of returning a bond when a license holder files a bond or irrevocable letter of credit as a replacement for a previously filed bond or letter of credit and the license holder has paid all taxes and penalties due. The Secretary already has this authority under G.S. 105-449.76 when a license is canceled.
- It creates a presumption that all fuel delivered to a storage facility marked for non-highway use was used for highway purposes and is therefore subject to tax **if** the Secretary determines that a bulk-end user or retailer used or sold any of the untaxed dyed diesel fuel from that storage facility to operate a highway vehicle. This presumption currently applies to alternative fuels in G.S. 105-449.138(b).
- It clarifies the due date for applications for refunds of the motor fuel tax.
- It requires an applicant for a license to engage in the alternative fuel business to be incorporated, organized, or formed in this State or authorized to transact business in this State. If the applicant is an individual or a general partnership, the applicant must designate an agent for service of process in this State. An applicant for a license to engage in the motor fuel business must already meet this requirement.

S.L. 1998-158 (Senate Bill 1242, Senator Hoyle)

AN ACT TO PROVIDE FOR A WIRELESS ENHANCED 911 SYSTEM FOR THE USE OF CELLULAR, PERSONAL COMMUNICATIONS SERVICE, AND OTHER WIRELESS TELEPHONE CUSTOMERS, AS RECOMMENDED BY THE JOINT LEGISLATIVE UTILITY REVIEW COMMITTEE, AND TO ALLOW STATE AGENCIES TO LEASE PUBLIC PROPERTY FOR THE CONSTRUCTION OF WIRELESS COMMUNICATIONS TOWERS AND TO ENCOURAGE CO-LOCATION OF SERVICES TO THOSE TOWERS, AND TO MAKE A TECHNICAL CORRECTION TO G.S. 62A-10.

This act establishes a system for charging cellular telephone users for enhanced 911 service and establishes a method of administering and distributing the funds collected. An enhanced 911 system is one that provides cellular users with 911 service, directs wireless 911 calls to the appropriate dispatch agency based on where the calls originate, and enables the dispatch agency to determine the location and telephone number of the caller.

The service charges authorized by the act went into effect October 1, 1998. The revenues will be used to reimburse cellular service providers and 911 dispatch agencies for their costs in establishing federally required wireless enhanced 911 systems. Thus, the act does not affect the General Fund.

The act creates a thirteen-member Wireless 911 Board that will determine the service charge to be levied on cellular telephone users for wireless enhanced 911 service, aggregate the charges collected, and distribute them for purposes of paying for these systems. The Board is apparently a State entity; it is chaired by the Secretary of Commerce.

The initial service charge is 80¢ per month. The Board may adjust the rate every two years to a rate that will ensure full cost recovery by cellular service providers and 911 dispatch agencies over a reasonable period of time. The charge cannot exceed 80¢ per month.

Cellular service providers will collect the monthly service charge from their customers and may deduct 1% of the amounts collected as reimbursement for administrative expenses. The funds are to be deposited with the State Treasurer within 30 days after the end of each month. The Board will distribute these funds, and may retain 1% for administrative expenses. The act clarifies that the service charges are not considered taxable gross receipts or taxable income to the cellular service providers that collect them.

Sixty percent of the funds may be used to reimburse cellular service providers for complying with federal wireless 911 requirements, including design,

upgrade, purchasing, leasing, programming, installing, testing, and maintaining of hardware and software components and data necessary to operate the system. Forty percent will be distributed to the agencies that receive incoming 911 calls and make the dispatches. Half of this 40% is distributed on a pro rata basis and the other half is distributed on the basis of population served. Dispatch agencies may use the funds only for the direct costs of establishing and maintaining a wireless enhanced 911 system. The act establishes audit and reporting requirements to assure that the funds are used only in accordance with law.

In 1996 and 1997, the Federal Communications Commission adopted orders intended to foster major improvements in the quality and reliability of 911 services available to customers of cellular service providers. The orders directed cellular service providers to adopt systems that automatically inform 911 dispatch agencies of the location and telephone number of cellular 911 callers. The FCC orders indicated that this requirement applies only if the system is requested by the 911 dispatch agencies, the dispatch agencies have made the necessary investment in equipment to receive the information, and a cost recovery mechanism is in place. This act provides the necessary cost recovery system.

S.L. 1998-162 (House Bill 1318, Representative Neely)

AN ACT TO LIMIT THE NONRESIDENT WITHHOLDING REQUIREMENT TO ATHLETES AND ENTERTAINERS, TO INCREASE THE THRESHOLD REQUIREMENT FOR NONRESIDENT WITHHOLDING, AND TO PROVIDE A MECHANISM TO ENHANCE COLLECTION OF TAXES FROM NONRESIDENTS ENGAGED IN CONSTRUCTION-RELATED BUSINESSES.

This act limits the withholding requirement for payments to nonresident contractors so that it applies only to payments to contractors doing business as athletes and entertainers. It clarifies that radio programs, like television and film programs, are a form of entertainment for purposes of the withholding requirement. It also limits the requirement to payments to a nonresident contractor in excess of $1,500 a year. These changes relating to withholding become effective retroactively as of January 1, 1998. Originally, the withholding requirement also applied to construction-related trades. Although this act removes construction-related trades from the income tax withholding requirements, it does require occupational licensing boards for construction-related trades to cooperate with the Department of Revenue to assure that nonresidents pay delinquent taxes before being licensed to do business in this State. Most of these changes affecting occupational licensing become effective

July 1, 1999. The changes made by this act are expected to reduce General Fund revenues by $7 million a year.

Many nonresidents who derive income from North Carolina do not pay the North Carolina tax due on this income. To address this collection problem, the 1997 General Assembly enacted S.L. 1997-109 to require payers to withhold 4% from the compensation paid to nonresident individuals and nonresident entities for personal services performed in North Carolina if the compensation exceeded $600 in the calendar year. The nonresident withholding requirement was suggested by the Department of Revenue and recommended to the 1997 General Assembly by the Revenue Laws Study Committee. The withholding requirement was phased in as follows: beginning January 1, 1998, it applied to payments to individuals for any personal services and payments to entities for services relating to entertainment, athletic events, and construction; it was to be expanded to payments to entities for all personal services effective January 1, 1999.

After S.L. 1997-109 became law, legislators, staff, and the Department of Revenue were contacted by businesses that were required to withhold from their payments for personal services. These businesses stated that the withholding requirement would create an expensive, time-consuming burden on them. They would have to reprogram their accounting software, examine invoices manually, and make difficult judgment calls regarding where services were performed. Large, multistate corporations in particular claimed that the new law would be burdensome. In response to these concerns, the Revenue Laws Study Committee recommended this act, which repeals nearly the entire withholding requirement. The only part that it retains is the requirement to withhold from payments for services relating to entertainment and athletic events.

As enacted by S.L. 1997-109, the withholding requirement applied to payments made to nonresident contractors only if the total payments exceeded $600 during a calendar year. The $600 threshold is the federal threshold for tax reporting under section 6041 of the Internal Revenue Code. This act raises the threshold for withholding from contract payments to nonresident athletes and entertainers from $600 to $1,500 a year. The higher threshold will have the effect of insulating organizations, such as PTAs, from having to withhold on their occasional payments to out-of-state entertainers.

The rollback of the withholding requirement becomes effective retroactively as of January 1, 1998. Anyone who had been complying with the law by withholding for services other than those performed by athletes and entertainers could choose to refund the withheld taxes only if the taxes had not yet been paid into the Department of Revenue. All taxpayers who had taxes withheld from their

payments will receive a credit for the withheld taxes when they file their income tax return.

The rationale for limiting the withholding requirement to athletes and entertainers is that athletic and entertainment events can be easily identified by those required to withhold, the entire performance is clearly taxable to the state where it occurs, and, because of the large sums often involved, the administrative burden of withholding is small compared to the benefit the State receives. For other personal services performed by nonresidents, the burden of compliance outweighs the benefit because the services are less easily identified and may be performed partly in this state and partly in another state. For those, such as large, multistate corporations, who deal with a myriad of contractors for goods and services throughout the nation, the burden can be significant.

The act also adds reporting and licensing requirements for nonresident individuals and foreign entities that seek occupational licenses for construction-related occupations. These changes affect four occupational licensing boards:

1. The State Licensing Board for General Contractors

1. The State Board of Examiners of Plumbing, Heating, and Fire Sprinkler Contractors

1. The State Board of Examiners of Electrical Contractors

1. The North Carolina State Board of Examiners for Engineers and Surveyors.

The act provides that each of these licensing boards must require a nonresident corporation or a nonresident limited liability company to first obtain a certificate of authority from the Secretary of State before being licensed by the board to do business or, in the case of engineers and surveyors, before having their certificate of licensure renewed. This requirement would become effective July 1, 1999. General law requires all foreign corporations and foreign limited liability companies to obtain a certificate of authority from the Secretary of State before transacting business in this State. G.S. 55-15-01, G.S. 57C-7-02.

The act also provides a mechanism to prevent nonresident individuals and foreign entities from renewing their occupational licenses if they (or one of their partners or members, in the case of a partnership or limited liability company) owe a delinquent income tax debt. A delinquent income tax debt is a final debt after the taxpayer has been notified of the final assessment and no longer has the

right to contest the amount. The provisions relating to individuals goes into effect July 1, 1999. The provisions relating to entities goes into effect July 1, 2000.

If requested by the Secretary of Revenue, each construction-related licensing board will provide the Secretary of Revenue annual lists identifying the name, address, and tax identification number of every nonresident individual and foreign entity licensed by the board. Occupational licensing boards are already required to obtain individual licensees' social security numbers under G.S. 93B-14. The Department of Revenue will check these lists against its records of taxpayers who owe delinquent income tax debts. If the Department of Revenue finds that a nonresident individual or a foreign corporation owes a delinquent tax debt, the Department will instruct the licensing board not to renew the taxpayer's license until the debt has been settled. If the Department of Revenue finds that a partner in a foreign partnership or a member of a foreign limited liability company owes a delinquent tax debt, the Department will instruct the licensing board not to renew the partnership or limited liability company's license until the debt has been settled. The license may be renewed once the licensing board receives written notice from the Secretary of Revenue that the debt has been settled.

This provision is similar to G.S. 93B-13, which revokes an occupational license if the licensee fails to comply with child support requirements. The provision is also similar to the law regarding property taxes on motor vehicles. The Division of Motor Vehicles provides the counties periodic lists of motor vehicles registered and renewed in this State. If the owner fails to pay local property taxes on the vehicle, the county notifies DMV not to renew the vehicle registration until the taxes are paid. This mechanism provides an incentive for taxpayers to pay their taxes.

Section 8 of the act clarifies that taxpayers are not entitled to an additional administrative hearing regarding a board's refusal to renew a license based on a delinquent income tax debt. The Department of Revenue will block renewals only for those debts for which the taxpayer has already been afforded full procedural rights required by the Due Process Clause of the United States Constitution.

S.L. 1998-171 (House Bill 1326, Representative Gray)

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO EXTEND THE CORPORATE INCOME TAX CARRY FORWARD FOR NET ECONOMIC LOSSES, TO CONFORM TO FEDERAL

GIFT TAX TREATMENT OF CONTRIBUTIONS TO QUALIFIED TUITION PROGRAMS, AND TO CORRECT TWO REDLINING ERRORS IN 1998 TAX LEGISLATION.

This act makes the following changes relating to tax law:

1. Upon recommendation of the Revenue Laws Study Committee, it rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from January 1, 1997, to September 1, 1998.

2. It conforms North Carolina tax law to the federal gift tax treatment of qualified tuition programs for taxable years beginning on or after January 1, 1998.

3. It extends the carryforward period for corporate net economic losses from five years to 15 years, effective for taxable years beginning on or after January 1, 1999, with a three-year cap on the amount of the extended losses that may be deducted.

Update Code Reference. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. This update generally has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law. Congress made numerous, significant changes to the Code in 1997 that will affect taxable income. Other changes to the Code were made by the Internal Revenue Service Restructuring and Reform Act of 1998. Because the State corporate and individual income taxes are based upon federal taxable income, these changes affect State policies and revenues.

The act provides that the recent federal tax changes that could increase a taxpayer's North Carolina taxable income for the 1997 tax year will not become effective until January 1, 1998. Under Article 1, Section 16 of the North Carolina Constitution, the General Assembly cannot pass a law that will increase a tax retroactively. There are a number of provisions in the federal Taxpayer Relief Act of 1997 and the Internal Revenue Service Structuring and Reform Act of 1998 that could increase taxable income for the 1997 tax year. Because the Code Update could not be acted upon until the 1998 Session of the General Assembly, these changes had to be given a delayed effective date.

The Code Update will reduce General Fund revenues by $6.97 million in fiscal year 1998-99, $4.01 million in fiscal year 1999-2000, $10.70 million in fiscal year 2000-01, $18.53 million in fiscal year 2001-02, and $33.64 million in fiscal year 2002-03.

The following list summarizes some of the more significant changes to the Code:

1. Repeals the former rules on rollover and one-time exclusion for capital gains on the sale of a taxpayer's principal residence and replaces them with an exclusion of $250,000 ($500,000 for joint filers) of capital gain from the sale of a residence occupied by a taxpayer as a principal residence for two of the previous five years.

2. Expands the business expense deduction for self-employed individuals' health insurance to a percentage of 50% effective in 2000. The percentage is then phased up reaching 100% in 2007.

3. Establishes Roth IRAs effective for tax years beginning on or after 1/1/98, which allow nondeductible contributions of up to $2,000 of compensation (limited for those with adjusted gross income above a certain amount).

4. Expands existing IRAs by increasing the income limits and allowing an IRA for the spouse of a disqualified active participant, effective for taxable years beginning on or after 1/1/98.

5. Provides an income tax exemption for the annual earnings on amounts contributed to qualified tuition programs, such as North Carolina's Parental Savings Trust Fund, for the future payment of room or board at an institution of higher education. (Since North Carolina law already exempted these earnings, the North Carolina exemption is repealed because the law will automatically piggyback the federal exemption.)

Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it, thereby

eliminating the necessity of bills like this. The answer to the question lies in both a policy decision and a potential legal restraint.

First, the policy reason for specifying a particular date is that, in light of the many changes made in federal tax law from year to year, the State may not want to adopt automatically all federal changes. By pinning references to the Code to a certain date, the State ensures that it can examine any federal changes before making the changes effective for the State.

Secondly, and more importantly, however, the North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Section 2(1) of Article V of the Constitution provides in pertinent part that the "power of taxation…shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on the issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would…be invalidated as an unconstitutional delegation of legislative power."

The Revenue Laws Study Committee explored the possibility of legislation that would automatically adopt federal changes to the Code each year, with legislative review and approval required in the succeeding legislative session. It was hoped that this approach would avoid the practical difficulties that occur when Code changes go into effect many months before the General Assembly has a chance to pass legislation adopting the changes. The Attorney General's Office reviewed the relevant case law in this State and other states before concluding that this approach would be unlikely to withstand a constitutional challenge.

Qualified Tuition Plan Gift Tax. The act adopts for North Carolina gift tax purposes the provisions of federal law listed below. Conforming to federal law will relieve taxpayers from unexpected gift tax liability and will simplify tax compliance and administration.

1. A distribution from a qualified tuition program is not a taxable gift, unless a new beneficiary, who is a generation below the original beneficiary, is named to the account or receives the account in a rollover.

2. A contribution to a qualified tuition program is a gift to the designated beneficiary, but not a gift of a future

interest. If the contribution were considered a gift of a future interest, a gift tax return would have to be filed even if the amount were under the $10,000 annual exclusion amount.

3. A contribution to a qualified tuition program is not a direct payment of tuition. If it were, it would be exempt from gift tax.

4. If a contribution exceeds the $10,000 annual gift tax exclusion amount, the donor may elect to avoid gift tax by treating the contribution as if it had been made over a five-year period. For example, a $25,000 contribution would not be taxable because it would be considered a gift of $5,000 a year over five years and thus would be below the $10,000 annual exclusion amount. These provisions apply to any qualified state tuition program under section 529 of the Internal Revenue Code. North Carolina's Parental Savings Trust Fund is such a program.

Corporate Loss Carryforwards. The act extends the corporate income tax carryforward for net economic loss deductions from five years to 15 years, effective beginning with the 1999 tax year. Losses from 1993 and later tax years will benefit from this extension. For the first three years this extension is in effect, the carryforward deduction for losses more than five years old is restricted to 15% of taxable income. Beginning with the 2002 tax year, there will be no cap on the deduction for losses carried forward. A net economic loss is the amount by which a corporation's deductions for a taxable year exceed its income from all sources, including income not taxable by the State. Income not taxable includes income items that are deductible in determining State net income as well as a multi-state corporation's nonbusiness income that is allocable to another state.

The carryforward period for the similar net operating loss deduction under the Internal Revenue Code was recently extended from 15 to 20 years, but most states allow no more than a fifteen-year carryforward period. Because it may be difficult for an auditor to substantiate a loss carryforward based on deductions that are ten to fifteen years old, the act clarifies that the corporation must maintain records that verify the amount of the loss deduction claimed and also provides that the taxpayer or the Secretary of Revenue may redetermine an item for a tax year that is closed under the statute of limitations in order to calculate a loss carried forward to an open year. The net economic loss carryforward will reduce General Fund revenues by $3.70 million for each fiscal year beginning fiscal year 1999-2000 and ending fiscal year 2001-02. The reduction for fiscal year 2002-03 and thereafter will be $16 million a year.

S.L. 1998-178 (Senate Bill 1228, Senator Dalton)

AN ACT TO ENHANCE THE CRIMINAL PROVISIONS FOR TAX VIOLATIONS.

This act increases the criminal penalties for willful tax evasion and for aiding and abetting tax evasion, effective December 1, 1998. The act was recommended by the Revenue Laws Study Committee.

Before 1995, a person who willfully attempted to evade paying the amount of tax due, or who willfully helped another taxpayer attempt to evade paying the amount of tax due, could be punished by an active prison sentence, a monetary fine, or both. Effective January 1, 1995, however, a person who committed these crimes could be punished only by a monetary fine. In some cases, the amount of tax money involved is quite large. In others, the deception is egregious. Some of the people charged with these crimes are charged with them repeatedly.

The Criminal Investigations Division of the Department of Revenue informed the General Assembly that punishment by fine only is not sufficient to deter many would-be tax evaders. For this reason, the Division recommended changing the classification of these two crimes from a Class I felony to a Class H felony, so that a sentencing judge would have the discretion to sentence defendants to active time if the circumstances justify such a punishment.

The act changes the nature of the offense for attempting to evade a tax and for attempting to help another evade a tax from a Class I felony to a Class H felony. For Class I felonies, a sentencing judge is limited to imposing a fine unless the person has been convicted of the crime several times. For Class H felonies, a sentencing judge may impose not only a fine, but also an active sentence for first-time offenders if it is justified. Unless otherwise stated, the amount of the fine is left to the discretion of the court. In order to give a sentencing judge more latitude, the act also deletes the tax statutes' cap on the fine that may be imposed for these offenses.

S.L. 1998-183 (House Bill 20, Representative McMahan)

AN ACT TO INCREASE TO SEVEN PERCENT THE INCOME TAX CREDIT FOR CHARITABLE CONTRIBUTIONS BY NONITEMIZERS.

This act increases the individual income tax credit for charitable contributions by nonitemizers, in order to provide an additional incentive for charitable giving. It increases the amount of the credit from 2.75% to 7% of

eligible contributions, effective beginning with the 1999 tax year. The act is expected to reduce General Fund revenues by almost $8 million a year.

Under the federal Internal Revenue Code, an individual who itemizes deductions may deduct contributions to nonprofit charitable organizations. Individuals who elect the standard deduction, however, may not deduct charitable contributions. An individual's North Carolina's income tax is based on the federal calculation of taxable income, with some adjustments. The federal disallowance of charitable deductions for nonitemizers is "piggybacked" by North Carolina tax law. Legislation was introduced in Congress in 1996 to allow nonitemizers to deduct charitable contributions, but it did not pass.

Individuals who elect the standard deduction are those whose total itemized deductions (such as mortgage interest, State and local property and income taxes, medical expenses, and charitable contributions) do not exceed the standard deduction amount. The federal standard deduction amounts for 1997 are $6,900 for a married couple filing a joint return and $4,150 for a single individual.

In 1996, the General Assembly enacted G.S. 105-151.26, which allows a North Carolina income tax credit for 2.75% of a nonitemizer's charitable contributions to the extent the contributions exceed 2% of the taxpayer's adjusted gross income. A tax credit is a dollar-for-dollar subtraction from tax rather than a subtraction from taxable income. Thus, if a taxpayer pays tax at the 7% rate, a 7% tax credit is equal to a full deduction. North Carolina's tax rates are 6%, 7%, and 7.75%. By raising the credit from 2.75% to 7%, this act would make the credit equivalent to the deduction currently enjoyed by most itemizers.

The House Select Committee on Nonprofits recommended a 7% nonitemizers tax credit to the 1996 General Assembly, but the percentage was reduced in the course of the legislative session. This act raises the credit to the level originally proposed. In the course of its study, the Committee on Nonprofits considered whether tax incentives make a difference in charitable giving. It learned that federal tax incentives do but state tax incentives probably do not because the state tax is so small that it does little to influence individual giving. However, the Committee believed that a state incentive may affect perceptions, and thus behavior, even if the tax reduction is too small to provide a significant economic incentive.

S.L. 1998-186 (Senate Bill 1150, Senator Dalton)

AN ACT TO DELAY THE SUNSET OF THE REQUIREMENT THAT COUNTIES USE PART OF THE TWO HALF-CENT

LOCAL SALES TAX PROCEEDS ONLY FOR PUBLIC SCHOOL CAPITAL OUTLAY PURPOSES.

This act, based on a recommendation of the Education Oversight Committee, extends the period of time during which counties must use part of their local sales tax proceeds for public school capital outlay purposes. The act does not affect General Fund revenues.

There are three Articles of the Revenue Act that authorize counties to levy local sales and use taxes. Article 39 authorizes a one-cent tax, Article 40 authorizes a half-cent tax, and Article 42 authorizes an additional half-cent tax. Article 40 and Article 42 provide that the county is required to use a percentage of the tax revenue for public school capital outlay purposes, including retirement of outstanding debt. The earmarking in Article 40, enacted in 1983, was for the first ten fiscal years the tax was in effect and the earmarking in Article 42, enacted in 1986, was for the first eleven years that the tax was in effect. In 1993, the earmarking was extended for an additional five years for both Articles. Most counties enacted the first half-cent tax under Article 40 in 1983, so its 15 years' earmarking would have expired in 1998; most counties enacted the second half-cent tax under Article 42 in 1986, so its 16 years' earmarking would have expired in 2002.

This act extends the time periods under Articles 40 and 42 by 13 years and 9 years, respectively, so that the earmarking will continue to the year 2011. For these additional years, counties will be required to use 30% of the tax revenue from the first half-cent local sales tax (Article 40) and 60% of the tax revenue from the second half-cent local sales tax (Article 42) only for public school capital outlay purposes. In 1985, the General Assembly exempted Burke County from the restriction that it use a percentage of the first half-cent local sales tax for public school capital outlay purposes. This exemption will remain in effect.

If a county can demonstrate that it does not need the earmarked revenue to meet its public school capital needs, it may petition the Local Government Commission to authorize it to use the money for any public purposes. In making its decision, the Commission must consider not only the public school capital needs but also the other capital needs of the county.

This act also defines public school capital outlay purposes as the term is defined in the School Budget and Fiscal Control Act. The term is defined broadly in that act to include appropriations for the acquisition of real property and buildings for school purposes as well as the acquisition of furniture, computers, equipment, buses, etc. The Local Government Commission currently interprets the term as it is defined in the School Budget and Fiscal Control Act. Therefore,

this clarification of the law will not change the way counties are currently using the money.

S.L. 1998-197 (House Bill 1126, Representative Miner)

AN ACT TO EXEMPT LOCAL PAY PHONE SERVICES FROM SALES TAX.

This act exempts from sales tax pay telephone calls that are paid for by coin, effective January 1, 2000. Credit card calls and other calls not paid for by coin would not be exempt. The sales tax exemption allowed by this act will reduce General Fund revenues by approximately $2 million annually. The gross receipts from sales of all local telecommunications services are subject to State sales tax at 3% (G.S. 105-164.4(a)(4a)) and State gross receipts tax at 3.22% (G.S. 105-120). There is no local sales tax on these services.

House Bill 1126 was introduced in April 1997 when pay telephone calls were regulated so that the owners were not permitted to raise the price of a call above 25¢. The owners complained that the sales tax forced them to operate at a loss because they could not increase the price of the calls to cover the tax. Later in 1997, however, pay telephones were deregulated and the price of most calls immediately increased by 40% or more, generating more than enough revenue to cover the 3% tax. Therefore, the effect of this act is to grant additional tax relief to pay phone owners.

Current law is very inconsistent with regard to sales taxes on sales from coin-operated machines. The following table shows the current law treatment:

Type of Coin Sale	**State Sales Tax**	**Local Sales Tax**	**Tax Break**
Phone Calls	0%	None	None
Cigarettes	4%	2%	None
Soft Drinks	4%	2%	None
Other Vending Sales	4%	2%	50% Reduction
Washers & Dryers	0%	0%	Exempt

Coin-operated washers and dryers are exempt from sales tax. Sales taxes on other coin-operated vending machines, except soft drink and cigarette machines, are reduced by 50%. Sales taxes on coin-operated soft drink and cigarette

machines are subject to the full 4% State sales tax and 2% local sales tax. Vending machine sales of food and beverages do not qualify for the reduced State sales tax on food, and are not subject to local prepared meals taxes.

S.L. 1998-218 (Senate Bill 1554, Senator Rand)

AN ACT TO AMEND THE EXCISE TAX ON CONTROLLED SUBSTANCES.

This act reduces certain tax rates of the excise tax on controlled substances in order to remove features of the tax found unconstitutional by the United States Court of Appeals for the Fourth Circuit in Lynn v. West. It also removes the 50% penalty for failure to pay the tax and provides instead that interest and penalties for this tax will be the same as for all other taxes. The tax, at these new, lower rates, is expected to generate $1.3 million in General Fund revenues and $3.9 million for State and local law enforcement agencies. The act became effective October 26, 1998.

The purpose of the tax rate reductions is to remove features of the tax that caused the federal court to hold it unconstitutional. If these rate reductions have the effect of rendering the tax constitutional, then the State can collect the tax. If a court later holds that these rate reductions did not render the tax constitutional, the State could be required to refund taxes illegally collected or to rescind criminal drug prosecutions. The rate reductions appear to address the federal court's concerns but, because the federal court did not provide a clear test of what would make the tax constitutional, there remains some risk that the tax might later be invalidated again notwithstanding the rate reductions. The issues, outlined below, are complex.

In Lynn v. West, the federal court ruled that the controlled substance tax was, "in reality," a criminal penalty rather than a tax, and could not be enforced without all the criminal procedure safeguards guaranteed by the Fifth and Sixth Amendments of the United States Constitution. As a result of the Lynn case, the Department of Revenue was forced to stop collecting the tax on the date the opinion was issued, January 13, 1998. The Department of Revenue did not stop collecting the tax on illicit spirituous liquor, however. The United States Supreme Court declined to review the Lynn case, so the case is now the controlling law.

The double jeopardy clause was not an issue in the Lynn case because only the federal government, not the State, had brought criminal charges against Lynn for illegal drug possession. The double jeopardy clause protects against successive prosecutions by the same sovereign, but not against prosecutions by different sovereigns. The holding in the Lynn case that the tax is a criminal penalty means,

however, that North Carolina would not be able to collect the tax from an individual and also prosecute the individual for a criminal drug violation. Therefore, the State was required to drop criminal charges against some drug defendants who had also been assessed the controlled substance tax.

The federal court in the Lynn case analyzed the tax under the United States Supreme Court's 1994 Kurth Ranch case holding Montana's illegal drug tax unconstitutional because it was a second punishment, not a true tax, and thus violated the double jeopardy clause of the Fifth Amendment. In analyzing a civil measure to determine if it is in fact a criminal penalty, the court will look first at whether the legislature intended it as a civil penalty and second, even if it is so intended, whether it is so punitive either in purpose or in effect to transform it into a criminal penalty. The Court in the Kurth Ranch case stated that the tax must be examined as a whole to determine whether it has crossed the line to becoming a criminal punishment. Neither a high rate of tax alone nor an obvious deterrent purpose alone would make a tax a criminal punishment, but these factors are significant, the Court ruled. The Court found both these factors present in the Montana law, as well as the fact that the tax was conditioned on the commission of a crime and had no relationship to lawful possession.

In the Lynn case, the federal court found that all four of these same factors were present in North Carolina's controlled substance tax: a high rate of tax, a deterrent purpose, application only to illegal activity, and no relationship to lawful possession. For this reason, the court ruled that North Carolina's controlled substance tax is a criminal penalty. This act lowers the tax rates, and the civil penalty for failure to pay, in the hope of addressing the first factor, high rates. It would be difficult to address the deterrent purpose of the tax, its application only to illegal drug possession, or its lack of a relationship to legal position.

Nearly a kilogram of cocaine was seized from Lynn in 1993. The tax rate was $200 a gram, with a penalty equal to 100% of the tax. Although no evidence of the value of cocaine had been offered, the court found that its market value was $25,000 a kilogram, which translates to $25 a gram. Thus, the court found the tax rate to be eight times the market value of the cocaine, which, when combined with the 100% tax penalty, yielded a total tax that was sixteen times the market value of the cocaine. The tax rate in the Kurth Ranch case, by comparison, was eight times the market value of the drug. The Lynn court's concern with North Carolina's high tax rate was compounded by the fact that the full rate applies no matter how pure or dilute the controlled substance may be.

This act provides a separate tax rate of $50 a gram for cocaine and changes the tax rate on drugs sold by dosage units from $400 to $200 per ten dosage units.

Crack cocaine is sold in dosage units. The bill also reduces the 50% failure to pay penalty to 10%, to keep it in line with a 1998 reduction in the tobacco tax penalty. Based on the court's holding that cocaine's market value is $25 a gram, the proposed rate tax would be twice the market value; when the 10% penalty is added, the total would be only slightly more than twice the market value. The act does not address the court's concern that the same tax rate applies whether the substance is pure or dilute.

The General Assembly enacted the excise tax on controlled substances in 1989 as a means of generating revenue for State and local law enforcement agencies and for the General Fund. Under the law, a person who acquires illegal drugs is required to pay tax on them within 48 hours of acquiring possession if the tax has not already been paid as evidenced by a tax stamp. A person paying the tax is not required to disclose his or her identity and any information obtained in assessing the tax is confidential and cannot be used in a criminal prosecution other than a prosecution for failure to comply with the tax statute itself. Seventy-five percent of the revenue generated by assessments of the tax is distributed to the law enforcement agencies whose investigation led to the assessment. The remainder of the revenue is credited to the General Fund.

The North Carolina Court of Appeals upheld the constitutionality of the State's excise tax on controlled substances in 1996 and the North Carolina Supreme court affirmed March 7, 1997. Because the constitutionality of the tax depends on an interpretation of the federal constitution, the federal courts are not bound by the opinion of the North Carolina courts.

S.L. 1998-212 (Senate Bill 1366,)

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 1997 AND TO MAKE OTHER

CHANGES IN THE BUDGET OPERATION OF THE STATE.

The Current Operations Appropriations and Capital Improvement Appropriations Act of 1998 contains the following thirteen tax law changes:

1. Repeals the State sales tax on food.

2. Repeals the State inheritance tax.

3. Allows public schools to obtain an annual sales tax refund.

4. Extends the deduction for subsidiary dividends to foreign corporations.

5. Allows a State individual income tax credit for long-term care insurance.

6. Decreases the insurance regulatory charge from 8.75% to 6%.

7. Sets the public utility regulatory fee at 0.09%.

8. Increases the conservation tax credit for corporate and individual taxpayers.

9. Amends the Revenue Act to make tax penalties uniform.

10. Extends the sunset for the qualified business investment tax credit.

11. Modifies the qualified business investment tax credit for the movie industry.

12. Directs a study of taxpayer attorney fees.

13. Revises the property tax exemption for continuing care retirement homes.

Repeal State Sales Tax on Food. In 1996, the General Assembly reduced the State sales tax on food from 4% to 3%, effective January 1, 1997. In 1997, the General Assembly reduced the State sales tax on food from 3% to 2%, effective July 1, 1998. This act completes the reduction by eliminating the remaining 2% State sales tax on food, effective May 1, 1999. The act also authorizes the Secretary of Revenue to earmark up to $174,000 of sales tax collections for 1998-99 for the administrative costs of revising and mailing forms. This section of the act will reduce General Fund revenues by $18.4 million in fiscal year 1998-99, $184.5 million in fiscal year 1999-2000, $190 million in fiscal year 2000-01, $195.7 million in fiscal year 2001-02, and $201.6 million in fiscal year 2002-03.

The sale of tangible personal property in North Carolina is subject to a 4% State sales tax unless it is specifically exempt from the tax. In 1971, 1983, and 1986, the General Assembly passed legislation allowing local governments to impose a local sales tax. The local sales tax rate is 2%. On most tangible personal property, the combined State and local sales tax rate is 6%. However, because of past

legislation reductions, the combined State and local sales tax rate on food, effective July 1, 1998, was 4%. This section of the act repeals the State's remaining 2% sales tax rate on food, but retains the 2% local sales tax rate. Therefore, when the provision becomes effective, there will only be a local 2% sales tax on food.

The sales tax on food applies to food that may be purchased with food stamps or other methods under the food stamp program. Federal law determines what can be purchased under the food stamp program and, therefore, what food is exempt from the State sales tax. Food purchased with food stamps is already exempt from both the State and the local sales tax, as required by federal law.

Eliminate North Carolina Inheritance Tax. The act repeals the State's inheritance tax but retains a State estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of State estate tax is known as a "pick-up" tax because it picks up for the State the amount of federal estate tax that would otherwise be paid to the federal government. The repeal of the State's inheritance tax is effective January 1, 1999, and applies to the estates of decedents dying on or after that date. This section of the act will reduce General Fund revenues by $52.5 million in fiscal year 1999-2000, $79.4 million in fiscal year 2000-01, $85.7 million in fiscal year 2001-02, and $92.6 million in fiscal year 2002-03.

Under prior law, North Carolina imposed an inheritance tax on property transferred by a decedent. The amount of tax payable depended on the relationship of the person transferring the property (the decedent) to the person receiving the property (the beneficiary). This was in contrast to federal law, which has a single rate schedule for estates.

State law classified beneficiaries into three classes and set different inheritance tax rates for each class. A Class A beneficiary was a lineal ancestor, a lineal descendant, an adopted child, a stepchild, or a son-in-law or daughter-in-law whose spouse was not entitled to any of the decedent's property. A Class B beneficiary was a sibling, a descendant of a sibling, or an aunt or uncle by blood. A Class C beneficiary was anyone who was not a Class A or Class B beneficiary.

Class A beneficiaries had the lowest inheritance rates and a $600,000 inheritance tax exemption. Class B beneficiaries had higher rates and no exemption. Class C beneficiaries had the highest rates and no exemption. Thus, North Carolina's rate structure favored transfers to children and parents by giving those transfers the lowest rates plus an exemption and preferred transfers to other close family members over transfers to more distant relatives or to persons who were not related.

Sales Tax Refunds for Schools. This section of the act adds local school administrative units to the list of governmental entities that may obtain an annual refund of the State and local sales and use taxes paid by them. The change became effective July 1, 1998, and applies to taxes paid on or after that date. The refunds apply to direct purchases of tangible personal property. They also apply to sales and use tax liability indirectly incurred by a local school administrative unit on building materials, supplies, fixtures, and equipment that become a part of any building that is owned or leased by the unit and is being built, altered, or repaired for use by the unit. To obtain the refund, a local school administrative unit must request the refund in writing within six months after the end of the unit's fiscal year. The request must include any information and documentation required by the Secretary of Revenue. This section of the act will reduce General Fund revenues by $14.8 million in fiscal year 1999-2000, $15 million in fiscal year 2000-01, $14.4 million in fiscal year 2001-02, and $12.6 million in fiscal year 2002-03.

Prior to 1961, the State granted sales and use tax exemptions to State and local governmental entities, including public schools, and nonprofit entities. Because of the number of abuses involving the exemption and the difficulty of auditing these transactions, the General Assembly changed the law in 1961 to allow refunds as opposed to outright exemptions. The statute lists those entities that are entitled to a refund. Nonprofit educational institutions, as well as most other nonprofit entities, are entitled to a semiannual refund of State and local sales and use tax.

The General Assembly did not include State agencies in the list of entities entitled to an annual refund of State and local sales taxes because the refund process would not benefit the General Fund, from which the agencies receive their appropriations, and would create unnecessary paperwork for the agencies. The General Assembly did not include public schools in the list of entities entitled to an annual refund for similar reasons. First, public school books and school lunches are exempt from sales tax. Second, most of the operating money for public schools comes from the General Fund, although most of the capital money comes from the counties.

Prior to the act, although a school board could not receive sales tax refunds, a county was entitled to a refund of State sales and use taxes paid if it purchased items on behalf of its school board. More than one-half of the counties have statutory authority to acquire property on behalf of their school boards and thus may receive sales tax refunds if they exercise that authority. The other counties do not have this authority, although the Attorney General's Office has stated that they may acquire property on behalf of their school board if they enter into an interlocal agreement with the school board. Under this act, the school board can

receive the refunds directly, without having to arrange for the county to acquire the property and apply for the refunds on its behalf.

Corporate Dividend Technical Change. This section of the act extends the deduction for subsidiary dividends to corporations domiciled in other States. This is a technical change only because, due to the requirements of the Interstate Commerce Clause of the United States Constitution, the Department of Revenue was forced in 1997 to extend the deduction to out-of-state corporations. The statutory change conforms the statutes to the current practice and to the requirements of the Constitution. This provision passed both the House and the Senate in 1997 but was not enacted that year.

Under prior law, G.S. 105-130.7(b) allowed a corporation domiciled in North Carolina that held more than 50% of the outstanding voting stock of another corporation (a subsidiary) to deduct dividends it receives from the subsidiary plus any expenses related to the dividends. The restriction of this deduction to North Carolina corporations created interstate commerce clause problems in light of the United States Supreme Court's 1996 Fulton decision, which struck down a similar provision in the intangibles tax. The Attorney General's Office advised the Department of Revenue that, if the General Assembly did not resolve the constitutional problem with this tax preference, the Department of Revenue could not enforce it. There was too much risk of personal liability on the part of Department of Revenue personnel in enforcing a provision that was so clearly flawed in the wake of the Fulton decision. This section of the act resolves the constitutional problem by extending the deduction to non-North Carolina companies, as the Department of Revenue had already done administratively.

The 1994-95 Revenue Laws Study Committee had recommended a different solution to this problem: allowing both North Carolina corporations and non-North Carolina corporations to deduct subsidiary dividends but not expenses related to the deductible dividends. The Revenue Laws recommendation was based on the basic tax principle that expenses related to untaxed income should not be deductible from taxed income. This policy is reflected in section 265 of the Internal Revenue Code and in G.S. 105-130.5(c)(3). The Revenue Laws Study Committee's recommendation was introduced in 1996, but was not enacted.

Credit for Long-Term Care Insurance. This section of the act allows a State individual income tax credit of 15% of the premium paid each year on long-term care insurance. The credit may not exceed $350 for each policy for which the credit is claimed. The credit may not exceed the amount of tax owed by the taxpayer, and there is no provision to allow unused portions of the credit to be carried forward. The credit becomes effective for taxable years beginning on or

after January 1, 1999, and expires for taxable years beginning on or after January 1, 2004. This section of the act will reduce General Fund revenues by $7.98 million in fiscal year 1999-2000, $8.87 million in fiscal year 2000-01, $9.82 million in fiscal year 2001-02, and $10.89 million in fiscal year 2002-03. The Legislative Research Commission is directed to study the effect of the credit on the State's Medicaid costs and to report its finding to the 2004 Session of the 2003 General Assembly.

A taxpayer may claim a credit for policies that provide coverage for either the taxpayer, the taxpayer's spouse, or a family member for whom the taxpayer provides over half of the support and whose income is below an exemption amount. A long term-care insurance policy is one that provides only coverage of long-term care services and that meets the following requirements:

1. Is guaranteed renewable.

2. Does not provide for a cash surrender value.

3. Provides that refunds and dividends may be used only to reduce future premiums or to increase future benefit.

4. Does not pay or reimburse expenses that are reimbursable under Medicare.

5. Satisfies consumer protection laws.

Under federal law, premiums paid on long-term care insurance contracts are treated as deductible medical expenses. Under the medical expense itemized deduction, unreimbursed medical expenses may be deducted to the extent that the expenses exceed 7.5% of adjusted gross income. To the extent a taxpayer will receive a deduction for long-tern care insurance premiums under the Code, the taxpayer will receive a deduction for State income tax purposes as well since North Carolina uses federal taxable income as the starting point for calculating State taxable income. To prevent a double tax benefit in those cases, the credit is limited to those expenses for which a deduction has not been claimed. The language in the act concerning no double tax benefit is identical to the language used in the credit for child health insurance enacted earlier in 1998.

Insurance Regulatory Charge. The act decreases the insurance regulatory charge from 8.75% to 6%, effective January 1, 1998. This charge was first imposed in 1991. Its purpose is to make the Department of Insurance receipt-supported and thereby eliminate General Fund support of the Department. The regulatory

charge is imposed on insurance companies that pay the gross premiums tax, other than service corporations such as Blue Cross/Blue Shield and Delta Dental Corporation. Health maintenance organizations do not pay the regulatory charge because they do not pay the gross premiums tax. The charge is a percentage of the insurance company's premiums tax liability.

In 1997, the General Assembly clarified that the premiums tax liability upon which the charge is levied is not reduced by any tax credits allowed a taxpayer for guaranty or solvency fund assessments. This change explains in part the reason why the charge is able to be decreased this fiscal year by 2.75%. The act ensures that the regulatory charge will continue to be based upon gross premium tax collections by providing that the premium tax liability upon which the charge is levied is not reduced by any tax credits allowed a taxpayer under Chapter 105 of the General Statutes. The Economic Opportunity Act of 1989, passed this session by the General Assembly, allows a tax credit against the gross premiums tax for investing in central administrative office property.

Public Utility Regulatory Fee. The act sets the public utility regulatory fee for fiscal year 1998-99 at 0.09%. This rate maintains the current 0.09% rate set in fiscal year 1997-98. The utility regulatory fee was imposed in 1989. Its purpose is to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

Amend Conservation Tax Credits. For taxable years beginning on or after January 1, 1999, the act increases an individual taxpayer's limit for the conservation tax credit from $100,00 to $250,000 and increases a corporate taxpayer's credit limit from $250,000 to $500,000. This section of the act will reduce General Fund revenues each fiscal year by $1.2 million. In 1997, the General Assembly increased the individual credit limit from $25,000 to $100,000, and increased the corporate credit limit from $25,000 to $250,000. The act also repeals the requirement that individual taxpayers add back the fair market value of the donated real property to their taxable income. This add-back requirement was originally placed in the law to prohibit individual taxpayers from receiving both a tax credit and a charitable deduction for the donated property.

This tax credit is allowed to individual and corporate taxpayers who make a qualified donation of an interest in North Carolina real property that is useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. The tax credit is equal to 25% of the fair market value of the property donated to the State, a

local government, or a body that is both organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions. Both corporate and individual taxpayers are allowed to carry forward for five years any unused portion of the credit.

North Carolina is the only state that allows a conservation tax credit. The credit was enacted in 1983. The General Assembly did not want an individual to receive a double tax benefit for the donation, so it prohibited a charitable contribution deduction for the portion of the donation used to calculate the tax credit. In 1989, federal taxable income became the starting point in determining North Carolina taxable income. In order to maintain the single tax benefit, an addition to the federal taxable income in the year of the donation was required in the amount of the fair market value of the donated property. This add-back can be a disincentive to donating property in two cases:

1. If the taxpayer never deducts the entire fair market value of the donation as a charitable deduction. This situation can occur because the federal law imposes limitations on the amount of charitable contributions deductions in any year based on the taxpayer's adjusted gross income (usually 30% of adjusted gross income).

2. If the taxpayer never claims the entire tax credit for the donation. This can occur because the taxpayer may be unable to claim the entire amount of the credit within the six-year period.

The act remedies these disincentives by no longer requiring an individual taxpayer to add the fair market value of the donated property to federal taxable income in arriving at North Carolina taxable income. This change results in an individual taxpayer receiving both a charitable contribution deduction and a tax credit for the donation. Current law does not allow a corporation to take a charitable contribution deduction for its donation.

Under the Internal Revenue Code, a donation of real property for conservation purposes is treated as a charitable deduction. A qualified appraisal of the donated land is required if the claimed deduction is more than $5,000. This appraisal must be attached to the federal tax return. No appraisal is required by the North Carolina Department of Revenue.

Revenue Penalties Uniform. The act amends several sections of the Revenue Act to make tax penalties uniform. This portion of the act was requested by the Department of Revenue and recommended by the Revenue Laws Study

Committee. These amendments, which are effective January 1, 1999, do the following:

- Repeal several penalties that are obsolete or ineffective.
- Provide that refunds of sales taxes, motor fuel taxes, and excise taxes on sacramental wine are barred only if filed more than 3 years after their due date. The current law provides a reduction of the amount refunded for late applications filed before the 3-year period expires.
- Clarify that additional taxes are assessable as penalties so that it is clear the taxes may be waived by the Secretary. The act also clarifies that penalties are assessable as additional taxes to ensure the taxpayer receives the full administrative and judicial remedies applicable to tax assessments. This clarification conforms with the following statutory definition of "tax" in G.S. 105-228.90: "[T]he terms 'tax' and 'additional tax' include penalties and interest as well as the principal amount."
- Provide a uniform penalty for most tax deficiencies that exceed 25% of the tax liability.
- Expand the statute concerning the personal liability of corporate officers who fail to remit certain taxes when due to include the manager and managing members of a limited liability company.

Extend Qualified Business Credit Sunset. The act extends the sunset for the qualified business investment tax credit an additional four years, until the year 2003. The act retains the current $6 million cap on the credit. This change became effective when the act became law on October 30, 1998.

The qualified business investment tax credit was enacted in August 1987 to promote economic development for North Carolina businesses. The initial credits applied to both corporations and individuals taxpayers, and there was a $12 million cap on the total amount of all tax credits. In response to a 1996 United States Supreme Court decision in Fulton Corp. v. Faulkner, the General Assembly reduced the $12 million cap to $6 million, limited the credit to individuals and small pass-through entities, and removed the requirement that the qualified businesses be headquartered or operating in North Carolina. The credit was to expire for investments made on or after January 1, 1999. The act extends the credit for four additional years until January 1, 2003.

The credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture or a qualified grantee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable

year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer filed an application with the Secretary of State. The unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed $6 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed with the Secretary of State. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total of $6 million in tax credits in proportion to the size of the credit claimed by each taxpayer.

Under the 1996 Fulton case, the original credit provisions clearly violated the interstate commerce clause of the federal constitution because they reduced a taxpayer's tax liability by an amount equal to 25% of the cost of purchasing stock in either a North Carolina business or an investment company whose purpose is to invest in North Carolina businesses, while no tax reduction was allowed for purchasing similar stock in out-of-state businesses or investment companies whose purpose is to invest in businesses that may not be North Carolina businesses. In response to the Fulton case, the Revenue Laws Study Committee discussed this credit along with several others, at great length. The original proposal of the Committee was to repeal all qualified business investment credits, effective January 1, 1997. In response to appeals to the Committee and to the General Assembly, the credit was expanded to include investments in businesses located both inside and outside North Carolina, but was no longer allowed for investments in investment companies and was limited to investments made by individuals and small pass-through entities under the theory that these investors are not likely to invest outside of a 50-mile radius of their home.

Qualified Business Credit for Movies. The act modifies the qualified business investment tax credit to make it more accessible for investors who provide capital for the film industry, effective for taxable years beginning on or after January 1, 1999. Specifically, the act modifies the qualified business investment tax credit in two ways:

1. Allows a qualified business venture in the film industry to pay off its investors in less than five years without causing the investors to forfeit the tax credit.

2. Provides that the effective date of registration for a qualified business venture whose application is accepted for registration is 60 days before the date its application was filed.

To be a qualified business venture eligible for the qualified business investment tax credit, the business must be engaged primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry and the business must be registered with the Secretary of State. The film industry is eligible to qualify for the credit, as a service-related industry.

To obtain a tax credit, a person must purchase the equity securities or subordinated debt directly from the qualified business. Subordinated debt is indebtedness that by its terms matures five or more years after its issuance, is not secured, and is subordinated to all other indebtedness. A taxpayer forfeits the credit if the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made. In the film industry, a project in which a person may invest does not usually last five years, making it difficult to satisfy the five-year minimum for the investment. The act addresses this problem by allowing a business engaged primarily in the film production industry to redeem its securities within five years and to mature its subordinated debt within five years without causing an investor to forfeit the tax credit. The act provides that this redemption is allowed only if (1) the redemption occurred because the qualified business venture completed the production of a film, sold the film, and was liquidated, and (2) neither the qualified business venture nor a related person continues to engage in business with respect to the film produced by the venture.

Under former law, no tax credit was allowed for an investment made in a qualified business venture before the date of the business's registration with the Secretary of State. In the film industry, a person invests in a project before the project is started. The practice is that the investments are placed in an escrow account until a sufficient amount of capital is obtained to begin a film's production. If enough funds are not raised, then the money in escrow is returned to the investors. To accommodate this unique situation, the act extends the time in which a taxpayer may make an eligible investment. It provides that the effective date of a business's registration is 60 days before the date its application is filed, as opposed to the date it is filed. The act also provides that if a taxpayer's investment is placed initially in escrow conditioned upon other investors' commitment of additional funds, the date of the taxpayer's investment is the date escrowed funds are transferred to the qualified business venture free of the condition, as opposed to the date the investment was actually made.

Study Taxpayer Attorney Fee Issue. The act directs the Revenue Laws Study Committee to study whether the State should reimburse a taxpayer for legal costs when the taxpayer substantially prevails in an administrative appeal or lawsuit with respect to the amount in controversy or with respect to the most significant issue or set of issues presented. Rule 11 of the North Carolina Rules of Civil Procedure is the general rule governing when a party to a legal action may recover reimbursement for legal costs, including attorney fees. Under this Rule, a party may be ordered to reimburse the other party its legal costs, including a reasonable attorney's fee, when the party's case is not well grounded in fact and law or is begun for an improper purpose, such as to harass the other party. This Rule is used in court actions, but does not apply to administrative appeals before the Tax Review Board. The Revenue Laws Study Committee is directed to report its recommendations to the 1999 General Assembly.

Continuing Care Retirement Homes Exempt. The act temporarily revises an existing property tax exemption for retirement facilities that was recently held unconstitutional by the North Carolina Supreme Court. The act exempts nonprofit continuing care retirement communities (CCRCs) whose governing body is not self-perpetuating but is selected by another publicly supported 501(c)(3) nonprofit. The act was agreed to by the Association of County Commissioners, the Association for Nonprofit Homes for the Aging, and other interest groups representing nonprofit entities of various types. It effectively restores the exemption for those CCRCs that were exempt under the law struck down by the court, but retains taxability of those CCRCs that have been taxed all along. It does not affect charitable homes for the aging, which are exempt under current law and were not affected by the court case.

The exemption will remain in effect for two years, the 1998-99 and 1999-2000 property tax years. During this period, the act directs the Legislative Research Commission to study the issue of property tax exemptions for nonprofit institutions in general and to report its findings and recommendations to the 2000 Regular Session of the 1999 General Assembly.

The distinction between CCRCs that have a governing body selected by a publicly supported 501(c)(3) and CCRCs that have a self-perpetuating governing body is rational under the constitution. A self-perpetuating nonprofit is less answerable to the public. The Internal Revenue Code recognizes the important distinction between publicly supported 501(c)(3)s and other 501(c)(3)s (private foundations). A publicly supported 501(c)(3) that selects the CCRC's governing body is more answerable to the public and less controlled by private interests.

Property owned by a nonprofit home for the aged, sick, or infirm is exempt from property tax if used for a charitable purpose. A charitable purpose is defined as

"one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward." The property tax exemption set out in the act is necessary because some continuing care retirement centers may not be charitable and therefore would not qualify for this exemption. In the 1980s, two cases held that certain continuing care retirement centers were not charitable for purposes of property tax exemption. In concluding that the institutions were not charitable in these cases, the court noted the following facts about one or both institutions:

1. The institution refused to admit applicants with health problems rendering them physically unable to care for themselves.

2. Substantial entrance fees and monthly fees were required from all residents, and applicants had to demonstrate that they were financially capable of supporting themselves for the period of their life expectancy.

3. The operation of the institution was funded entirely or mainly from fees paid by residents, not by donations or endowments.

4. The costs were so high that only a small percentage of the elderly could afford the home.

5. The home retained the right to terminate a resident for nonpayment of fees unless nonpayment was beyond the resident's control.

In each case, the court concluded that merely supplying care and attention to elderly pensions cannot, alone, constitute charity. The court found that these retirement communities were not providing for the special needs of individuals who are in need of charity, the aid of whom benefits society as a whole in addition to the residents. The court in one case also noted that allowing such a retirement home to qualify because its residents were elderly would give those residents preferential treatment over the elderly who live in their own homes and must pay property taxes.

Under the act, an institution that fails to qualify as charitable will receive a property tax exemption for its property if it meets all of the following conditions:

1. The institution owns the property and uses it for a retirement community that includes a skilled nursing facility or an adult care facility and also includes independent living units. (In other words, as under prior law, the exemption applies to continuing care retirement communities, but not stand-alone nursing homes or rest homes.)

2. The institution must be nonprofit and exempt from income tax, and its assets upon dissolution must revert to a 501(c)(3) charitable organization.

3. The institution must have an active fund-raising program to assist it in providing services to those who do not have the financial resources to pay the fees.

4. The governing body of the institution must be selected by a charitable nonprofit that is exempt under section 501(c)(3) of the Internal Revenue Code and is a publicly supported charity. (A publicly supported charity is a charity that is not a private foundation under section 509 of the Code).

From its enactment in 1987 until it was struck down by the North Carolina Supreme court as unconstitutional in 1998, G.S. 105-275(32) provided a property tax exemption for continuing care retirement centers that were owned and operated by religious or Masonic organizations. The court found that the exemption was an establishment of religion in violation of the First Amendment of the United States Constitution. The effect of the court case is that the property of continuing care retirement centers previously exempt under the statute would have been taxable beginning with the 1998-99 property tax year, unless they qualified for exemption as charitable homes under G.S. 105-278.6. There would be no taxation for earlier years, however. As earlier noted, this act temporarily revises this property tax exemption effective for taxes imposed for taxable years beginning on or after July 1, 1998.