1999 Tax Law Changes

ELIMINATE STAMPS FOR DEED TAX

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-28	**HB 56**	**Representative Hill**

AN ACT TO ELIMINATE THE USE OF STAMPS TO INDICATE WHETHER THE EXCISE TAX ON CONVEYANCES HAS BEEN PAID AND TO MAKE THE PENALTIES THAT APPLY TO THIS TAX THE SAME AS FOR OTHER TAXES.

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Overview: This act eliminates the requirement that tax stamps be used to indicate whether the excise tax on conveyances has been paid. It also makes the penalties for failure to pay the tax the same as for other taxes.

Fiscal Impact: The act will not affect local or State revenues significantly.

Effective Date: July 1, 2000.

Background & Analysis: The excise tax on conveyances, known as the deed stamp tax, is a State tax on instruments transferring an interest in real property. The register of deeds of the county in which the property is located collects the tax when the deed transferring the property is recorded. The person presenting the instrument for recording is responsible for indicating on the instrument the amount of tax due. The register of deeds must collect the tax due and mark on the instrument to indicate payment of the tax and the amount paid. The tax rate is $1.00 for each $500.00 (0.2%) of the value of the property conveyed. The county retains one-half of the net proceeds of the tax and remits the remaining one-half to the State. 75% of the funds remitted to the State is dedicated to the Parks and Recreation Trust Fund created in G.S. 113-44.15 and 25% is dedicated to the Natural Heritage Trust Fund created in G.S. 113-77.7. None of the State's share of the deed stamp tax goes to the General Fund.

Under prior law, the Register of Deeds had to use tax stamps to indicate the tax had been paid. This act removes the requirement that tax stamps be used to indicate the tax has been paid. Tax stamps are no longer the best method for tracking payment of the conveyance tax now that metering machines and similar equipment are available. About 85 of the 100 counties have switched from stamps to more modern methods of tracking the tax. The act does not prohibit a county from using stamps to indicate that the tax has been paid.

However, effective July 1, 2000, the Department of Revenue will no longer be responsible for ordering and maintaining an inventory of various denominations of stamps to sell to the counties that choose to use them.

The act continues the work the legislature began last session when it amended several sections of the Revenue Act to make tax penalties uniform by providing that the civil and criminal penalties applicable to all other State taxes apply to the conveyance tax. Under prior law, willful evasion of the tax was a Class 3 misdemeanor punishable by a fine of between $100 and $1,000. The general penalty contained in Article 9 of Chapter 105 for failure to pay the tax due is 10% of the amount of tax due. The penalty for willfully failing to pay the correct amount of tax due is a Class 1 misdemeanor. Attempting to evade a tax due is punishable as a Class H felony.

The Revenue Laws Study Committee, upon the recommendation of the Department of Revenue recommended this legislation.

CONTINUING CARE RETIREMENT HOMES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-191	**SB 325**	**Senator Hoyle**

AN ACT TO MAKE CORRECTIONS AND CONFORMING CHANGES RELATING TO TAXATION OF CONTINUING CARE RETIREMENT HOMES.

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Overview: The act makes corrections and conforming changes to the 1998 legislation that temporarily revised a property tax exemption for continuing care retirement centers (CCRCs), which had been held unconstitutional in 1998. The act makes the following changes retroactive to the 1998 tax year:

- Removes an unconstitutional grandfather clause from the exemption.
- Clarifies that the entity that selects the governing board of the nonprofit CCRC may be a corporation or an unincorporated association.
- Provides that the entity that selects the governing board of the nonprofit CCRC may be a charitable organization, a fraternal beneficiary association, or a domestic fraternal association.

- Discourages counties and cites from collecting prior years' taxes on exempt CCRCs on or after January 1, 1998.

Fiscal Impact: Insignificant impact.

Effective Date: Changes are retroactive to the 1998 tax year.

Background & Analysis: In 1998, the General Assembly exempted from property tax those CCRCs whose governing body is not self-perpetuating but is selected by another publicly supported charitable nonprofit. That act effectively restored the exemption for those CCRCs that were exempt under the law struck down by the North Carolina Supreme Court, but retained taxability of those CCRCs that had been taxed all along. It did not affect charitable homes for the aging, which were already exempt and were not affected by the court case.

While the 1998 legislation was in committee, an amendment was added limiting the exemption to those CCRCs who met the definition as of a certain date. Such a grandfather clause in a property tax provision is not a valid classification under the North Carolina Constitution. After the law was enacted, the Institute of Government noted the unconstitutional grandfather clause, and some counties determined that they would not recognize the exemption because it had this unconstitutional provision. This act removes the unconstitutional grandfather clause that limited the property tax exemption to CCRCs whose charter or bylaws met the definition on August 15, 1998.

The act also expands the definition of the appointing entity to include associations and fraternal entities. To qualify for the property tax exemption under the 1998 law, the governing board of the CCRC had to be appointed by a publicly supported charitable 501(c)(3). After the 1998 legislation was enacted, some CCRCs determined that their boards were appointed by nonprofit associations, rather than corporations, and that some of these nonprofits were fraternal (501(c)(8) and (10)) rather than charitable.

The act removes the financial incentive for assessing retroactive taxes on exempt CCRCs. It does so by reducing the annual State reimbursement to a county or municipality for the repeal of the intangibles tax by 110% of the amount of taxes collected in that year on exempt CCRCs for a year prior to the 1998 tax year. This part of the act is repealed effective September 1, 2003, because the five-year discovery period will have expired then.

Lastly, the act authorizes the Legislative Research Commission to study the issue of property tax exemptions for nonprofits and directs the Legislative Research Commission to report its findings and recommendations to the 2000 Session of the 1999 General Assembly. On August 25, 1999, the Legislative Research Commission referred this issue to the Revenue Laws Study Committee.

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REAL PROPERTY TAX PENALTY

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-297	**SB 817**	**Senator Ballance**

AN ACT TO PROVIDE AN EXCEPTION TO THE LATE LISTING PENALTY FOR CERTAIN REAL PROPERTY IN COUNTIES THAT HAVE NOT ADOPTED PERMANENT LISTING AND TO PHASE IN PERMANENT LISTING IN ALL COUNTIES.

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Overview: This act requires the board of county commissioners of each county to install a permanent listing system. (*Note:* The act only applies to the following six counties: Clay, Graham, Swain, Vance, Warren, and Yancey.) It also provides that the 10% late listing penalty will not apply to property that has not been improved or transferred since it was last listed.

Fiscal Impact: Insignificant impact.

Effective Date: Each of the six counties affected must have a permanent listing system for taxable years beginning on or after July 1, 2004. The prohibition on imposing the 10% late listing penalty is effective for taxes imposed for taxable years beginning on or after July 1, 1999 and sunsets July 1, 2004.

Background & Analysis: There are only six counties that have not adopted a permanent listing system for property tax purposes: Clay, Graham, Swain, Vance, Warren, and Yancey. Under a permanent listing system, the assessor rather than the owner is responsible for listing all real property for property tax purposes. The owner of the property does not need to respond to the listing form unless the property has been improved or transferred since the last listing. The 10% late listing penalty does not apply to property listed under a permanent listing system. However, the penalty does apply if the taxpayer fails to furnish the assessor with information concerning improvements to the property not reflected on the listing form.

To encourage counties to install a permanent listing system as soon as possible, the act provides that, effective for taxes imposed for taxable years beginning on or after July 1, 1999, the 10% late listing penalty will not apply to property that has not been improved or transferred since it was last listed. The prohibition on imposing the late listing penalty sunsets July 1, 2004. The late listing penalty applies to property that should have been listed for tax purposes but is not. When the property is "discovered", the property is taxed for the year it was discovered and the preceding five years it escaped taxation. Each year's taxes are computed separately. A late listing penalty equal to 10% of the amount of the tax for the earliest year the property was not listed is added to the amount of tax due. The penalty is computed separately for each year the failure to list occurred.

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TECHNOLOGY COMMERCIALIZATION CREDIT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-305	**SB 1110**	**Senator Rand**

AN ACT TO PROVIDE AN INCENTIVE FOR BUSINESSES TO FIND COMMERCIAL USES FOR TECHNOLOGY DEVELOPED BY RESEARCH UNIVERSITIES.

Overview: This act adds a new investment tax credit, the technology commercialization credit, to the William S. Lee Quality Jobs and Business Expansion Act, effective for taxable years beginning on or after January 1, 2000.

Fiscal Impact: Beginning with the 2000-2001 fiscal year, the maximum General Fund revenue loss is expected to be $2.1 million per year.

Effective Date: Effective for taxable years beginning on or after January 1, 2000.

Background & Analysis: The new investment tax credit is an alternative to the existing 7% tax credit for investing in machinery and equipment. The technology commercialization credit applies only to investments in machinery and equipment used in production based on technology licensed from a research university. In addition, to qualify, the machinery and equipment must be located in a tier one, two, or three enterprise area. Finally, the taxpayer's investment must equal at least $10 million during the taxable year, and must total at least $100 million over a five-year period. If the investment totals between $100 million and $150 million over five years, the technology commercialization credit is equal to 15% of the amount invested. If the investment equals or exceeds $150 million over five years, the technology commercialization credit is equal to 20% of the amount invested. The technology commercialization credit remains available for 10 years of investments at a single location. The taxpayer's eligibility for the technology commercialization credit is based on the Secretary of Commerce's certification that the taxpayer will invest either $100 or $150 million over five years. If the taxpayer does not achieve the certified level of investment, the credit is forfeited. As for the existing investment tax credit, forfeiture of the credit triggers forfeiture of any worker training credit taken for training workers to operate the new machinery and equipment.

The technology commercialization credit is more generous than the existing investment tax credit under the William S. Lee Act in the following ways:

- The existing investment tax credit is 7% of the amount invested. The technology commercialization credit is 15% or 20% of the amount invested, depending upon the size of the investment.

- The existing investment tax credit must be taken in seven annual installments beginning the year after the year the investment is placed in service. The technology commercialization credit may be taken in the year the investment is placed in service.
- The existing investment tax credit applies only to the extent the new investment is not offset by the amount of machinery and equipment the taxpayer either sold or took out of service in the three-year period before the new investment was placed in service. This restriction limits the existing credit to net increases in North Carolina investment, and disallows it for investments, that, in effect, is a replacement or relocation of pre-existing machinery and equipment. The technology commercialization credit is not required to be offset by machinery and equipment sold to another taxpayer if the new owner keeps the machinery and equipment in service in North Carolina. In addition, this new investment tax credit is not required to be offset by machinery and equipment the taxpayer takes out of service if it was in service at a separate location and was used in a business that is not competitive with the technology commercialization business.
- The existing investment tax credit, like all other William S. Lee Act credits, may be taken against the taxpayer's income tax or franchise tax, but not both. The technology commercialization credit may be taken against both income tax and franchise tax. The taxpayer must determine what percentage of the credit will be taken against each tax, and must maintain the same percentage for the purpose of carryforwards. If new investment is made in a second or subsequent tax year, the taxpayer may elect a different percentage with respect to the credit for each tax year. The election is binding.
- The existing investment tax credit, like all other William S. Lee Act credits, may be carried forward for five years unless the investment amount exceeds $150 million over a two-year period, in which case it may be carried forward for 20 years. The technology commercialization credit may be carried forward for 20 years.

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ZERO ESC TAX/TRAINING CONTRIBUTION

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-321	**HB 275**	**Representative Redwine**

AN ACT TO IMPLEMENT A ZERO UNEMPLOYMENT INSURANCE TAX RATE FOR MORE EMPLOYERS WITH POSITIVE

EXPERIENCE RATINGS, AND TO TEMPORARILY REDUCE THE UNEMPLOYMENT INSURANCE TAX BY TWENTY PERCENT FOR MOST EMPLOYERS AND SUBSTITUTE AN EQUIVALENT CONTRIBUTION TO FUND ENHANCED EMPLOYMENT SERVICES AND WORKER TRAINING PROGRAMS.

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Overview: This act makes two changes to unemployment insurance taxes:

- It changes the minimum credit ratio of employers who are granted a zero tax rate from 5% to 4%, effective April 1, 1999.
- It temporarily reduces unemployment insurance taxes for most employers by 20% and levies a corresponding contribution to be used for enhanced reemployment services and worker training programs, effective January 1, 2000. The rate of contribution is the lesser of 20% or a percentage that yields an amount that, when combined with the employer's unemployment insurance taxes, is no greater than the amount of tax the employer would have paid under existing law. These changes will sunset in two years.

Fiscal Impact: *See Background & Analysis section.*

Effective Date:	Minimum credit ratio change	April 1, 1999
	Reduce UI Tax/Remployment fund contribution	January 1, 2000

Background & Analysis:

Minimum Credit Ratio Change. In 1995, the General Assembly set a zero unemployment insurance tax rate for employers with credit ratios of 5% or greater. This act allows more employers to have a zero unemployment tax rate by lowering the threshold from 5% to 4%. The credit ratio is the ratio of an employer's credit balance in the Unemployment Insurance (UI) Fund relative to the employer's payroll. The UI Fund is maintained by the U.S. Treasury and funded by the State unemployment insurance tax. This part of the act is effective with respect to calendar quarters beginning on or after April 1, 1999. The Employment Security Commission (ESC) recommended this change due to the solvency of North Carolina's UI Fund and the increasing stability of labor markets. As of April 30, 1999, the balance in the Unemployment Insurance Trust Fund stood at $1.22 billion. In addition, a reserve fund contains an additional $200 million, due to the Fund's solvency and North Carolina's low unemployment rate. ESC estimates this change will affect over 10,000 employers, with a tax savings to employers of over $1,000,000 in the first year. With an additional 6,400 employers reaching the 4% credit ratio each year, ESC estimates that 38,000 employers will benefit from this zero tax rate by 2004.

<u>Reduce UI Tax/Reemployment Fund Contribution.</u> The act also reduces the unemployment insurance taxes employers pay to the Employment Security Commission. The reduction is 20% for most employers, slightly less for new employers, and less for roughly 3,400 employers with a high debit ratio. Those employers who pay at a zero tax rate are not affected by this change. The act levies a new tax equal to a percentage of each employer's unemployment insurance tax. The tax is called a "training and reemployment contribution." The percentage rate of the contribution is the lesser of 20% or a percentage that yields an amount that, when combined with the employer's reduced UI tax, is no greater than the amount of UI tax the employer would have paid under the prior law. Thus, when the UI tax reduction and the new contribution are netted, all employers will pay the same or slightly less. These changes become effective January 1, 2000, and sunset January 1, 2002.

It is estimated that the new contribution will generate $22.9 million in FY 1999-2000 and $60.8 million in FY 2000-2001. The new contribution will be credited to a non-reverting account subject to appropriation by the General Assembly. The account is called the "Employment Security Commission Training and Employment Account." The act states the intent of the General Assembly that 4/5 of the proceeds will be appropriated annually from the account to the Department of Community Colleges for nonrecurring expenditures for various worker training programs. The act amends *The Current Operations and Capital Improvements Appropriations Act of 1999* to appropriate from the Employment Security Commission Training and Employment Account to the Community Colleges System Office the sum of $18 million for the 1999-2000 fiscal year and the sum of $48.5 million for the 2000-2001 fiscal year. The act states the intent of the General Assembly that the remaining 1/5 of the proceeds will be appropriated annually from the account to the Employment Security Commission for the costs of collecting and administering the new contribution, and for nonrecurring expenditures for enhanced reemployment services. The act amends the budget bill to appropriate from the Account to the Employment Security Commission the sum of $4.5 million for the 1999-2000 fiscal year and the sum of $12.1 million for the 2000-2001 fiscal year.

Unemployment insurance taxes are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the Trust Fund.

The General Assembly reduced unemployment insurance tax rates in recent years because the balance in the federal trust fund was higher than needed to pay benefits. The tax rates will automatically double when the trust fund balance falls below $800 million. By reducing the unemployment insurance tax rates by 20% for two years, the changes made by this act could cause the balance in the trust fund to fall faster, triggering an automatic tax increase earlier than might otherwise occur. On the other hand, it is hoped that the enhanced reemployment services funded by the new contribution would shorten the average period before a worker is reemployed, thereby reducing benefit payments for the trust fund. The new contribution would sunset automatically if a drop in the trust fund balance triggered an unemployment insurance tax increase.

History of UI Fund Reductions. Since 1992, the General Assembly has enacted the following legislation to reduce the amount of money in the Unemployment Insurance Fund:

- **1992** - suspended the 20% surcharge on unemployment taxes.
- **1993** - cut unemployment taxes for positive rated employers by an average of 30% for any calendar year in which the balance in the Fund equals or exceeds $800,000,000.
- **1994** - cut the unemployment taxes for positive rated employers by an average of 38.7% and cut the unemployment taxes for new employers by 20%.
- **1995** - cut the unemployment taxes for positive rated employers by an average of 23%, set a zero rate for employers with credit ratios of 5.0 or over, and reduced from 60% to 50% the percentage of annual average wages used to calculate the taxable wage base.
- **1996** - reduced unemployment taxes in three ways by (1) assigning a one-year zero unemployment insurance tax rate for all positive rated employers, (2) giving overdrawn employers additional time to make contributions to their accounts so that they may qualify for the zero tax rate in 1996, and (3) permanently reducing the tax rate for new employers from 1.8% to 1.2%.

INTANGIBLES TAX SETTLEMENT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-327	**SB 1043**	**Senator Rand**

AN ACT TO PROVIDE FUNDS TO MEET THE REQUIREMENTS OF A CONSENT JUDGMENT UNDER THE INTANGIBLES TAX CASES.

Overview: This act approves a settlement agreement executed by the Speaker of the House of Representatives and the President Pro Tempore of the Senate on July 8, 1999, in settlement of Smith, et al. v. State, 95 CVS 06715 and Shaver, et al. v. State, 98 CVS 00625. These cases were initiated by taxpayers who paid intangibles tax on stocks for tax years 1990, 1991, 1992, 1993, and 1994, without protesting the payment in a timely manner. The act also appropriates the funds necessary for the refunds.

Fiscal Impact:

- Appropriates $200 million on October 1, 1999, from the Savings Reserve Account for fiscal year 1999-2000 to a settlement fund to pay tax refunds claimed by the above taxpayers.
- Directs the General Assembly to allocate the remaining $240 million to the settlement fund by July 10, 2000.

Effective Date: July 20, 1999.

Background & Analysis: On July 8, 1999, a settlement agreement was signed by the President Pro Tempore of the Senate, the Speaker of the House of Representatives, and the Class Counsel for the plaintiffs in two pending lawsuits dealing with the question of when refunds should be paid to taxpayers who paid intangibles tax on stocks for the 1990-94 tax years and who did not timely protest payment of this tax. The agreement was in response to two Superior Court of Wake County decisions regarding nonprotester refunds. On May 25, 1999, the superior court held the State liable for $360 million of refunds and interest for the 1991-94 tax years in Smith, et al. v. State of North Carolina, 95 CVS 06715. In a more recent decision, the superior court held that the State was liable for $110 million in refunds and interest for the 1990 tax year in Shaver, et al. v. State, 98 CVS 00625.

On the same day as the July 8, 1999, settlement agreement, the Superior Court of Wake County entered a consent order tentatively approving the settlement agreement. The consent order provides for the following:

- The General Assembly will appropriate $440 million to a settlement fund over the next two years:

    1. The General Assembly must allocate $200 million to the fund before October 1, 1999. This money will be drawn from the Savings Reserve Account.
    2. The General Assembly must allocate the remaining $240 million to the fund by July 10, 2000.

- Within the Settlement Fund, 85% of the funds will be allocated to the "Smith/Shaver Claims Fund Account" and 15% will be allocated to the "Smith/Shaver Administration Account". Interest and earning on all proceeds will be added as principal to the taxpayers' Claims Fund Account.
- The class counsel under the supervision of the court will administer the Settlement Fund.
- No disbursement will be made from the Claims Fund Account until after August 1, 2000.
- Class members will be provided full notice of the terms of the settlement agreement and their rights.
- The State is immune from any further liability for claims brought by taxpayers regarding the payment of intangibles tax on shares of stock under the repealed G.S. 105-203. This statute imposed an intangibles tax on shares of stock and provided a

taxable percentage deduction reducing a taxpayer's liability for this tax in proportion to the issuing company's income taxed in North Carolina. In 1997, the North Carolina Supreme Court held the statute unconstitutional because it violated the commerce clause by discriminating against out-of-state companies.

- The Class Counsel will be developing a timetable for implementing the refund procedures and payment to individual taxpayers.

Pursuant to the terms of the above consent order, the act provides for the following appropriations:

- $200 million is appropriated from the Savings Reserve Account for the 1999-2000 fiscal year to the Department of the State Treasurer on October 1, 1999. This sum is to go to a reserve for the Smith/Shaver cases and is to be held in reserve for allocation pursuant to the above consent order. The act states the intent of the General Assembly to restore to the Savings Reserve Account the sum of $200 million during the 2000-2001 fiscal year.
- An additional $240 million is allocated no later than July 10, 2000, in accordance with the above consent order.

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PHASE II FUNDS/IMMUNITY/TAX EXEMPT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-333	**HB 74**	**Representative Baker**

AN ACT TO AUTHORIZE THE APPOINTMENT BY THE SPEAKER OF THE HOUSE OF REPRESENTATIVES AND THE PRESIDENT PRO TEMPORE OF THE SENATE OF MEMBERS OF THE BOARD OF DIRECTORS OF THE CERTIFICATION ENTITY FOR THE PHASE II SETTLEMENT FUNDS, TO PROVIDE THE MEMBERS OF THE BOARD OF DIRECTORS LIMITED IMMUNITY FROM CIVIL LIABILITY, TO PROVIDE AN EXEMPTION FROM STATE INCOME TAX FOR INTEREST, INVESTMENT EARNINGS, AND GAINS OF CERTAIN TRUST FUNDS, TO PROVIDE A CORPORATE INCOME TAX CREDIT FOR MANUFACTURERS PRODUCING CIGARETTES FOR EXPORTATION TO A FOREIGN COUNTRY, AND TO PROHIBIT THE SALE OF CERTAIN PACKAGES OF CIGARETTES.

Overview: The act does the following:

- Board of Directors. It provides for the appointment of the board of directors of a nonprofit corporation that will be the certifying entity to distribute money to tobacco growers and allotment holders in North Carolina. Pursuant to an agreement among four tobacco manufacturers, the manufacturers will pay the sum of $5.15 billion into the National Tobacco Grower Settlement Trust over a twelve-year period. This trust will provide payments to tobacco growers and allotment holders in fourteen grower states, including North Carolina. This money, referred to as Phase II settlement funds, will be used to ameliorate potential adverse economic consequences of likely changes in the tobacco market on grower states. This provision became effective July 22, 1999.
- Board of Directors' Immunity. It provides immunity to the board of directors for certain acts or omissions arising out of the performance of the member's duties as a member of the nonprofit corporation. This provision became effective July 22, 1999.
- Income Tax Exemption. It provides an income tax exemption for the interest, investment earnings, and gains of a trust that is established to compensate those who suffer economic loss as a result of a settlement agreement between the State and one or more manufacturers to settle claims of the State against the manufacturers for damages arising from a product of the manufacturers. This change is effective for taxable years beginning on or after January 1, 1999.
- Corporate Income Tax Credit. It creates a corporate income tax credit for manufacturers who produce cigarettes for exportation to a foreign country. The amount of the credit varies depending upon the amount of cigarettes exported in the tax year compared to the amount exported in 1998. This credit is effective for taxable years beginning on or after January 1, 1999, and sunsets for cigarettes exported on or after January 1, 2005.
- Unlawful to Sell Certain Cigarettes. It makes it unlawful to sell cigarettes in North Carolina if the cigarettes were originally manufactured for export to a foreign country. The Secretary of Revenue is authorized to cancel the license or certificate of registration of a person who violates this law. This change is effective December 1, 1999, and applies to offenses committed on or after that date.

Fiscal Impact: The above tobacco export credit and tax exemption for the earnings of the settlement trust fund are expected to reduce General Fund revenues by $8.7 million in fiscal year 1999-2000, $9 million in fiscal year 2000-2001, $9.3 million in fiscal year 2001-2002, $9.6 million in fiscal year 2002-2003, and $9.9 million in fiscal year 2003-2004.

Effective Date: *See Overview section.*

Background & Analysis:

History of the Master Settlement Agreement. On November 23, 1998, forty-six states, including North Carolina, and four tobacco manufacturers signed a Master Settlement Agreement, that settled existing and potential claims of the states against the manufacturers for damages arising from the tobacco products of the manufacturers. The manufacturers agreed to make payments to the states totaling $206 billion through the year 2025. Pursuant to the terms of the Master Settlement Agreement, North Carolina and the four tobacco manufacturers entered into a consent decree, filed in Wake County Superior Court on December 21, 1998. State of North Carolina v. Phillip Morris, Incorporated, et al., 98 CVS 14377. This consent decree directed the Attorney General to create a nonprofit corporation for purposes of receipt and distribution of 50% of the funds allocated to North Carolina under the Master Settlement Agreement. The consent decree also required that the creation of the corporation had to be approved by the General Assembly. On March 16, 1999, the General Assembly in Senate Bill 6 (S.L. 1999-2) approved the creation of a nonprofit corporation to distribute 50% of Phase I of the settlement funds allocated to North Carolina. S.L. 1999-2 directs that these funds be used for the public charitable purposes of providing economic impact assistance to economically affected or tobacco-dependent regions of the State. S.L. 1999-2 further states the intent of the General Assembly to allocate the remaining 50% of the Phase I settlement funds as follows:

- 25% to a trust fund to be established by the General Assembly for the benefit of tobacco producers, tobacco allotment holders, and persons engaged in tobacco-related businesses.
- 25% to a trust fund to be established by the General Assembly for the benefit of health.

Under the terms of the Master Settlement Agreement, the four manufacturers also acknowledged the adverse effect that the terms of the Agreement would have on the tobacco grower community. The Agreement contains provisions, such as market restrictions, that are expected to result in a decline in demand for tobacco products. As part of the consideration for settling the claims, the Agreement obligated the manufacturers to address these economic concerns of the tobacco growers and tobacco quota holders.

To meet the obligation, the manufacturers agreed to establish a trust called the National Tobacco Grower Settlement Trust. They agreed to pay up to $5.15 billion over the next twelve years into the Trust, referred to as Phase II settlement funds. Proceeds of the Trust would be allocated directly to tobacco growers and tobacco allotment holders in fourteen grower states, including North Carolina, based on a plan developed by a nonprofit corporation in each state composed of government leaders and public members. The Superior Court of Wake County must approve the trust and the payments made under it.

The trust is designed to be a qualified settlement fund under the Internal Revenue Code. As such, it is taxable as a corporate taxpayer at the tax rate of a trust. The primary benefit of being a qualified settlement fund is that the manufacturers who contribute the principal to the fund may claim a tax deduction on the contributions when they are paid into the fund. If it is determined that the trust does not meet the requirements of a qualified settlement fund, the trust's taxation does not change because contributions to a trust are not included in its gross income. However, the manufacturers would not be able to claim a deduction for their contributions until the money was distributed to the growers and quota holders.

For federal and state tax purposes, the contributions to the trust are tax-exempt. To calculate North Carolina taxable income for both corporations and trusts, one begins with federal taxable income. Since the contributions are not included in income for federal tax purposes, they are not included in income for State tax purposes. However, the interest, investment earnings, and gains of both a qualified settlement fund and a trust are taxable for federal and State tax purposes. Some states exempt qualified settlement funds from state income tax. Locating the settlement fund in a state that does not tax it can maximize the amount of funds distributed to those who suffer economic loss because of the Master Settlement Agreement. Because of North Carolina's role in producing the economic loss, and the desire to have the settlement fund located in this State, the act exempts the interest, investment earnings, and gains of the settlement fund from State income tax.

Provisions of the act. The act carries out the management and distribution of the Phase II funds as follows:

- Board of Directors/Immunity. It authorizes the Speaker of the House of Representatives to appoint one State Representative and the Senate Pro Tempore to appoint one State Senator to the certification board. This is the board that will determine how the Phase II funds will be distributed to North Carolina tobacco farmers and allotment holders. The other members of the board are the Governor, the Commissioner of Agriculture, the Attorney General, two members of the North Carolina congressional delegation selected by the delegation, and four to seven citizens appointed by the Governor. The act provides for limited immunity from liability for the members of the board while performing their duties on behalf of the board. Immunity is not provided for intentional wrongdoing, willful or wanton misconduct, or motor vehicle accidents. Since the board will be a private board, not a State agency, its members will not be covered by the liability insurance coverage the State obtains for its officers and employees.
- Corporate Income Tax Deduction. It provides for a corporate income tax deduction from federal taxable income on the interest, investment earnings, and gains earned on funds in a qualified settlement fund that meets the following conditions:

    1. The settlors of the fund are two or more manufacturers that signed a settlement agreement with North Carolina to settle existing and potential claims of the State against the manufacturers for damages attributable to a product of the manufacturers.
    2. The purpose of the fund is to address potential adverse economic consequences resulting from a decline in demand of the manufactured product expected to occur because of market restrictions and other provisions in the settlement agreement.
    3. A court of North Carolina approves and retains jurisdiction over the fund.
    4. Certain portions of the distributions from the fund are made in accordance with certifications that meet the criteria in the settlement agreement and are provided by a nonprofit entity, the governing board of which includes State officials

- Income Tax Deductions for Trusts. It provides for an income tax deduction for trusts similar to the above deduction. The provision for a tax deduction is set out in both the corporate and trust income tax statutes in case it is determined that the trust does not meet the requirements of a qualified settlement fund.

- Corporate Income Tax Credit/Cigarette Exportation. It allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries. The credit is a dollar amount per cigarette exported for those manufacturers who export at least 50% as many cigarettes in the taxable year as they did in calendar year 1998. The dollar amount ranges from forty cents to twenty cents per 1,000 cigarettes exported. The credit is capped at the lesser of $6 million per year or 50% of the manufacturer's corporate tax liability for any given year. Prior to enactment of the act by the General Assembly in the 1999 Session, the issue was raised as to whether or not this tax credit violates GATT, one of the international trade agreements. The General Assembly staff was of the opinion that the tax credit violates GATT, while counsel for one of the four tobacco manufacturers disagreed. It is clear, however, that any challenge to the credit must come from a foreign government. If a foreign government challenges the credit, then the U.S. Justice Department may sue North Carolina. If the Department wins, then federal statute provides that relief is prospective only and persons who have already used the credit cannot be required to repay it. Private citizens have no cause of action on the issue.
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- Unlawful to Sell Certain Cigarettes. It prohibits the sale in North Carolina of a package of cigarettes that meets one or more of the following descriptions:

    1. The package differs from the labeling requirements of federal law.
    2. The package is labeled "For Export Only", "U.S. Tax Exempt", "For Use Outside U.S.", or with similar wording.
    3. The package was altered by adding or deleting the wording described in the above two descriptions.
    4. The package was imported into the United States after January 1, 2000, in violation of federal law.
    5. The package violates federal trademark or copyright laws.

    A violation of this law is a Class A1 misdemeanor and an unfair trade practice. A package of cigarettes that violates this law is considered contraband and may be seized by a law enforcement officer. The Secretary of Revenue is authorized to cancel the license or the certificate of registration, whichever is applicable, of a person who violates this law.

REVENUE LAWS TECHNICAL CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-337	**SB 55**	**Senator Cochrane**

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

Overview: This act makes numerous technical and clarifying changes to the revenue laws and related statutes as recommended by the Revenue Laws Study Committee.

Fiscal Impact: Insignificant impact.

Effective Date: July 22, 1999, unless otherwise provided *(see Background & Analysis section)*.

Background & Analysis: The following table provides a section-by-section analysis of the changes:

Section	*Explanation*
1	Corrects an incorrect effective date for the income tax treatment of enhanced wireless 911 fees.
2	Updates list of debtors' property that is retained free of creditors' claims, to add Roth IRAs to regular IRAs and to update terminology for regular IRAs.
3	Reinstates increase in notary commission fee from $25 to $30 that was enacted in the 1998 budget bill but was deleted inadvertently by another 1998 bill. This fee increase became effective October 1, 1999.
4 – 11	Changes references to the inheritance tax, which was replaced with an estate tax effective for the estates of decedents dying on or after January 1, 1999.
12	Corrects a grammatical error by deleting the word "or" in G.S. 93B-15.
13	Deletes language in G.S. 105-32.8 that a person "is subject to the penalties in G.S. 105-236" when that person fails to report a federal correction or determination of the maximum state death tax credit allowed an estate or of the maximum state generation-skipping transfer tax credit allowed. Failure to report to the Secretary of Revenue would still result in forfeiture of the right to any refund due by reason of the determination. Since repeal of the inheritance tax laws, there are no penalties in G.S. 105-236 that apply to this section.
14	Combines G.S. 105-37.1 (Amusements) and G.S. 105-38 (Amusements-Circuses and other traveling amusements) into one statute. These are the amusements subject to 3% gross receipts tax.
15	Moves the language that exempts certain motion pictures from the privilege tax imposed on motion pictures in G.S. 105-38.1 to the list of

	exemptions in G.S. 104-40 (Amusements exempt from tax).
16	Repeals G.S. 105-109.1 because it is no longer needed. This statute provides that interest will be assessed on the taxes on gross receipts levied on amusements in G.S. 105-37.1 and G.S. 105-38, the tax on installment paper dealers, and the tax on publishers of newsprint publications. This interest runs from the time these taxes were due until paid. This statute is no longer needed now that Article 9 (General Administration; Penalties and Remedies) applies to the privilege license statutes. This repeal also clarifies that interest applies to late payments of the 1% gross receipts tax on movies.
17	Repeals G.S. 105-113 because it is obsolete. This statute requires the sheriff of each county and clerk of the board of alderman of each city to make an annual report to the Secretary of Revenue containing the name and business of every person in the county or city required to obtain a State license under Article 2 of Chapter 105 of the General Statutes.
18	Clarifies that the possession of more than six hundred cigarettes on which tax has been paid to (was "bearing the tax stamp of") another state or country, by any person other than a licensed distributor, is prima facie evidence that the cigarettes are possessed in violation of this State's tobacco products tax. The underlined language clarifies how the Department currently administers this law. This change is needed because there are states that do not use stamps.
19	Updates the statutory cross-references in the Unauthorized Substance tax law.
20	Clarifies scope of franchise tax to include savings and loan associations, as enacted in 1998.
21	Clarifies that a corporation that owes franchise tax but not income tax must apportion its franchise tax using the apportionment formula that would apply to income tax if the corporation were subject to that tax. The law is silent on this issue, and this new language sets out the Department's position.
22	Removes a reference to G.S. 105-130.17 concerning the form of an affirmation because the subsection in that statute pertaining to the form of the affirmation was repealed in 1998. It provides that the affirmation must be in the form required by the Secretary. It also modernizes statutory language. The reference to G.S. 105-236 is unnecessary because the administrative provisions in G.S. 105-236 automatically apply to the corporate income tax statutes.
23	Restores the word "generator" which was inadvertently deleted in 1998.

	This statute was later repealed by S.L. 1999-342.
24	Changes "Division" to "Part" to conform to new terms enacted in 1998.
25	Changes the reference to the Code section in G.S. 105-152(e). This statute concerns joint tax liability and the innocent spouse. In the IRS Restructuring Act of 1998, the Code section 6013(e) was deleted and substituted in section 6015.
26	Removes reference to repealed statute.
27	Changes "Division" to "Part" to conform to new terms enacted in 1998.
28	Transfers the definitions of "moped" and "special mobile equipment" from Chapter 20 to the sales tax statute in Chapter 105, and then places a cross-reference to the sales tax statute in Chapter 20. These items are subject to sales tax. The Department of Revenue, rather than the DMV, administers the sales tax on special mobile equipment.
29	Adds the term "card-operated" to the sales tax exemption from receipts derived from coin or token-operated washing machines, extractors, and dryers. New technology permits the use of credit and debit cards on this equipment, and the Department has administratively allowed the sales tax exclusion for equipment operated with cards.
30	Clarifies that the certificate of registration filed with the Department by a retailer who makes taxable sales is void if for a period of 18 months the retailer files no returns or files returns showing no sales. Some retailers make only wholesale sales or exempt sales. Those retailers do not need to file sales tax returns and their certificate should not be void because they fail to file a return for a period of 18 months. There was a similar provision in the law prior to its rewrite last session.
31	Deletes the word "burlap" from the reference to the sales tax exemption for the lease or rental of burlap tobacco sheets used in handling tobacco in the warehouse and transporting tobacco to and from the warehouse. This change is necessary because tobacco sheets are now made of other material.
32	Clarifies the filing requirement for the excise tax on piped natural gas. Payment is required monthly and a return is required quarterly. The Department is currently administering the filing requirement this way.
33	Changes references to the inheritance tax, which was replaced with an estate tax effective for the estates of decedents dying on or after January 1, 1999.

34	Adds reference to limited liability companies to conform to remainder of statute.
35	Revises and recodifies a statute that included redundant references to the taxability of property transferred to a tax-exempt nonprofit corporation.
36	Changes statutory references to conform with the movement of the definitions from Chapter 20 to Chapter 105 made in section 28 of this act.
37-42	Deletes references to the "annual filing" of motor carrier reports. The Department of Revenue does not allow annual filing because of the International Fuel Tax Agreement requirements. The reports must be filed quarterly. They also change the reference to motor fuel from "gasoline and other motor fuel" to "motor fuel and alternative fuel". These references were not changed when tax at the rack was enacted in 1995 and need to be updated. Section 41 also conforms the registration of motor carriers with the current administrative practice.
43-44	Conforms motor fuel penalty-hearing statute to other hearing procedure statutes. Also clarifies that a request for a hearing must explain why the person is not liable for the penalty.
45	Corrects an incorrect statute reference.
46	Savings clause
47	Effective date

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OMNIBUS ESC CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-340	**HB 276**	**Representative Redwine**

AN ACT MAKING VARIOUS CHANGES TO THE EMPLOYMENT SECURITY LAWS OF NORTH CAROLINA.

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Overview: This act contains a number of changes recommended by the Employment Security Commission. It includes the following tax law changes, which became effective July 22, 1999, as well as technical and conforming changes:

- Section 1 authorizes electronic funds transfer and credit card payments for unemployment insurance taxes.
- Section 2 extends the requirement for automated filing of employee information in the "Employer's Quarterly Tax and Wage Report" to employers with 100 or more employees.
- Section 8 authorizes the Department of Revenue to share with the Employment Security Commission additional taxpayer information for use in the NC WORKS study and Section 10 prohibits the Commission from disclosing this information.

Fiscal Impact: Insignificant impact.

Effective Date: July 22, 1999.

Background & Analysis:

EFT/Credit Card Payments. Before enactment of this act, the employment security law contained no provisions allowing payment of unemployment insurance contributions by electronic funds transfer (EFT) or by credit card. Section 1 of this act authorizes employers to utilize EFT for paying unemployment insurance contributions. The act defines "EFT" as a transfer of funds using an electronic terminal, a telephone, a computer, or magnetic tape to instruct or authorize a financial institution to credit or debit an account. This definition is identical to the definition of EFT that applies in the Revenue Act, as provided in G.S. 105-228.90. Section 1 also authorizes the Employment Security Commission to establish policies to permit employers to pay unemployment insurance contributions by credit card. The policies must require the employer to pay any fee charged to the ESC for use of the card.

Automated Filing of Employee Information. Under prior law, an employer with 250 or more employees, and an agent who reports wages for an employer with 250 or more employees, must file the employee information portion of the quarterly tax and wage report on magnetic tapes or diskettes, as prescribed by the Employment Security Commission. Section 2 of this act extends the electronic filing requirement to employers with 100 or more employees, and to their reporting agents.

Information for Use in NC WORKS Study. G.S. 108A-29(r) requires each county's Job Service Employer Committee or Workforce Development Board to study the working poor in that county and report annually to various oversight committees of the General Assembly. This report is called the NC WORKS report. The tax secrecy law authorizes the Department of Revenue to disclose individual income taxpayer information to the Employment Security Commission in order to assist the county committees and boards with the report. The Employment Security Commission may use the information only in a nonidentifying form for statistical and analytical purposes. The prior law authorized the Department of Revenue to share the following information: name, social security number, spouse's name, county of residence, filing status, federal personal exemptions, federal taxable income and North

Carolina additions to it, North Carolina income, and total income. Section 8 of this act expands the type of information that may be shared to include spouse's social security number, exemption for children, nonresidents' and part-year residents' exemption for children, credit for children, and detailed information related to the credit for child care and employment-related expenses. Section 10 of this act clarifies that this information is subject to the same confidentiality law as other tax information obtained by the Employment Security Commission.

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USE TAX PAYMENT/OTHER CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-341	**HB 1433**	**Representative Miller**

AN ACT TO PROVIDE FOR INDIVIDUALS TO PAY THEIR ANNUAL USE TAX WITH THEIR INCOME TAX FORMS, TO PROMOTE ELECTRONIC FILING, AND TO IMPROVE TAX COLLECTION.

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Overview: This act simplifies use tax collection and seeks to improve tax collection in several ways:

- It provides that an individual who owes use tax to the State on non-business purchases can pay the tax with the individual's income tax return.
- It promotes the electronic filing of semimonthly sales tax reports.
- It directs the Secretary of Revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities.
- It directs the Department of Revenue and the State Controller to study the feasibility of a central collection operation.
- It prohibits State agencies from contracting with a vendor who is required under G.S. 105-164.8(b) to collect State sales and use tax but refuses to do so.

Fiscal Impact: The act is expected to increase General Fund revenues by $1.67 million in fiscal year 1999-2000, $1.75 million in fiscal year 2000-2001, $1.84 million in fiscal year 2001-2002, $1.93 million in fiscal year 2002-2003, and $2.03 million in fiscal year 2003-2004.

Effective Date: *See Background & Analysis section.*

Background & Analysis: North Carolina has a State and Local sales and use tax at the combined rate of 6%. (The combined rate is 6 ½ % in Mecklenburg County.) The sales tax is paid on purchases made in this State. The tax is collected by the retailer and remitted to the State. The use tax complements the sales tax by taxing transactions that are not subject to the sales tax because of movement in interstate commerce. Like the sales tax, the use tax is imposed on the purchaser. Unlike the sales tax, the responsibility for remitting the use tax to the Department of Revenue is also on the purchaser.

The 1997 General Assembly enacted S.L.1997-77, which established an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-state purchases. This change relieved consumers of the need to file either monthly or quarterly returns. *(For additional background information on use taxes, see below.)*

Use Tax Payable on Income Tax Returns. The act further simplifies use tax collection by providing that the use tax will be paid on the taxpayers' income tax returns. An individual who owes use tax on nonbusiness purchases and who must remit a State income tax return must pay the use tax owed with the income tax return. The income tax return will have space on it to indicate the amount of use tax owed. By placing the use tax on the individual income tax return, as opposed to a separate use return sent to the taxpayer with the income tax return, it is hoped that taxpayers' awareness of their responsibility to pay the tax will increase since taxpayers must affirm that the information on the income tax return is true and complete by signing the return. The Secretary of Revenue is required to provide information on the individual income tax form and instructions to explain a person's obligation to pay use tax on items purchased from mail order, Internet, or other sellers that do not collect State sales tax on items. The Secretary must also provide a method to help a person determine the amount of use tax owed. This method must list categories of items that are commonly sold by mail order or Internet and must include a table that gives the average amounts of use tax payable by taxpayers in various income ranges.

This portion of the act is effective for taxable years beginning on or after January 1, 1999.

Use of Use Tax Revenue. The act allows the Department of Revenue to use some of the additional use tax revenue collected under it to promote tax collections as follows:

- The Department may use $150,000 to pay for the costs of programming, form revision, and resources for taxpayer assistance in connection with the new use tax collection method.
- The Department may use $500,000 to implement a program to allow semimonthly sales and use taxpayers to file their returns electronically.
- The Department may use some of the revenue to contract for the collection of delinquent tax debts owed by nonresidents and foreign entities. A delinquent tax debt is the amount of tax due as stated in a final notice of assessment issued to the taxpayer when the taxpayer no longer has the right to contest the debt. The Department must report on its collections pursuant to this contract to the Revenue Laws Study Committee.
- The Department may use up to $50,000 to conduct a study, in cooperation with the State Controller, to identify and evaluate proposals for more efficient collection of

taxes. The Department must report is findings, recommendations, and estimated revenue gains to the Revenue Laws Study Committee by May 1, 2000.

State Contracts with Certain Vendors Prohibited. Effective July 1, 1999, the State is prohibited from contracting with a vendor for goods or services if the vendor is required by G.S. 105-164.8(b) to collect use tax for the State but refuses to do so. G.S. 105-164.8 requires a retailer that is engaged in business in this State to collect use tax on a mail order sale. Subsection (b) of this statute provides that a retailer that makes a mail order sale is engaged in business in this State if the retailer meets one or more of the following conditions:

- Is a corporation engaged in business under the laws of this State.
- Maintains offices in this State.
- Has representatives in this State who solicit business or transact business on behalf of the retailer.
- Is purposefully or systematically exploiting the market in this State by any media-assisted, media-facilitated, or media-solicited means, including direct mail advertising, distribution of catalogs, computer-assisted shopping, etc.
- Resides in a jurisdiction that has a compact or reciprocity with North Carolina to support North Carolina's taxing power.
- Consents to the imposition of the collection of the tax.

Disclosure of Information. Effective July 1, 1999, the act also amends the tax secrecy provisions to allow the Secretary of Revenue to make two disclosures.

1. The Secretary may provide the Secretary of Administration with a list of vendors who refuse to collect the State's use tax even though they are required to do so under G.S. 105-164.8.
2. The Secretary may provide the public with access to a database containing the names and account numbers of taxpayers who are not required to pay sales and use tax because of an exemption or because they are authorized to pay the tax directly to the Department.

Additional Background on Use Tax Collections: In the 1980s, states around the country became increasingly aware of the revenue loss associated with taxpayer avoidance of the use tax. The potential increase in State and local revenue for North Carolina, if full taxpayer compliance were achieved, would exceed $100 million.

The most cost-effective manner to collect the tax, from a state's point-of-view, is to require the out-of-state retailers to collect and remit the use tax. However, in 1967, the U.S. Supreme Court ruled in National Bellas Hess Inc. v. Department of Revenue that a state could not require an out-of-state retailer to collect its use tax unless the retailer has enough contacts with the state to subject it to the state's taxing jurisdiction. The Supreme Court reaffirmed this decision in 1992 in Quill Company v. North Dakota.

States have negotiated with direct marketers on at least two occasions to craft a voluntary collection agreement where marketers would collect the tax and states would simplify their reporting requirements. Both of these efforts were unsuccessful.

There are three efforts currently under way to address the issue of out-of state purchases:

- The National Tax Association Communications and Electronic Commerce Tax Project is focusing on a simplified multi-state approach to sales and use taxation of remote sellers which would require states to adopt common definitions of tax base components and impose a single tax rate statewide.
- The Advisory Commission on Electronic Commerce was established by the Internet Tax Freedom Act. This Act was part of the omnibus federal budget bill signed into law on October 21, 1998. The Advisory Commission has 18 months from this date to study electronic commerce issues and to make a report to Congress.
- The Multistate Tax Commission Tax Simplification Project is comprised of representatives of business and state and local governments who are focusing on ways to simplify the sales and use tax in the areas of uniformity and reporting. The act contains several recommendations made to the Project by the North Carolina representatives. These recommendations are (1) the promotion of electronic filing of semimonthly sales and use tax reports, (2) the authority of the Secretary of Revenue to provide the Secretary of Administration with a list of vendors who refuse to collect the State's use tax even though the vendors are required by law to collect the tax, and (3) the authority of the Secretary of Revenue to provide the public with access to a database containing the names and account numbers of taxpayers who are not required to pay sales and use tax.

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SIMPLIFY RENEWABLE ENERGY CREDITS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-342	**HB 1472**	**Representative Hackney**

AN ACT TO SIMPLIFY AND MODERNIZE TAX CREDITS FOR INVESTING IN RENEWABLE ENERGY SOURCES.

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Overview: This act repeals nine corporate and individual income tax credits relating to energy savings devices and replaces them with a tax credit for investing in renewable energy property.

Fiscal Impact: The effect of this act on General Fund revenues cannot be estimated.

Effective Date: The act becomes effective beginning with the 2000 taxable year.

Background & Analysis: The General Assembly enacted several individual and corporate income tax credits in the 1980s to encourage the following energy saving investments:

- Solar energy equipment.
- Conversion of industrial boilers to wood fuel.
- Peat facility.
- Olivine brick facility.
- Methane gas facility.
- Wind energy device.
- Hydroelectric generator.

Of these credits, there is no evidence that the ones for peat, wind energy, olivine bricks, and methane have ever been used. This act repeals nine income tax credits for these types of property and substitutes a general credit for investing in renewable energy property. The new credit applies to a broader category of property and is, generally, more generous than the prior law credits. The intent of the act is that the broader category of renewable energy property will reflect technological advances in renewable energy and that the more generous credit percentages, caps, and carryforwards will encourage more investment in renewable energy property.

The credit percentage for the prior law credits ranged from 10% to 40% of the taxpayer's investment; the new credit percentage is 35% of the investment. Most of the prior law credits were capped at between $1,000 and $25,000 per installation. The renewable energy credit is capped at between $1,400 and $10,500 for residential installations and at $250,000 per installation for nonresidential installations (although the credit must be taken in five annual installments unless it is for a single family dwelling installation). The prior law credits were allowed against income tax only; the renewable energy credit is allowed against either income or franchise tax, but may not exceed 50% of the taxpayer's tax liability for a taxable year. Only about half of the prior law credits allowed carryforwards; the renewable energy credit may be carried forward for five years.

The act defines renewable energy property as any of the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, and animal wastes.
- Hydroelectric generators.
- Solar energy equipment.
- Wind equipment.

The amount of the credit is 35% of the cost of the property placed in service. In the case of renewable energy property that serves a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The credit may not exceed the following amounts:

Type of Property	*Maximum Credit*
Nonresidential Property	$250,000 per installation
Residential Property – Solar energy equipment for domestic water heating	$1,400 per dwelling unit
Residential Property – Solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating	$3,500 per dwelling unit
Residential Property – All other renewable energy property for residential purposes	$10,500 per installation

The credit is patterned after the business tax credit and is codified in the same Article. Like the business tax credit, the renewable energy tax credit has the following limitations and conditions:

- The renewable energy tax credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward for the succeeding five years.
- A taxpayer that claims any other credit allowed with respect to renewable energy property may not take the renewable energy tax credit with respect to the same property.
- A taxpayer may not take the renewable energy tax credit if the taxpayer leases the property from another person, unless the taxpayer obtains the lessor's written certification that the lessor will not claim a credit with respect to this property.
- The Department of Revenue must report each year on the number of taxpayers claiming the credits, the cost of the property for which the credits were claimed, and the total cost to the General Fund of the credits claimed.
- The business tax credit is repealed effective January 1, 2002, while the remainder of the Article is repealed effective January 1, 2006. Consequently, the renewable energy tax credit is set to sunset on January 1, 2006.

<u>Prior Credits Repealed.</u> The following chart lists the prior law credits repealed by this act:

G.S.	*Short Title*	*%*	*Ceiling*	*Carry-forward*
105-130.23.	Credit against corporate income tax for solar energy equipment in residential	40%	$1,500 per unit	Five years

	buildings.			
105-151.2.	Credit for solar energy equipment.	40%	$1,500 per unit	Five years
105-130.26 & 105-151.5.	Credit for conversion of industrial boiler to wood fuel.	15%	None	Five years
105-130.27A.	Credit for construction of a peat facility.	20%	None	Five years
105-130.29.	Credit for construction of an olivine brick facility.	20%	None	Five years
105-130.30 & 105-151.10.	Credit for construction of a methane gas facility.	10%	$2,500 per installation	None
105-130.31 & 105-151.9.	Credit for installation of a wind energy device.	10%	$1,000 per installation	None
105-130.32 & 105-151.8.	Credit for installation of solar energy equipment for the production of heat or electricity in certain processes.	35%	$25,000 per installation	None
105-130.33 & 105-151.7.	Credit against corporate income tax for installation of a hydroelectric generator.	10%	$5,000 per installation	None

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NEWSPRINT TAX CREDIT CHANGE

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-346	**HB 1479**	**Representative Miller**

AN ACT TO AMEND THE NEWSPRINT RECYCLING TAX.

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Overview: This act modifies the excise tax on virgin newsprint by postponing the increase in the percentage of recycled content required and by expanding the credit for recycling.

Fiscal Impact: The act is expected to reduce revenues in the Solid Waste Management Trust Fund by less than $1,000 per year.

Effective Date: July 1, 1999

Background & Analysis: A publisher must pay a privilege license tax of $15 for each ton of newsprint it consumes that does not have a minimum recycled content. The General Assembly enacted this excise tax on newsprint in 1991 to encourage the use of recycled newsprint. The minimum amount of recycled paper required has been phased up since 1991 from 12% to 35% and was set to increase to 40% in 2001. This act delays this increase in the minimum recycled content percentage until 2005.

There is a credit that can be used towards the recycled content percentage goals for publishers who develop and operate, or contract for the operation of, a newspaper recycling program. Under prior law, a publisher could receive one-half ton credit toward its total recycled content tonnage for each ton of newsprint it recycled. This act increases the credit from one-half ton to one ton, and expands it to include recycling of magazines as well as newsprint.

The proceeds of the tax are earmarked for the Solid Waste Management Trust Fund. The tax generates less than $2,000 a year in revenue. The tax does not apply if the producer cannot meet the recycled content goal because of an inability to obtain newsprint made from recycled paper at a price or quality comparable to other newsprint, to acquire an amount needed for a publication, or to acquire the amount needed in a reasonable amount of time.

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MOTOR VEHICLE TAX VALUE/E&R BOARD

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-353	**HB 315**	**Representative C. Wilson**

AN ACT TO PROVIDE THAT A MOTOR VEHICLE'S PROPERTY TAX VALUE IS DETERMINED AS OF JANUARY 1 PRECEDING THE DUE DATE OF THE TAX AND TO AUTHORIZE THE STOKES

BOARD OF EQUALIZATION AND REVIEW TO MEET AFTER ITS FORMAL ADJOURNMENT.

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Overview: This act provides that a classified motor vehicle's property tax value is to be determined on January 1 of the year the taxes are due, effective for taxes imposed for taxable years beginning on or after July 1, 2000. The act also extends the authority of the Stokes County Board of Equalization and Review to meet after its adjournment upon completion of its duties to examine and review the county's tax list for the current year and to hear a request from a taxpayer regarding the taxpayer's property appraisal or listing.

Fiscal Impact:

- Motor vehicle tax value change: This change does not affect General Fund revenues but is expected to reduce local government revenues by $27.6 million in fiscal year 2000-2001, $29.5 million in fiscal year 2001-2002, $31.6 million in fiscal year 2002-2003, and $33.8 million in fiscal year 2003-2004.
- Stokes Co. E&R Bd. Change: No fiscal impact.

Effective Date:

- Motor Vehicle Tax Value Change: Effective for taxes imposed on taxable years beginning on or after July 1, 2000.
- Stokes County E&R Bd. Change: July 22, 1999.

Background & Analysis:

Motor Vehicle Property Tax Change. The act changes the date for the determination of the property tax value of a classified motor vehicle from January 1 preceding the date the new registration is applied for or the current registration expires to January 1 of the year the taxes are due. Under the current system, classified vehicles are taxed on a revolving, year-round schedule. Every month, the Division of Motor Vehicles (DMV) provides each county a list of the motor vehicles in the county for which registration was renewed or obtained two months earlier. The county lists and appraises the vehicles and sends each vehicle owner a bill for the county, city, and special district taxes due. If the owner does not pay the taxes due on a classified, registered vehicle, DMV will refuse to renew the vehicle registration the following year unless the owner obtains a receipt showing that the taxes have been paid.

For classified motor vehicles, the ownership, situs, and taxability of the vehicle are determined annually as of the day on which a new registration is applied for or the day on which the current vehicle registration is renewed. However, the value of the vehicle is determined annually as of January 1 preceding the date the new registration is applied for or the current registration expires. Therefore, property tax bills that taxpayers receive in January through April of each year are based on the value of the vehicles as of January of the preceding year. This means that the property tax assessment can reflect values as old as 16 months. By moving the property tax valuation date to January 1 of the year the taxes are due, the act ties the value of the vehicle closer to its true value in money. The value of a vehicle, like all other tangible personal property, is based upon its true value in money as prescribed by G.S. 105-283.

Stokes County Equalization and Review Board Change. The second part of the act authorizes the Stokes County Board of Equalization and Review to continue meeting after the Board has performed its statutory duties of examining and reviewing the tax lists for the current year and of hearing any request of a taxpayer with respect to the listing or appraisal of property. G.S. 105-322(e) requires a board of equalization and review to complete the above duties by a specified date. The act amended this statute, effective July 22, 1999, to allow the Stokes County Board of Equalization and Review to continue to meet upon completion of these statutory duties in order to carry out the following duties:

- To hear and decide all appeals relating to discovered property.
- To hear and decide all appeals relating to the appraisal, situs, and taxability of classified motor vehicles.
- To hear and decide all appeals relating to audits of property classified at present-use value and to audits of property exempted or excluded from taxation.

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AMEND BILL LEE ACT/INCENTIVES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-360	**SB 1115**	**Senator Kerr**

AN ACT TO PROVIDE FOR WIDELY SHARED PROSPERITY BY AMENDING THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT, BY PROVIDING ADDITIONAL TAX INCENTIVES FOR VARIOUS BUSINESSES, AND BY MAKING RELATED CHANGES.

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Overview: This act amends the tax laws to expand existing tax incentives for businesses, add new tax incentives and tax reductions for specific businesses, and make related changes. The provisions of the act are listed below, followed by a detailed summary of each provision.

PROVISION	*EFFECTIVE DATE*	*FISCAL IMPACT*
Extend Sunsets on Bill Lee Act Credits.		
Extend sunset on Bill Lee Act from 2002 to 2006, and require Department of Commerce to continue studying impact of Bill Lee Act incentives.	8/4/99	The extension of the sunset will result in a loss of revenue to the General Fund of approximately $13.1 million in the 2002-2003 fiscal year; the loss is expected to increase to as much as $38.1 million by fiscal year 2005-2006.
Incentives for Interstate Passenger Air Carrier Hubs.		
Add passenger air carrier training centers to Bill Lee Act credits.	1/1/99	This change will have an insignificant impact on General Fund revenues.
Allow an interstate passenger air carrier a sales tax exemption for aircraft parts and accessories purchased for use at its hub in this State.	5/1/99	This change will reduce General Fund revenues by approximately $1.2 million a year. It will also reduce local sales tax revenues.
Reduce sales tax from 6% to 1% with an $80 cap for flight crew training aircraft simulators purchased by an interstate passenger air carrier for use at its hub in this State.	5/1/99	This change will reduce General Fund revenues by approximately $400,000 a year. It will also reduce local sales tax revenues.
Incentives for Non-Profit Insurance Companies.		
Allow certain nonprofit insurance companies an eight-year sales tax refund for taxes paid on building materials and fixtures, and a four-year sales tax refund for taxes paid on capitalized computer equipment.	5/1/99	These changes will reduce General Fund revenues by approximately $600,000 in fiscal year 2000-2001, $1.2 million in fiscal years 2001-2002 and 2002-2003, and by

		approximately $100,000 in fiscal year 2003-2004.
Incentives for Tiers One and Two.		
Extend Bill Lee Act credits to electronic mail order houses that create at least 250 jobs in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $2.7 million beginning in fiscal year 2001-2002; the loss in revenues is expected to grow to $5.8 million in fiscal year 2004-2005 and decline slightly in fiscal year 2005-2006 to approximately $4.4 million.
Extend Bill Lee Act credits to customer service centers in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $600,000 a year in fiscal year 2001-2002; the loss in revenues is expected to grow to an annual loss of $2.4 million by fiscal year 2005-2006.
Allow annual refund of 6% sales taxes paid on capitalized machinery and equipment sold to businesses eligible for Bill Lee Act credits and located in tiers one and two.	1/1/00	This change will reduce General Fund revenues by approximately $100,000 a year beginning in fiscal year 2000-2001. The annual loss is expected to increase to $1 million by fiscal year 2005-2006.
Incentives for Small Counties.		
Give a more favorable tier designation to small counties.	1/1/00	This change is expected to have an insignificant impact on General Fund revenues.
Close Development Zone Loopholes.		

Close loopholes in definition of development zones.	8/1/99	This change is expected to increase General Fund revenues by $100,000 a year in fiscal years 2000-2001 and 2001-2002, by $600,000 a year in fiscal year 2002-2003, and by $300,000 a year in fiscal year 2003-2004.
Credit for Development Zone Projects.		
Allow a 25% credit for contributions to nonprofits for capital projects within development zones.	1/1/00	This change is expected to reduce General Fund revenues by $2.5 million in fiscal year 2001-2002 and by $4 million for each year thereafter.

Affordable Housing Tax Credit.		
Allow a credit for rehabilitating or constructing affordable housing, effective for new projects.	Beginning: 1/1/00 Sunset: 1/1/06	This change is expected to reduce General Fund revenues by $1.5 million a year in fiscal year 2001-2002, and by as much as $10.1 million a year by fiscal year 2005-2006.
Extend Bill Lee Act Credits to Insurance Company Administrative Offices.		
Allow all Bill Lee Act credits to be taken against insurance premiums tax.	1/1/99	This change is not expected to significantly affect General Fund revenues.
Quality Jobs Assurance.		
Require businesses to provide health insurance and meet environmental, safety, and health standards in order to qualify for Bill Lee Act credits.	1/1/00	This change is not expected to significantly affect General Fund revenues.

Application Fee and Information Changes.		
Eliminate the $75 application fee for Bill Lee Act credits in tiers one and two and increase the fee to $500 per credit in other tiers, with a cap of $1,500 per applicant.	9/4/99	This change is not expected to significantly affect General Fund revenues.
Require applicants for Bill Lee Act credits to provide additional information to enable Commerce to evaluate the effectiveness of the credits in providing employment to residents of development zones.	9/4/99	N/A
Require taxpayers to include with their tax returns the information that they must generate under current law to establish eligibility for the Bill Lee Act credits.	1/1/00	N/A
Clarify Business Definitions and Refunds.		
Clarify definitions of industries covered by Bill Lee Act, effective immediately	8/4/99	N/A
Clarify sales tax refunds for sales of fuel to interstate air carriers.	10/1/99	N/A
Research and Development Credit.		
Provide that research and development credit will not expire when the corresponding federal credit expires.	1/1/99	This change is not expected to significantly impact General Fund revenues.

Industrial Development Fund/Environmental Certification.		
Require projects to obtain an environmental certification in order to qualify for funding from the Industrial Development Fund (Building Renovation Fund), effective when the act becomes law.	8/4/99	N/A

Dept. of Commerce to Oversee Interstate Cooperative Efforts.		
Require the Department of Commerce to support reasonable efforts to reduce interstate competition in luring businesses from one state to another.	8/4/99	N/A
Brownfields Property Fee Changes.		
Increase fees paid to the Department of Environment, Health, and Natural Resources for brownfields agreements applied for after the act becomes law.	8/4/99	This change is not expected to significantly impact General Fund revenues.

Fiscal Impact: *See chart above.*

Effective Date: *See chart above.*

Background & Analysis:

Extend Sunset on Bill Lee Act Credits. The William S. Lee Quality Jobs and Business Expansion Act was enacted in 1996, effective beginning with the 1996 tax year, with a sunset effective in 2002. The Act required the Department of Commerce to report annually on the credits allowed by the Act. In 1997, the General Assembly added specific issues that the Department of Commerce was required to study and report back on in 1999. Before 1996, North Carolina had made little use of tax incentives to lure businesses to the State. Even without incentives, North Carolina was consistently one of the top states in attracting industry. The array of credits authorized by the William S. Lee Act was viewed as an experiment, to be evaluated in five years to determine whether the incentives were cost effective and actually affected behavior, or merely provided tax reductions to businesses that would have located or expanded in any case. This act extends the 2002 sunset for an additional four years, to 2006, and it renews the requirement that the Department of Commerce study the effect and effectiveness of the Bill Lee Act incentives and report the results of its study to the 2001 General Assembly.

Incentives for Interstate Passenger Air Carrier Hubs. The act provides three incentives for interstate passenger air carriers with hubs in this State. A hub is defined as the airport where the carrier has allocated at least 60% of its aircraft property tax value and at which the majority of its boarding passengers are connecting from other airports, not originating at that airport. U.S. Airways, whose hub is in Charlotte, qualifies for the credit. Midway Airlines, whose hub is at Raleigh-Durham, should qualify for the credit by the end of 1999.

The first incentive for passenger air carriers is to provide that the Bill Lee Act definition of central administrative offices includes centralized training offices at an air carrier's hub, effective beginning with the 1999 tax year. This change allows the air carrier to qualify for the central administrative office credit, described below, as well as for the existing Bill Lee Act credit for creating jobs, credit for investing in machinery and equipment, credit for research and development, and credit for worker training. These credits can be taken with respect to the training center only.

The central administrative office credit is allowed to taxpayers that purchase or lease real property to be used as central administrative office property with 40 or more employees. The amount of the credit is equal to 7% of the eligible investment amount and may not exceed $500,000. The credit is taken in seven equal installments over the seven years following the taxable year in which the property is first used as a central administrative office.

The second incentive for passenger air carriers is a sales tax exemption for the carrier's purchases of aircraft lubricants, parts, and accessories for use at its hub, effective beginning May 1, 1999. These purchases would otherwise be subject to sales tax at 6%, but interstate air carriers are allowed a partial refund of the tax under G.S. 105-164.14(a). In 1998, the General Assembly enacted a similar exemption for air couriers (Federal Express), effective January 1, 2001.

The third incentive for passenger air carriers is a sales tax reduction from 6% to 1% with an

$80 cap, for purchases of aircraft simulators for flight crew training for use at the hub, effective beginning May 1, 1999. The tax reduction would also apply to interstate air couriers. U.S. Airways plans to establish a flight crew training center at its Charlotte hub, where it would use aircraft simulators.

<u>Incentive for Nonprofit Insurance Companies</u>. The act provides a sales tax refund to certain nonprofit insurance companies for State and local taxes they pay on building materials, supplies, fixtures, and equipment that become a part of their real property and on capitalized computer systems hardware and software. The refund is effective beginning with taxes paid on May 1, 1999. The computer equipment refund expires for taxes paid on or after January 1, 2004, and the building materials refund expires for taxes paid on or after January 1, 2008. To qualify for these refunds, the insurance company must be operated for the exclusive purpose of providing insurance products to nonprofit charitable organizations and their employees. In addition, the Secretary of Commerce must have certified that the insurance company will invest at least $20 million in this State. TIAA, which has announced plans to build an office in Mecklenburg County, fits this description. If TIAA fails to make the $20 million investment within five years after it first receives a refund, it forfeits all refunds it received as a result of this incentive.

<u>Incentives for Enterprise Tiers One and Two</u>. The act provides three incentives for development in enterprise tier one and two counties, which are the counties considered most in need of economic development based on high unemployment, low per capita income, and low population growth. The first incentive extends all of the Bill Lee Act credits to electronic mail order houses that create at least 250 jobs located in an enterprise tier one or two county. The second incentive extends all of the Bill Lee Act credits to certain customer service centers located in an enterprise tier one or two county. An eligible customer service center is a subdivision of a telecommunications or financial services company that provides support services to the company's customers by telephone to support the company's products and services. To qualify, at least 60% of the center's calls must be incoming. This requirement will prevent telemarketing operations from qualifying. The credits allowed under the Bill Lee Act, which this act extends to these electronic mail order houses and customer service centers effective January 1, 2000, are the credit for creating jobs, the credit for investing in machinery and equipment, the credit for research and development, the credit for worker training, and the credit for investing in central administrative office property.

The third incentive allows an annual sales tax refund on taxes paid at 6% (6.5% in Mecklenburg County) on capitalized machinery and equipment sold to a taxpayer engaged in one of the businesses eligible for Bill Lee Act credits, for use in an enterprise tier one or two county. This provision will become effective for taxes paid on or after January 1, 2000. In addition to tier one and two customer service centers and electronic mail order houses discussed above, the following businesses are eligible for Bill Lee Act credits: air courier services, central administrative offices (with at least 40 new jobs), data processing, manufacturing, warehousing, and wholesale trade.

Incentives for Small Counties. The act allows certain counties to qualify for a lower enterprise tier designation, effective January 1, 2000. Under the Bill Lee Act, all counties are divided into five enterprise tiers, ranked by economic distress as measured by a formula that combines unemployment, per capita income, and population growth. Those counties in lower-numbered tiers receive more favorable incentives than those in higher tiers.

First, this act changes the rules for assigning enterprise tier designations to provide that the tier number that would otherwise be assigned by the formula is reduced by one for counties that have a population of less than 50,000 and also have more than 18% of their residents below the federal poverty level. Under this provision, Alleghany, Ashe, Beaufort, Cherokee, Perquimans, Scotland, Vance, and Yancey Counties would move from tier two to tier one; Bladen, Hoke, Jones, Madison, Pamlico, and Pasquotank Counties would move from tier three to tier two; and Duplin, Greene, and Watauga Counties would move from tier four to tier three. Second, the act provides that a county that has a population of less than 25,000 cannot be designated higher than tier three. Under this provision, Polk and Currituck Counties would move from tier five to tier three. Third, the act provides that a county is designated as tier one if it has a population of less than 10,000 and also has more than 16% of its residents below the federal poverty level. Under this provision, Camden, Clay, and Jones Counties would become tier one counties.

Close Development Zone Loopholes. In 1998, the General Assembly amended the Bill Lee Act to provide additional incentives for businesses that locate or expand in development zones, which are economically distressed areas located within cities. The statutory conditions for qualifying as a development zone were designed to target only these relatively small, economically distressed areas. The statutory conditions contained loopholes, however, that allowed large areas outside of cities to qualify, even if they were not economically distressed throughout. The act closes those loopholes, effective for development zone designations made on or after January 1, 2000.

The 1998 legislation defined a development zone as an area that meets all of the following conditions: (1) consists of one or more contiguous census tracts, block groups, or both, (2) has a population of 1,000 or more, at least 20% of whom are below the poverty level, and (3) is located at least partly in a city with a population over 5,000. This act closes the loopholes in this definition by requiring that:

- Every census tract and census block group in the zone must be located in whole or in part within the primary corporate limits of the city.
- Every census tract and census block group in the zone must have more than 10% of its population below the poverty level, or must be immediately adjacent to a tract or group that has more than 20% of its population below the poverty level.
- None of the census tracts or census block groups may be located in another development zone.

The act also shortens the period during which designation as a development zone is effective, from four years to two years, and requires zone applicants to notify every city in which part of the proposed zone would be located.

The following enhanced incentives apply in development zones: If a business locates in a development zone, the wage standard it has to meet is the same as for tier one counties -- slightly lower than the standard for other counties. In addition, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and there is no threshold for the credit for investing in machinery and equipment.

Credit for development zone projects. The act creates a new tax credit for taxpayers that contribute cash or property to certain nonprofit agencies to be used for an improvement project in a development zone. An improvement project is a project to construct or improve real property for community development purposes or to acquire real property and convert it for community development purposes. The new credit becomes effective beginning with the 2000 tax year.

The credit allowed is 25% of the amount contributed by the taxpayer. The total amount of credits that may be allowed in a taxable year is capped at $4 million. Taxpayers are required to apply to the Secretary of Revenue for these credits. If the total amount applied for in a year exceeds $4 million, the Secretary will reduce each applicant's credit proportionally.

The credit is allowed for contributions to a development zone agency, defined as a community action agency, a community-based development organization, a community development corporation, a community development financial institution, a community housing development organization, or a local housing authority. To qualify for the credit, all of the following conditions must be met:

- The agency must contract in writing to use the contribution for an improvement project in a development zone and to repay the taxpayer with interest if the contribution is not so used.

- The Department of Commerce must certify that the agency will undertake an improvement project in a development zone. To support this certification, the agency must provide the Department documentation establishing the identity of the agency, the nature of the project, and that the project is for a community development purpose in a development zone.
- The taxpayer must be unrelated to the agency and must not control, be controlled by, or be under common control with the agency.
- The taxpayer must not receive anything of value for the contribution.

A taxpayer forfeits the tax credit for a contribution to the extent the development zone agency uses the contribution for anything other than an improvement project in a zone. Development zone agencies are required to file with the Department of Commerce annual, audited financial statements. If the Department of Commerce finds that any part of a contribution was used for a purpose other than an improvement project, it must notify the Department of Revenue of the resulting forfeiture.

Affordable housing tax credit. The act creates a new tax credit for rehabilitating or constructing low-income housing, effective for buildings allocated federal credits on or after January 1, 2000. The credit expires for buildings allocated federal credits on or after January 1, 2006. The credit is equal to a percentage of the amount of the taxpayer's federal credit for low-income housing with respect to eligible North Carolina low-income housing. The credit is 75% for buildings located in tier one or two and 25% for buildings located in other tiers. North Carolina low-income housing is eligible if it meets one of the following conditions:

- It is located in a tier one or two enterprise area.
- It is located in a tier three or four enterprise area and has at least 40% of its residential units that are rent-restricted and are occupied by individuals whose income is 50% or less of area median gross income.
- It is located in a tier five enterprise area and has at least 40% of its residential units that are rent-restricted and are occupied by individuals whose income is 35% or less of area median gross income.

The credit is not taken in one year but is spread out over five years beginning when the federal credit is first claimed for the building. The federal credit is first claimed either when the building is placed in service, or the next year, at the taxpayer's election. The federal credit is taken over eleven years.

The federal credit requires that either (1) at least 20% of the residential units are rent-restricted and occupied by individuals whose income is 50% or less of area median gross income or (2) at least 40% of the residential units are rent-restricted and occupied by individuals whose income is 60% or less of area gross income. By providing a higher credit for tier one and two projects and by limiting the State credit to projects that are either in tier one or two or serve lower-income residents, the act is designed to steer investments toward these projects.

The federal credit requires that the low-income housing be used for that purpose for at least 30 years. If this requirement is not met, all or part of the taxpayer's credit is recaptured.

Under the State credit, if federal recapture is required, the taxpayer forfeits the North Carolina credit to the same extent. In addition, if the taxpayer no longer qualifies for the federal credit during one of the five years a State installment could otherwise be claimed, the taxpayer is no longer eligible for the State credit. This situation could occur if the taxpayer sold its interest in the low-income housing.

Under federal law, a limited amount of credit is allowed to each state each year, and these credits are allocated among applicants based on selection criteria designed to reward projects that will serve the lowest income tenants for the longest periods. At least 10% of the credits each year must be set aside for projects sponsored by nonprofits. The amount of federal credit allocated to North Carolina will be $9.2 million for the 2000 through 2002 tax years and is expected to increase to $13 million for the 2003 and 2004 tax years. By limiting the State credit to a percentage of the federal credit, the act automatically caps the potential revenue loss to the State.

Extend Bill Lee Act credits to insurance company administrative offices. The act allows all the Bill Lee Act credits to be taken against gross premiums tax, effective beginning in the 1999 tax year. Currently, only the real property credit for central administrative offices may be taken against gross premiums tax.

In 1997, the General Assembly extended the Bill Lee Act credits to central administrative offices that created at least 40 new jobs and created a new tax credit for taxpayers that purchase or lease real property to be used as central administrative office property. In 1998, the General Assembly allowed the real property credit for central administrative offices to be taken against the gross premiums tax as well as against the income tax and the corporate franchise tax. Insurance companies pay gross premiums tax in lieu of income tax. The 1998 legislation did not change the rule that the other Bill Lee Act credits could be taken against only income tax and corporate franchise tax. The 1998 change created a situation in which insurance companies were treated differently from other businesses with respect to central administrative offices. A business, other than an insurance company, that builds a central administrative office can take against income tax not only the real property credit for that office, but also the jobs credit, the investment tax credit, and the worker training credit. An insurance company can take against gross premiums tax only the real property credit, but not the jobs credit, the investment tax credit, or the worker training credit. By extending the other Bill Lee Act credits to gross premiums tax, the act provides uniform treatment for insurance companies and other businesses that build central administrative offices.

Quality jobs assurance. The purpose of the original William S. Lee Act was to provide incentives for "high quality jobs." Accordingly, only certain industries qualify for the Bill Lee Act credits and a taxpayer must meet a wage standard with respect to the jobs at the locations for which it claims a credit. This act adds three additional standards to assure that credits are allowed only with respect to high quality jobs. These standards become effective for new credits beginning January 1, 2000. First, the taxpayer must pay at least 50% of basic health insurance coverage for the full-time positions for which it takes a credit. Second, the taxpayer must certify that the business location with respect to which it claims a credit has not had a significant environmental violation in the last five years and has no pending enforcement actions for significant environmental violations. Third, the taxpayer must certify that the business location with respect to which it claims a credit has no outstanding or unresolved OSHA citations and has had no serious violation within the last three years. The Department of Environment and Natural Resources and the Department of Labor are authorized to audit the environmental and OSHA certifications, respectively, and report to the Department of Revenue if they determine that a certification was inaccurate.

Application, fee, and Information changes. A taxpayer that wishes to claim a Bill Lee Act credit must apply to the Department of Commerce for certification that it meets the eligibility requirements for the credit. The application must include information to enable the Department of Commerce to determine the applicant's eligibility, and be accompanied by a $75 fee to defray part of the costs of administering the program. This act requires applicants to include information necessary to enable the Department of Commerce to provide data required in its periodic reports to the General Assembly. This data will assist the General Assembly in evaluating the cost effectiveness of the Bill Lee Act credits.

The act also eliminates the $75 fee for credits claimed with respect to enterprise tier one and two counties. For other credits, the fee is increased to $500 per credit claimed, not to exceed $1,500 per taxpayer. The Department of Commerce will retain ¼ of the fee proceeds for the costs of administering the program, and remit the remaining proceeds to the Department of Revenue for its use in administering and auditing the Bill Lee Act credits. These changes became effective September 4, 1999.

The Bill Lee Act incentives recommended by the Department of Commerce over the last four years have contained many conditions and standards a taxpayer must meet in order to be eligible for the incentives. The incentives also contain what are known as "clawback" provisions, which require a taxpayer to forfeit a targeted incentive if it turns out the taxpayer did not meet the conditions for qualifying for the incentive, and to lose future installments of a tax credit if the job or investment on which the credit was based does not remain in place. This act requires taxpayers that claim Bill Lee Act credits to include with their tax returns information about whether the jobs and investments have remained in place and whether other conditions have been met. The act allows the Department of Revenue to share this information with the Employment Security Commission and the Department of Commerce; this sharing should enable the Department of Commerce to evaluate whether the incentives are accomplishing their purpose of creating high-quality jobs throughout the State.

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Clarify business definitions and refunds. The act clarifies the statutory definitions of the types of businesses that are eligible for the Bill Lee Act credits. In 1998, the General Assembly changed the statutory references from the Standard Industrial Classifications (SIC) to the North American Industrial Classification System (NAICS) to conform to the federal system adopted effective January 1, 1999. This system is used to classify most of the data available about industries or kinds of business in the economy. Upon review of the NAICS system, it was discovered that further terminology changes were needed to the Bill Lee Act definitions to assure that the credits would be available to the types of businesses covered by the prior law's definitions.

The act clarifies that interstate air carriers are allowed a partial refund of sales taxes paid on fuel, effective October 1, 1999. This clarification will not change the way the law is currently administered.

Research and Development Credit. The act modifies the research and development credit so that it will not automatically expire if the corresponding federal credit expires. The credit for research and development is allowed only to taxpayers that claim one of the federal research and development credits. In past years, the federal credit has expired and then been renewed retroactively, creating uncertainty for taxpayers. This act amends the State credit so that it is based on the federal credit as of January 1, 1999. Expiration of the federal credit will not affect the State credit. If the federal credit is later modified, the General Assembly can consider whether to update its cross-reference to adopt the federal modifications.

Industrial Development Fund environmental certification. The act requires, as a condition for funding from the Industrial Development Fund (Building Renovation Fund), that a project receives certification from the Department of Environment and Natural Resources that it will not have a significant adverse effect on the environment. This change became effective when the act became law, August 4, 1999.

Commerce to Pursue Interstate Cooperative Efforts. The act requires the Department of Commerce to encourage reasonable interstate agreements and federal legislation to control the use of excessive incentives in interstate competition in luring businesses from one state to another. The Department is to report on these efforts by March 1, 2000, and March 1, 2001.

Brownfields Property Fee Changes. Lastly, the act makes changes related to the fees collected by the Department of Environment and Natural Resources in connection with brownfields agreements, effective when the act becomes law, August 4, 1999. These changes increase the application fee from $1,000 to $2,000, and increase the agreement fee from $500 to the actual cost to the State of all activities relating to the brownfields agreement. The $2,000 application fee is a credit against the agreement fee. These sections provide that interest on fees accrues to the Department's Brownfields Account rather than to the General Fund, that unpaid fees are a lien on all of the developer's property as well as on the brownfields property, and that the Department may contract for services necessary to implement the brownfields property law.

Brownfields property is abandoned, idle, or underused property at which expansion or redevelopment is hindered by actual or possible environmental contamination and that is or may be subject to cleanup requirements under State or federal law. Under current law, the Department of Environment and Natural Resources can enter into a brownfields agreement with the owner of brownfields property, under which the owner is allowed to clean up the property to a level that will allow the property to be used for specified purposes but would not meet current cleanup standards. The owner agrees to clean up the property as specified in the agreement and to limit future uses of the property to those specified in the agreement, i.e., uses that are safe given the less than complete cleanup of the property. This agreement benefits the State by causing a contaminated property to be at least partially cleaned up and put to productive use in place of having a "greenfield" pristine site developed. Under the agreement, the owner is relieved of liability for further cleanup of the property.

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MODIFY HISTORIC REHABILITATION CREDIT

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-389	**SB 251**	**Senator Horton**

AN ACT TO ALLOW THE HISTORIC REHABILITATION TAX CREDIT TO BE ALLOCATED BY A PASS-THROUGH ENTITY TO ITS OWNERS AND TO REQUIRE CORPORATIONS THAT ARE REQUIRED TO PAY FEDERAL-ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER TO PAY STATE-ESTIMATED INCOME TAX BY ELECTRONIC FUNDS TRANSFER.

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Overview: This act modifies the tax credit for rehabilitating income-producing historic property and it requires corporations that are required to pay federal income tax estimated payments by electronic funds transfer (ETF) to pay State income tax estimated payments by ETF. The Revenue Laws Study Committee recommended the latter change in House Bill 62, introduced by Rep. Gray. The House Finance Committee added the provisions of House Bill 62 to this act.

Fiscal Impact:

- Historic Rehabilitation Tax Credit: The fiscal impact of the tax credit changes is unclear.

- Corp. Income Tax Payable by EFT: The Department of Revenue estimates an annual gain of $334,662 to the General Fund from the EFT requirement.

Effective Date:

- Historic Rehabilitation Tax Credit: The changes to the tax credit for rehabilitating income-producing historic property are effective for taxable years beginning on or after January 1, 1999.
- Corp. Income Tax Payable by EFT: The requirement for corporations to pay State income tax estimated payments by EFT becomes effective for taxable years beginning on or after January 1, 2000.

Background & Analysis:

Historic Rehabilitation Tax Credit. This act modifies the tax credit for rehabilitating income-producing historic property in two substantive ways and one technical way:

- It allows a pass-through entity, such as a Subchapter S corporation, to allocate the credit among any of the entity's owners, as long as the amount of credit allocated does not exceed the owner's adjusted basis in the pass-through entity. The credit amount may be allocated among any of the pass-through entity's owners, in the entity's discretion. The allocation provision sunsets in three years. Under prior law, the credits were allocated in the same proportion as other income items allocated to the owners under the Code.

- It adds provisions to recapture the credit if the taxpayer is required to recapture the credit under the Code or if a partner or owner disposes of its interest in the pass-through entity.

- It consolidates the credits for rehabilitating an historic property into one tax Article. The credits are currently duplicated in two separate statutes in the individual and corporate parts of the income tax Article in Chapter 105.

Taxpayers are allowed an income tax credit of 20% of the expenses of rehabilitating an income-producing historic structure and a credit of 30% of the expenses of rehabilitating an historic structure that is not income-producing. The credit for income-producing structures is lower because federal law also allows a 20% credit for those expenses, yielding a combined credit of 40%. The 20% credit is allowed only if the taxpayer qualifies for the federal credit and the 30% credit is allowed only if the taxpayer does not qualify for the federal credit. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

A pass-through entity may qualify for the rehabilitation credits and pass the credits on to its owners. A pass-through entity is an entity, such as a partnership, a limited liability company, or a Subchapter S corporation, that is treated as owned by individuals or other entities under federal tax law and whose income, losses, and credits are reported by the owners on their State income tax returns.

Under the Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership, and tax credits are allocated among partners in a partnership in accordance with the partnership agreement. The allocation made by the partnership agreement must have a substantial economic effect, which means that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. Therefore, the allocation agreement of partners cannot give one partner 100% of the income, loss, or credits of the partnership. Under prior North Carolina law, the pass-through entity was required to allocate a tax credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, were allocated under the

Code. This meant that if foreign investors were involved in a qualifying rehabilitation project, their tax credits could not be redistributed to North Carolina investors with State income tax liability.

In putting together an investment group for an income-producing historic rehabilitation project, the project sponsors may find some investors that can benefit from only the federal credit, because they have little or no North Carolina tax liability, and other investors that can benefit from both the federal and the North Carolina credit because they have both types of tax liability. This act changes the allocation of the credit to allow the maximum tax credit available for each of the project investors. It allows a pass-through entity to allocate the credit for rehabilitating an income-producing historic structure among any of its owners, as long as the amount of the allocated credit does not exceed the owner's adjusted basis in the entity, as determined under the Code. The adjusted basis is determined at the end of the taxable year in which the historic structure is placed in service. Each year an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return that shows both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 and G.S. 105-269.15. G.S. 105-131.8 provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-269.15 provides that the tax credit allowed a partner is based on the partnership agreement, which must have substantial economic effect.

The act also requires forfeiture of all or part of the credit for an income-producing historic structure when the following occurs:

- Forfeiture for Disposition. -- When a taxpayer is required by the Code to recapture part or all of the federal credit, then the taxpayer must forfeit the corresponding part of the State credit. Under the Code, the recapture does not apply if the property is disposed of because of the death of the taxpayer, a mere change in form of doing business, or a transfer between spouses or incident to a divorce

- Forfeiture for Change in Ownership. -- If an owner of a pass-through entity that qualified for the credit disposes of all or a portion of the owner's interest in the pass-through entity within five years after the date the structure was placed in service so that the owner's interest is reduced to less than 2/3 of its interest at the time the structure was placed in service, the owner must forfeit a portion of the credit. This recapture does not apply if the change in ownership is due to the death of the owner or to a merger or consolidation requiring approval of the members of the taxpayer pass-through entity to the extent the entity does not receive cash or property.

If a taxpayer or owner of a pass-through entity forfeits the credit, then the taxpayer or owner is liable for all past taxes avoided plus interest. The past taxes and interest are due 30 days after the credit is forfeited.

Electronic Funds Transfer. The act requires corporations that are required to pay federal income tax estimated payments by EFT to pay State income tax estimated payments by EFT, effective for taxable years beginning on or after January 1, 2000. This change in the law will eliminate thousands of returns, not payments, each year. It will enable the State to receive tax payments more quickly and thus gain three to five days of interest on the payments.

In 1993, the General Assembly authorized the Department of Revenue to collect taxes by EFT. The average tax payment must be at least $20,000 a month before the tax payment must be submitted by EFT. The $20,000 threshold applies separately to each tax. This act creates a different rule for corporate estimated income tax payments in order to increase the efficiency of State tax collections and to conform the State's method of collecting corporate estimated income tax payments with federal law so that a taxpayer has only one set of rules to learn and follow. For federal purposes, a corporation whose depository taxes exceed $200,000 in a twelve-month period must pay its corporate income tax estimated payments by EFT. The federal regulations list the different types of depository taxes. Examples of depository taxes include social security taxes, withheld income taxes, and corporate estimated income taxes. The Internal Revenue Service raised the threshold from $50,000 to $200,000 in July 1999. The higher threshold will limit the EFT requirement to the largest 9% of taxpayers, but other taxpayers are expected to use EFT voluntarily.

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1999 FEE BILL

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-413	**HB 289**	**Representative Luebke**

AN ACT TO SET THE PUBLIC UTILITY REGULATORY FEES, TO SET THE INSURANCE REGULATORY CHARGE, TO IMPOSE THE INSURANCE REGULATORY CHARGE ON SERVICE CORPORATIONS AND ON HEALTH MAINTENANCE ORGANIZATIONS IN THE YEAR 2000, TO ALLOW THE DEPARTMENT OF AGRICULTURE AND CONSUMER SERVICES TO IMPOSE FEES THAT REFLECT THE ACTUAL COST OF RENDERING THE SERVICE, AND TO LIMIT THE FEE THAT AN APPLICANT MUST PAY FOR A WATER QUALITY CERTIFICATION THAT IS REQUIRED FOR A PERMIT UNDER THE COASTAL AREA MANAGEMENT ACT OF 1974.

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Overview: This act makes three tax law changes and two fee changes; only the tax law changes are summarized here. This act sets the tax rates for the public utility regulatory fee for the 1999-2000 tax year and for the insurance regulatory fee for the 1999 calendar year. The act also expands the scope of the insurance regulatory fee to include health maintenance organizations and medical service corporations, effective beginning in the 2000 calendar year.

Fiscal Impact:

- Public Utility Regulatory Fee: This fee is expected to generate $8.5 million.
- NC Electric M'ship Corp.: This fee is expected to generate $200,000.
- Insurance Regulatory Fee: The fee is set at 7% for the 1999 calendar year (the 1998 rate was 6%). This charge is expected to generate $20.65 million for the 1999-2000 fiscal year (an increase of $1.45 million over the previous year). In addition, effective in 2000, health maintenance organizations (HMO's) and medical services corporations will be required to pay the fee. This requirement will generate between $2.45 million and $2.8 million. *(See Background & Analysis section for more detailed information.*

Effective Date:

- Public Utility Regulatory Fee: 1999-2000 tax year
- NC Electric M'ship Corp.: 1999-2000 tax year
- Insurance Regulatory Fee: 1999-2000 calendar year; effective for HMO's and medical services corporations in 2000.

Background & Analysis:

Public Utility Regulatory Fee: The act sets the general rate for the public utility regulatory fee at 0.09% for the 1999-2000 fiscal year. This is the same rate that was in effect for the 1997-1998 fiscal year and is expected to generate $8.5 million. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is revenue derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric rates and service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina.

Secondly, the act sets at $200,000 the special public utility regulatory fee imposed on the North Carolina Electric Membership Corporation, effective for the 1999-2000 fiscal year.

The proceeds of the fee will be credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations. The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiaries must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levies a flat-rate regulatory fee to be paid by the North Carolina Electric Membership Corporation. The General Assembly must establish the fee amount each year. The North Carolina Electric Membership Corporation is the only electric membership corporation in North Carolina whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives." Thus, the fee imposed on the North Carolina Electric Membership Corporation will be passed on to its member electric membership corporations.

Insurance Regulatory Fee: First, the act sets the insurance regulatory charge at 7% for the 1999 calendar year, an increase from the 6% rate in effect for 1998. The charge is expected to generate $20.65 million for the 1999-2000 fiscal year, an increase of $1.45 million over the previous year. The insurance regulatory charge is a tax that was enacted in 1991 to make the Department of Insurance receipt-supported and thereby eliminate General Fund support for the Department. The charge is a percentage of each insurance company's premiums tax liability.

Second, the act imposes the insurance regulatory charge on health maintenance organizations and medical service corporations, effective beginning in 2000. The fee will be levied on each company's hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because medical service corporations pay premiums tax at a rate of 0.5% rather than 1.9% and because health maintenance organizations do not pay premiums tax. Adding health maintenance organizations and medical service corporations to the insurance regulatory charge will increase the base against which the charge is levied by $35 to $40 million. At a regulatory charge rate of 7%, this would generate $2.45 to $2.8 million in proceeds.

Prior to the enactment of this act, the insurance regulatory charge was imposed only on insurance companies that pay the gross premiums tax, other than medical service corporations such as Blue Cross Blue Shield and Delta Dental Corporation, which were exempt. Health maintenance organizations did not pay the regulatory charge because they do not pay the gross premiums tax. Prior to 1995, these entities contributed to the Department of Insurance Fund through insurance audit and examination fees. However, in 1995, the General Assembly eliminated the insurance audit and examination fees for insurance companies, health maintenance organizations, medical corporations, and guaranty associations. The revenue generated by these audit fees was an estimated $4.5 million annually. The costs of the audits are now paid for by the insurance regulatory charge as part of the costs of regulating the insurance industry. This act distributes the responsibility for funding the Department of Insurance among all the entities that it regulates.

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PENSION TAX WITHHOLDING

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-414	**HB 1466**	**Representative Cansler**

AN ACT TO PROVIDE FOR WITHHOLDING OF NORTH CAROLINA INCOME TAXES FROM TAXABLE PENSIONS, ANNUITIES, AND DEFERRED COMPENSATION.

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Overview: This act requires a person paying pensions, annuities, and deferred compensation to withhold North Carolina individual income tax from the payments unless the recipient elects not to have the tax withheld, effective January 1, 2001. Income that is exempt from tax is exempt from this withholding requirement. Therefore, the act does not apply to retirement income paid to federal, State, and local retirees with five years of creditable service as of August 12, 1989, because this income is exempt from State income tax due to a court decision in the Bailey, Emory, and Patton lawsuits.

Fiscal Impact: Unable to determine.

Effective Date: Taxable years beginning on or after January 1, 2001.

Background & Analysis: Under federal law, withholding is required on pensions, annuities, and certain deferred income, including IRAs. Prior to this act, North Carolina has not piggybacked this aspect of federal law. This act provides that a pension payer required to withhold federal income tax on a pension payment to a resident of North Carolina must also withhold State income tax. A recipient may elect to not have tax withheld from the pension payment. The pension payer must notify each recipient of the right to elect not to have tax withheld. An individual who elects not to have tax withheld from the pension payment must estimate their income tax liability each year and pay the tax in four installments.

In the case of periodic payments, the pension payer must withhold as if the recipient were a married person with three exemptions, unless the recipient provides an exemption certificate reflecting a different filing status or number of exemptions. For a non-periodic payment, the pension payer must withhold 4% of the payment. A pension payer who fails to withhold or remit the tax that is withheld is liable for the tax.

Currently, the Department of Revenue allows voluntary withholding by employers. The holder of an IRA, although not an employer, may also enter into a voluntary withholding agreement. However, if the payer withholds the tax but does not pay it to the Department of Revenue, the taxpayer's only recourse is against the payer. The Department cannot credit the taxpayer and pursue the payer. Under this act, effective for taxable years beginning on or after January 1, 2001, the withholding will be mandatory unless the recipient elects not to have the tax withheld.

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UPDATE CODE/ CRIMINAL DEADLINE/ RESEARCH

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-415	**HB 1476**	**Representative Miller**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO EARMARK PART OF THE RESULTING REVENUE GAIN FOR TAX RESEARCH, TO DIRECT THE STATE AUDITOR TO CONDUCT A PERFORMANCE AUDIT OF THE DEPARTMENT OF REVENUE, TO CONFORM TO THE FEDERAL STATUTE OF LIMITATIONS FOR WILLFUL FAILURE TO COMPLY WITH STATE TAX LAWS, AND TO INCREASE THE AMOUNT OF TIME A TAXPAYER HAS TO PROTEST THE PAYMENT OF A TAX.

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Overview: This act makes the following changes relating to tax law:

- **Update IRC Reference.** It rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from September 1, 1998, to June 1, 1999. This change became effective August 5, 1999.

- **Conform Criminal Deadline to Federal.** It conforms the State statute of limitations, with respect to the willful failure to comply with the State's tax laws, to the federal statute of limitations. This change is effective December 1, 1999, and applies to prosecutions brought on or after the date for cases where the existing statute of limitations had not expired prior to December 1, 1999.

- **Extend Protest Period.** It increases the amount of time a taxpayer has to protest the payment of a tax from one year to three years. This change is effective for taxes paid on or after January 1, 1999.

- **Dept. of Revenue Tax Research Positions.** It earmarks part of the revenue generated by this act to pay for four new tax research positions for the Department of Revenue, as recommended by the Revenue Laws Study Committee. This change became effective August 5, 1999.

- **Performance Audit.** It earmarks part of the revenue generated by this act for a performance audit of the Department of Revenue, to be conducted by the State Auditor, addressing technology issues, internal organization, budgeting and fiscal management, staffing, and other issues. This change became effective August 5, 1999.

<u>Fiscal Impact</u>: The Code Update is expected to increase General Fund revenues by $11.55 million in fiscal year 1999-2000, $2.95 million in fiscal year 2000-2001, $1.4 million in fiscal year 2001-2002, $900,000 in fiscal year 2002-2003, and $100,000 in fiscal year 2003-2004.

<u>Effective Date</u>: *See Overview section.*

<u>Background & Analysis</u>:

<u>Update Code Reference.</u> Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. This update generally has the greatest effect on State corporate and individual income taxes because these taxes are based on federal taxable income and are therefore closely tied to federal law.

Since the General Assembly updated the State's reference to the Internal Revenue Code to September 1, 1998, Congress has enacted two bills that affect the Code. On October 21, 1998, the President signed into law Public Law 105-277, which includes the Tax and Trade Relief Extension Act of 1998. On April 19, 1999, the President signed into law Public Law 106-21, which extends the tax benefits available with respect to services performed in a combat zone to services performed in the Kosovo area.

<u>Public Law 105-277:</u> **This** federal law extended the research and development credit, created or extended tax breaks aimed particularly at individuals, small businesses, and farmers, narrowed some tax exemptions, and made many technical changes. The following is a summary of some of the more significant provisions:

- It extends the research and development credit through June 30, 1999. North Carolina's credit for research and development is based upon this federal credit.

- It accelerates the deduction for health insurance costs of self-employed individuals. Self-employed individuals are entitled to deduct a portion of the amount paid for health insurance for the self-employed individual and the individual's spouse and dependents. Under prior law, the amount that could be deducted was being phased up from 45% in 1998 to 100% in 2007. Public Law 105-277 accelerated the amount that could be deducted to 60% for tax years beginning in 1999 through 2001, to 70% for tax years beginning in 2002, and to 100% for tax years beginning in 2003 and thereafter. This change will treat the self-employed the same as employees, who may exclude from income 100% of employer-provided health insurance.
- It provides a five-year net operating loss carryback for farmers, effective for net operating losses arising in taxable years beginning after December 31, 1997. A net operating loss is the amount by which business deductions exceed business gross income. Generally, a net operating loss may be carried back two years and forward 20 years to offset taxable income in such years. Public Law 105-277 created an exception for farming losses. A farming loss is defined as the amount of any net operating loss attributable to the income and deductions of a farming business.
- It permanently extends the income averaging provision for farmers. An individual engaged in a farming business may elect to compute current year tax liability by averaging, over the prior three-year period, all or a portion of the taxable income that is attributable to the farming business. This provision would have expired for taxable years beginning on or after January 1, 2001.
- It allows a taxpayer that wins a contest, lottery, jackpot, etc., and elects to take the payment as an annuity to claim the prize winnings as income at the time they are received. Prior to the enactment of this law, a person who had the option of receiving either a lump-sum distribution or an annuity was required to include the value of the award in gross income in the year in which the prize was won, even if the annuity option was exercised.
- It permanently extends the charitable market-value deduction for contributions of qualified appreciated stock to private foundations.
- It limits specified liability losses to product liability losses and amounts allowable as a deduction that are in satisfaction of a liability under a federal or state law requiring reclamation of land, decommissioning of a nuclear power plant, dismantlement of a drilling platform, remediation of environmental contamination, or a payment under any workers compensation act. A specified liability loss may be carried back 10 years rather than being limited to the general two-year carryback period. Prior to the enactment of this law, a specified liability loss included other liabilities that arose under federal or state law or out of any tort of the taxpayer.
- It requires certain deductible liquidating distributions of a regulated investment company or real estate investment trust to an 80% corporate owner to be included in the corporation's income.

Public Law 106-21: This federal law extends the tax benefits available under the Internal Revenue Code with respect to services performed in a combat zone to services performed in a "qualified hazardous duty area". The term "qualified hazardous duty area" means any area of the Federal Republic of Yugoslavia, Albania, the Adriatic Sea, and the northern Ionian Sea during the period that any member of the Armed Forces of the United States is entitled to combat pay for services performed in the area.

Under the Code, all or most of military personnel's combat pay is exempt from income tax. Since North Carolina begins its calculation of taxable income with federal taxable income, this pay is also exempt from State income tax. The Code also extends the time military personnel and those serving in support of the military personnel have to file and pay their taxes. Public Law 106-21 extends these provisions to those individuals within the "qualified hazardous duty area" defined above and to those individuals supporting Operation Allied Force who are away from their permanent duty stations. The extension lasts until 180 days after taxpayers leave the defined areas or their supporting operation, plus the number of days they were there during the tax filing season after the air strikes began on March 24, 1999. The tax relief provisions also apply during any period of hospitalization resulting from injuries or illness incurred while serving in the combat zone. During the extension, affected taxpayers will not accrue any interest or penalty charges and the IRS will not pursue any tax enforcement action. G.S. 105-249.2 prohibits the Secretary of Revenue from assessing interest or a penalty against a taxpayer for any period that is disregarded for federal income tax purposes.

Background for Code Update. Since the State corporate income tax was changed to a percentage of federal taxable income in 1967, the reference date to the Internal Revenue Code has been updated periodically. In discussing bills to update the Code reference, the question frequently arises as to why the statutes refer to the Code on a particular date instead of referring to the Code and any future amendments to it. The answer to the question lies in both a policy decision and a potential legal restraint.

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

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

In 1997, the Revenue Laws Study Committee explored the possibility of legislation that would automatically adopt federal changes to the Code each year, with legislative review and approval required in the succeeding legislative session. It was hoped that this approach would avoid the practical difficulties that occur when Code changes go into effect many months before the General Assembly has a chance to pass legislation adopting the changes. The Attorney General's Office reviewed the relevant case law in this State and other states before concluding that this approach would be unlikely to withstand a constitutional challenge.

Conform Criminal Deadline to Federal. Under North Carolina law, it is a Class 1 misdemeanor to willfully fail to collect, withhold, or pay over taxes or to willfully fail to file a return or pay the tax due. Under prior law, the State had three years from the date of the violation to prosecute the taxpayer that violated the tax law. Under federal law, the IRS has six years from the date of the prosecution to pursue the violation. Sections 2 and 3 of this act conform the State statute of limitations to the federal statute of limitations by extending the time the State has to pursue a violation of the tax laws from three years to six years. This change is effective December 1, 1999, for cases where the three-year statute of limitations has not already expired.

Extend Protest Period. The act extends the time a taxpayer has to challenge the unconstitutionality of most taxes from one year to three years, effective for taxes paid on or after January 1, 1999. The time limit remains at 30 days for excise taxes on alcoholic beverages, soft drinks, tobacco products, and controlled substances. In North Carolina, if a taxpayer believes a tax is unconstitutional, the taxpayer must pay the tax and contest the tax by requesting a refund after paying the tax. This procedure is known as "paying under protest".

Tax Research Positions. Upon recommendation of the Revenue Laws Study Committee, the act authorizes the Secretary of Revenue to draw funds from the revenues generated by updating the Internal Revenue Code reference to fund four tax research positions in the Department of Revenue, effective January 1, 2000. The Revenue Laws Study Committee determined that there is a need for in-depth tax research that cannot be met by the current three-person staff. Adding four new tax analyst positions would provide a tax research resource capable of serving the needs of the legislative and executive branches for analyses of various tax proposals and of the effect of changes in the economy on the tax base.

Performance Audit. The act directs the Office of the State Auditor to conduct a performance audit of the Department of Revenue, addressing the following areas: (i) tax collection and tax auditing activity, with particular attention to the cost, efficiency, and effectiveness of the Integrated Tax Administration System and subsequent automation projects; (ii) current methods of processing tax returns and payments and the ability to employ the latest technology in this processing; (iii) internal organization and management; (iv) budgeting and fiscal management; (v) current and future staffing requirements; and (vi) any other issues the State Auditor considers necessary or desirable. The State Auditor is to submit an interim progress report to the Senate and House Appropriations Subcommittee on General Government and the General Assembly's Fiscal Research Division by May 30, 2000, and a final report to the General Assembly by January 1, 2001. The Secretary of Revenue is directed to draw $100,000 from funds generated by the act to pay for the performance audit.

NO SALES TAX FEE/OTHER CHANGES

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-438	**SB 1112**	**Senator Kerr**

AN ACT TO PROMOTE ELECTRONIC COMMERCE BY REPEALING THE SALES TAX REGISTRATION FEE AND TO MAKE OTHER CHANGES TO THE TAX LAWS AND RELATED STATUTES.

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Overview: This act makes numerous tax law changes as described below:

- **Privilege Tax on Loan Agencies.** It reduces the annual privilege tax on loan agencies from $750.00 to $250.00. In addition, the act expands the scope of the tax to include pawnbrokers and check cashers. This change is effective July 1, 1999.
- **Repeal Sales Tax Registration Fee.** It repeals the one-time $15.00 registration fee retailers and wholesalers must pay when registering with the Department of Revenue for sales and use tax purposes. This change is effective January 1, 2000.
- **Repeal Sales Tax on Medical Equipment and Sundries.** It exempts durable medical equipment and medical sundries from sales tax. This change is effective October 1, 1999.
- **Repeal Sales Tax on Prescription Drugs.** It exempts physicians and other medical professionals who buy drugs to administer to their patients, and State hospitals (other than UNC hospitals) from paying sales and use tax on prescription drugs. (Note: other prescription drugs, including prescriptions, drugs purchased by the UNC hospitals, drug samples distributed by the manufacturer, and drugs purchased for use in the commercial production of animals, are either exempt from sales and use tax or the tax is refundable.) This change is effective October 1, 1999.
- **Repeal Sales Tax Exemption for Traded-In Items.** It repeals the sales tax exemption for certain traded-in items. This change is effective October 1, 1999.
- **Repeal Unconstitutional Sales Tax Provisions.** It repeals two sales tax provisions that may be unconstitutional: the requirement that a nonprofit corporation must be chartered in North Carolina in order to claim an exemption from collecting sales tax on items sold as a part of an annual fundraiser, and the sales tax exemption for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use in free publications that contained advertising of a general nature. Both changes are effective October 1, 1999.

- **Airport Authority Sales Tax Refunds.** It entitles all local airport authorities created by the General Assembly to receive sales tax refunds. This change is effective July 1, 1999.
- **Tax Penalty and Assessment Changes.** It makes several changes to tax penalty and assessment rules, including authorizing the Secretary of Revenue to waive bad check penalties in the same manner as other penalties are waived, and conforming the negligence penalty for large corporate income tax deficiencies with other large tax deficiencies. The tax penalty changes are effective October 1, 1999, and the assessment changes are effective August 10, 1999.
- **Special Mobile Equipment Changes.** The act allows untaxed diesel fuel to be used in special mobile equipment, effective October 1, 1999, and also allows a quarterly refund for tax paid on any taxed motor fuel used to operate special mobile equipment, effective for taxes paid on or after January 1, 1999. It also increases the registration fee for special mobile equipment from $20.00 to $40.00, effective January 1, 2000. Finally, it expands the maximum width of special mobile equipment from 96 inches to 102 inches, effective August 10, 1999.
- **Miscellaneous Tax Law Changes.** The act also makes the following minor tax law changes:
    - Political Parties Financing Fund. Requires that the individual income tax return contain a line authorizing a contribution to the Political Parties Financing Fund, effective August 10, 1999.
    - Definition of a Utility for Sales Tax Purposes. Clarifies the definition of a utility for sales tax purposes, effective August 10, 1999.
    - No Sales or Use Tax/Certain Tangible Personal Property. Provides that sales and use taxes do not apply to tangible personal property that a merchant manufactures or purchases for resale but then withdraws from inventory and donates to a governmental entity, effective October 1, 1999.
    - Increase Restaurant Service Charges Not Subject to Sales Tax. Increases the amount of the service charge that may be added to a restaurant patron's bill without being subject to sales tax, effective October 1, 1999.
    - Information Sharing/DOR and Law Enforcement. Authorizes the Department of Revenue to share information about excise taxes on tobacco, alcohol, and unauthorized substances with law enforcement officials, effective August 10, 1999.
    - Repeal Certain Motor Fuel Tax Licenses. Repeals the requirement that bulk end users and retailers of undyed diesel fuel obtain a motor fuel tax license, and clarifies that a motor fuel supplier is allowed a discount of the tax due only if the tax is paid on time, effective August 10, 1999. Repeals the requirement that a bonded importer of motor fuel was required to obtain an import confirmation number, effective August 10, 1999.
    - DOR Authorized to Use Certain Information. Authorizes the Department of Revenue to use information in the State Directory of New Hires to administer tax collection, effective August 10, 1999.

Fiscal Impact: Taken as a whole, the act is expected to increase General Fund revenues by less than $1 million a year the first three years it is in effect and then reduce General Fund revenues by less then $1 million a year the next two years it is in effect.

Effective Date: *See Overview section.*

Background & Analysis:

Privilege Tax on Loan Agencies. Under prior law, loan agencies were subject to an annual privilege tax of $750. Effective July 1, 1999, Section 2 of this act reduces the tax to $250 a year and expands its scope to apply to pawnbrokers and check cashers. This change is expected to reduce General Fund revenues by less than $300,000 a year. Pawnbrokers and check cashers are engaged in a similar business as loan agencies; the intent of the act is that similar taxpayers should be treated the same. Earlier versions of the bill would have retained the tax at $750, but the tax was reduced in response to complaints from pawnbrokers. The privilege tax statute caps at $100 the local privilege tax that counties and towns may levy on these businesses. Under former law, counties and towns were authorized to levy a local privilege tax of up to $275 on pawnbrokers.

Repeal Sales Tax Registration Fee. Under prior law, retailers and wholesalers were required to pay a fee of $15 when registering with the Department of Revenue for sales and use tax purposes. Registration is a one-time requirement before a merchant can begin a business that is subject to sales or use tax. Sections 1 and 1.1 of this act repeal the $15 fee effective January 1, 2000. Eliminating the fee will enable the Department of Revenue to handle registrations electronically. This change is expected to reduce General Fund revenues by approximately $540,000 a year.

Repeal Sales Tax on Medical Equipment and Sundries. Section 5 of this act exempts from sales tax durable medical equipment and medical sundries that are eligible for coverage under Medicare and Medicaid, effective October 1, 1999. This change is expected to reduce General Fund revenues by approximately $700,000 a year. The new exemption applies only to items purchased on prescription or by a certificate of medical necessity. While the item must be eligible under Medicare or Medicaid, the exemption applies whether or not it is purchased by a beneficiary under those programs. Durable medical equipment includes a variety of medical items such as wheelchairs, IV bag holders, and cane stands. Medical sundries are items that are easily and frequently disposed of, like latex gloves, gauze, medical tape, and syringes.

Repeal Sales Tax on Prescription Drugs. Sections 6 and 7 of this act exempt from sales tax all prescription drugs, effective October 1, 1999. This change is expected to reduce General Fund revenues by approximately $2 million a year. Under prior law, most prescription drugs were already either exempt from State and local sales and use taxes or refundable. The prior exemptions for prescription drugs applied to drugs purchased with a prescription (G.S. 105-164.13(13)), prescription drugs distributed free of charge by the manufacturer of the drugs (G.S. 105-164.13(13b)), and prescription drugs purchased for use in the commercial production of animals (G.S. 105-164.13(2a)). Prescription drugs distributed free of charge by the manufacturer include samples given to physicians to give to patients and drugs donated to groups such as the American Red Cross.

Most hospitals receive refunds of State and local sales and use taxes paid on prescription drugs they acquire. G.S. 105-164.14(b) allows all nonprofit hospitals, except those operated by the State, and all for-profit hospitals to receive refunds of State and local sales and use taxes paid on prescription drugs. G.S. 105-164.14(c) allows the University of North Carolina Hospitals at Chapel Hill to receive refunds of State and local sales and use taxes paid on prescription drugs acquired for use by the hospital. The State General Fund receives a refund of local sales and use taxes paid by the other State hospitals on prescription drugs.

Thus, after combining the exemptions and refunds for prescription drugs, the only entities that were paying tax on prescription drugs were physicians and other medical professionals who buy the drugs to administer to patients in the course of their practice and State hospitals, other than the UNC hospitals. The exemptions and refunds for prescription drugs had evolved over the years in a piecemeal fashion, leaving this small segment subject to the taxes.

In addition to the UNC hospitals, the State operates four psychiatric hospitals: Dorothea Dix Hospital, Broughton Hospital, Cherry Hospital, and John Umstead Hospital. The State also operates various Alcohol and Drug Treatment Centers and Mental Retardation Centers around the State. These centers are in-patient facilities similar to hospitals. State agencies generally do not receive a refund of State sales and use taxes. These agencies receive an appropriation from the State that includes the amount needed to pay sales and use taxes.

Repeal Sales Tax Exemption for Traded-in Items. Section 8 of this act simplifies the sales tax treatment of traded-in items by repealing the exemption for certain traded-in items, effective October 1, 1999. This change is expected to increase General Fund revenues by approximately $1.2 million a year. Under prior law, if a used item were traded-in on the purchase of a new item, the used item would not be subject to sales tax when it was resold if the person who traded it in paid the full amount of sales tax on the new item purchased. This law created problems for retailers who were required to retain the tax records on the new item with the used item to determine the sales tax treatment of the used item when it was resold. If the items in question were subject to a reduced tax rate, as farm equipment is, then upon resale the traded-in item would be subject to local but not State sales tax, an added complication for retailers. Under this section, traded-in items will be subject to full State and local sales tax, as other used items are.

Repeal Unconstitutional Sales Tax Provisions. Sections 9 and 10 of this act address two sales tax provisions that are probably unconstitutional. Under prior law, certain nonprofit corporations were not required to collect sales taxes on items sold as part of an annual fundraiser. To qualify for the exemption, the corporation was required to have been chartered in North Carolina for two years. This classification does not have a rational basis and thus probably violated the uniformity requirements of the constitution. Section 9 of this act repeals the requirement that the corporation be chartered in North Carolina, effective October 1, 1999. This change is expected to have a negligible impact on General Fund revenues.

Prior law granted a sales tax exemption for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use as component parts in free circulation publications that contained advertising of a general nature. The exemption applied to general shoppers guides but not to more specialized guides, such as real estate guides. The first amendment of the United States Constitution does not allow a state to discriminate between publications based on their content. The prior law exemption clearly violated this rule by exempting guides with general content but not those with narrower content. Section 10 of this act repeals the exemption, effective October 1, 1999, so that supplies sold for all free publications will be subject to tax on a uniform basis. This change is expected to increase General Fund revenues by approximately $2.5 million a year.

Airport Authority Sales Tax Refunds. Under prior law, a local airport authority created by local act of the General Assembly was entitled to an annual refund of sales and use taxes it paid if the local act creating it gave it all the rights of a municipality, declared it to be a municipality, or specifically authorized it to receive sales tax refunds. Section 14 of this act expands the refunds to all local airport authorities created by the General Assembly, effective for purchases made on or after July 1, 1999. This change is expected to reduce General Fund revenues by between $4,000 and $18,000 a year.

Under prior law, 24 of the 33 local airport authorities were authorized to receive the sales tax refunds. Each year, local bills would be introduced to grant refunds for additional airport authorities. Two were added in 1999 by S.L. 1999-104. Because there appeared to be no reason to distinguish between those authorities entitled to refunds and those not entitled to refunds, Section 14 provides that all local airport authorities will be treated alike and local bills will no longer be necessary to add airport authorities one by one to the refund provision.

The refunds apply to direct purchases of tangible personal property. They also apply to sales and use tax liability indirectly incurred by a local airport authority on building materials, supplies, fixtures, and equipment that become a part of any building that is owned or leased by the authority and is being built, altered, or repaired for use by the authority. To obtain a sales and use tax refund, an authority must request the refund in writing within six months after the end of its fiscal year. The request must include any information and documentation required by the Secretary of Revenue.

Tax Penalty and Assessment Changes. Sections 15, 16, 17, and 19 of this act make changes in tax penalties and tax assessment rules. The tax penalty changes are effective October 1, 1999, and the assessment changes are effective August 10, 1999. No estimate is available of the impact these changes will have on General Fund revenues.

Under prior law, the Secretary of Revenue was permitted to waive all tax penalties except the penalty for bad checks. The exception had been made at the request of the Department of Revenue to reduce the administrative burden of having to consider and act on waiver requests with respect to bad checks. Sections 15 and 17 repeal the exception for the bad check penalty, so that all tax penalties will be subject to the same waiver authority. This change is not expected to have a significant impact on General Fund revenues. The penalty for bad checks is 10% of the amount of the check, with a minimum of $1 and a maximum of $1,000.

Under prior law, there were three general categories of negligence penalties: a general negligence penalty of 10% and two large tax deficiency penalties of 25%. The large negligence penalty applied to income tax only if the taxpayer understated taxable income by an amount equal to ¼ or more of gross income. The large negligence penalty applied to other taxes if the taxpayer understated tax liability by ¼ or more. The large deficiency test for income taxes is more forgiving than the stricter large deficiency test for other taxes. Section 16 of this act, requested by the Department of Revenue, limits the more forgiving large deficiency test to individual incomes taxes and moves corporate income taxes to the stricter large deficiency test that applies to other taxes.

The authority of the Department of Revenue to assess taxes and to make refunds of taxes is subject to statutory time limitations. Under prior law, a taxpayer that is under investigation by the Department of Revenue could voluntarily waive the time limit for assessments in order to allow time for the investigation to be completed properly. The time limit for making refunds could not be extended, however. Thus, if the additional investigation to which the taxpayer agreed showed that a refund, rather than an assessment, was appropriate, the refund could not be made. Section 19 of this act, requested by the Department of Revenue, modifies the tax refund time limitations to state that the taxpayer's extension of the assessment time limits automatically extends the time in which the taxpayer can request a refund.

Special Mobile Equipment Changes. Sections 22, 24, and 27 through 29 of this act make changes related to special mobile equipment. Special mobile equipment is a vehicle that has a permanently attached crane, mill, ditch-digging apparatus, or similar attachment. The vehicle is driven on the highway only to get to and from a non-highway job. It is not designed or used primarily for the transportation of persons or property.

Sections 22, 24, and 27 address a problem relating to motor fuel tax. The motor fuel tax is designed to apply only to fuel used for highway purposes. Motor fuel used for non-highway purposes is instead subject to sales tax. Thus, special mobile equipment should not have to pay motor fuel tax on the fuel it uses for non-highway purposes. However, under prior law, it could not use dyed (untaxed) diesel fuel and was not authorized to receive a refund of motor fuel tax paid on clear (taxed) diesel fuel. Section 22 of this act provides that dyed (untaxed) diesel fuel may be used in special mobile equipment, effective October 1, 1999. Section 24 of this act allows a quarterly refund for tax paid on motor fuel used to operate special mobile equipment off-highway, effective for taxes paid on or after January 1, 1999. As a result of these changes, the motor fuel used in special mobile will be subject to sales tax rather than motor fuel tax. This change will result in a small but unknown reduction in Highway Fund revenues and a corresponding increase in General Fund revenues. Section 27 of this act increases the registration fee for special mobile equipment from $20 to $40, effective January 1, 2000. This increase should generate about $40,000 or more in annual Highway Fund revenues to offset the decrease that will result from the motor fuel tax changes in Sections 22 and 24.

Section 28 of this act expands the maximum width of special mobile equipment from 96 inches to 102 inches. Section 29 of this act provides that vehicles being towed by special mobile equipment may carry property that does not exceed the weight of the towed vehicle. These sections, effective August 10, 1999, conform the law to reflect prevailing practices with regard to special mobile equipment.

Miscellaneous Changes. The remaining sections of this act make minor changes to various tax law statutes.

- Political Parties Financing Fund. The law requires that the individual income tax return contain a line authorizing a contribution to the Political Parties Financing Fund. Section 3 of this act removes the requirement that the line be color-contrasted with the color scheme of the remainder of the return. Beginning next year, income tax returns will have a uniform ink color for purposes of optical character reading. With the implementation of optical character reading, the color contrast requirement is not compatible with efficient processing of the millions of tax returns filed each year because the contrast color would interfere with recognition of the proper fields.

- Definition of a Utility for Sales Tax Purposes. Sections 4 and 12 clarify the definition of a utility for sales tax purposes. Under prior law, the definition contained a sales exemption for municipalities that are supplied electricity by the federal government and are required to make payments in lieu of taxes. These sections move the exemption from the definition statutes to the exemption statutes. Under prior law, the definition included electric power companies subject to the gross receipts tax under G.S. 105-116. In anticipation of a possible rewrite of the gross receipts tax statutes as part of deregulation, these sections remove the cross-reference to the gross receipts tax and clarify that all sellers of electric power are considered utilities for sales tax purposes.

- No Sales or Use Tax/Certain Tangible Personal Property. Section 11 of this act provides that sales and use taxes do not apply to tangible personal property that a merchant manufactures or purchases for resale but then withdraws from inventory and donates to a governmental entity, effective October 1, 1999. This change is not expected to have significant impact on General Fund revenues. The prior law granted a tax exemption only for property donated to a nonprofit organization. In some cases, merchants donate property to schools or other governmental entities; this change allows these donations to benefit from the same sales tax exemption as donations to nonprofits. A wholesale merchant or retailer does not pay sales or use taxes when purchasing the products or the ingredients used to manufacture the products because the products are to be resold. Sales and use taxes do not apply to property purchased for resale or ingredients purchased to manufacture products for resale. If the wholesale merchant or retailer chooses not to sell the goods, the wholesale merchant or retailer becomes liable for use tax on the goods because the resale exemption no longer applies. Without these specific exemptions for donations, a merchant who donates to charity would become liable for sales and use tax.

- Increase Restaurant Services Charges Not Subject to Sales Tax. Section 13 of this act increases the amount of the service charge that may be added to a restaurant patron's bill without being subject to sales tax, effective October 1, 1999. Under prior law, sales tax applied to a service charge added to the sales price of food and beverages unless the service charge (1) did not exceed 15%, (2) was stated separately on the menu and the bill, and (3) was turned over to the personnel who served the meals. This section increases the maximum percentage of the service charge from 15% to

20%, to reflect the current practice in some restaurants. If the three conditions are met, the service charge is considered a tip and is not part of the sales price for sales tax purposes.

- Information Sharing/DOR and Law Enforcement. Section 18 of this act amends the tax secrecy law effective August 10, 1999, to allow the Department of Revenue to share with law enforcement agencies information about the tobacco products excise taxes, alcoholic beverages excise taxes, and unauthorized substances excise taxes, when this information is needed to fulfill a duty imposed on the Department of Revenue or on the law enforcement agency. The Department of Revenue works closely with law enforcement agencies to enforce the excise taxes on controlled substances and illicit liquor.

- Repeal Certain Motor Fuel Tax Licenses. Sections 20 and 21 of this act repeal the requirement that bulk end users and retailers of undyed diesel fuel get a motor fuel tax license, effective August 10, 1999. The licenses are not necessary because the Department of Revenue can obtain the same information from the Department of Agriculture and Consumer Services. Because there was no fee for these licenses, their repeal will have no fiscal impact.

  A motor fuel supplier that files a timely motor fuel tax return is allowed a discount of 0.1% of the tax due, not to exceed $8,000 a month, to cover the supplier's expenses incurred in collecting the motor fuel tax. Section 23 of this act clarifies that the discount is allowed only if the tax is paid on time, effective August 10, 1999.

  Under prior law, a bonded importer of motor fuel was required to obtain an import confirmation number using a transport truck to import fuel obtained from a supplier that is not a trustee for remittance of the motor fuel tax to the State on behalf of the importer. Section 25 of this act repeals this requirement effective August 10, 1999. The Department of Revenue requested this change, which is not expected to have any fiscal impact. The Department determined that the import confirmation number was not necessary because there are very few bonded importers in this category and the suppliers from whom they obtain the fuel have been collecting the tax and remitting it to the Department.

- DOR Authorized to Use State Directory of New Hires. Section 30 of this act allows the Department of Revenue to use information in the State Directory of New Hires for the purpose of administering the taxes it has a duty to collect. The State Directory of New Hires was established in 1997 to assist in the location of persons owing child support. The Department of Health and Human Services maintains the Directory. Every employer in the State must report to the Directory the hiring of every employee for whom a federal W-4 form is required to be completed. The report must contain the name, address, and social security number of the newly hired employee and the name, address, and federal and State tax ID numbers of the employer. This section became effective August 10, 1999.

TAX LIEN ADVERTISEMENT & COLLECTION

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-439	**HB 120**	**Representative Owens**

AN ACT TO IMPROVE THE PROCEDURES FOR NOTIFYING OWNERS AND ADVERTISING TAX LIENS ON REAL PROPERTY.

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Overview: This act makes the following changes relating to property tax collection, effective January 1, 2001:

- In the case of real property that the owner transferred after the January 1 visitation date, the taxing unit's newspaper advertisement of tax liens for delinquent taxes must be in the name of the person to whom the property was transferred.
- Before the newspaper advertisement is published, the tax collector must mail a notice to the listing owner and, if the listing owner has transferred the property after the visitation date, to the person to whom the property was transferred.
- It allows the taxing unit to begin in rem foreclosure proceedings 30 days after the tax liens are advertised, rather than waiting six months as required under prior law.

Fiscal Impact: Small, one-time impact on the costs of county operations.

Effective Date: January 1, 2001.

Background & Analysis: Property must be listed for property tax in January of each year. The listing owner is the taxpayer who owned the property as of January 1 (the visitation date). The listing owner is liable for property taxes for the fiscal year beginning July 1 following the visitation date, even if the property is transferred to another person after the visitation date. The taxes become due in September and become delinquent on January 6 of the following year. Although most counties send tax listing notices and tax bills to the taxpayer, they are not required by law to do so. Property owners are charged with notice that they must list their property for taxes and pay the taxes; otherwise, enforcement measures will be taken against the property. The legal effect of this law is to prevent a taxpayer from using lack of notice as an excuse for not paying property taxes or as a defense to a collection remedy against the property.

If property taxes remain unpaid by February of the fiscal year in which they become due, the taxing unit (a county, city, or taxing district) is required by statute to order the tax collector to advertise the tax liens in a local newspaper under the name of the listing owner. This act provides that the tax collector must send a notice of the amount of the tax liens by first class mail at least 30 days before the tax lien advertisement is to be published. The notice must go to the person who listed the property (the listing owner) and, if the property was transferred during the one-year period beginning on the January 1 visitation date preceding the fiscal year in which the taxes become due, also to the person to whom the property was transferred (the record owner).

This act also changes the content of the tax lien advertisement. Under prior law, the advertisements contained the listing owners' names followed by a description of the property and the amount of delinquent tax due. This act provides that each parcel's tax lien will be noted under the record owner's name rather than the listing owner's name if the property was transferred after the January 1 visitation date preceding the fiscal year the taxes become due.

If delinquent property taxes remain unpaid after the advertisement of the tax lien, the tax collector may begin an in rem foreclosure proceeding against the property. Under prior law, the tax collector was required to wait six months after the advertisement before foreclosing. The earliest tax liens can be advertised is March; therefore, September was the earliest an in rem foreclosure proceeding could be initiated. Because a local government's fiscal year begins July 1, the collection of property taxes through an in rem foreclosure proceeding could not begin until the succeeding fiscal year after the taxes are due. This act allows the tax collector to initiate an in rem foreclosure proceeding as early as 30 days after the tax liens were advertised. This change enables collectors to collect the taxes in the fiscal year in which they are due.

REGIONAL TRANSPORTATION AUTHORITY AMENDMENTS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-445	**HB 937**	**Representative Gray**

AN ACT TO AMEND THE REGIONAL TRANSPORTATION AUTHORITY ACT CONCERNING JURISDICTION OF THE ENTIRE AREA OF THE COUNTY IN CERTAIN CIRCUMSTANCES AND MEMBERSHIP OF THE AUTHORITY, AND TO AUTHORIZE THE AUTHORITY TO CREATE SPECIAL TAX DISTRICTS WITHIN ITS JURISDICTION.

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Overview: The act makes the following three changes affecting regional transportation authorities:

- **Jurisdiction of Piedmont Authority for Regional Transportation.** It expands the jurisdiction of a regional transportation authority (Piedmont Authority for Regional Transportation) to include the entire area of any county that has a member of its board of commissioners serving on the authority's board of trustees.

- **Membership of Piedmont Authority for Regional Transportation.** It expands the board of a regional transportation authority (Piedmont Authority for Regional Transportation) to include the chair of the airport authorities of the two most populous counties within the authority's jurisdiction.

- **Special Tax Districts.** It provides that a regional transportation authority (the Piedmont Authority for Regional Transportation) may create special tax districts consisting of one or more entire counties within the authority's jurisdiction and may levy its taxes within the special districts to the extent the taxes have not already been levied throughout the entire jurisdiction of the authority. The authority may not levy or increase a tax within the special district unless the board of commissioners of each county in the special district has adopted a resolution approving the levy or increase.

Fiscal Impact: The above changes affect only local revenues.

Effective Date: August 10, 1999.

Background & Analysis: In 1997, the General Assembly enacted S.L. 1997-417, which authorized a regional transit authority to levy a gross receipts tax of up to 5% on retailers within the region engaged in the business of renting passenger motor vehicles and motorcycles. The tax was expanded by S.L. 1999-452 to include property-hauling vehicles under 7,000 pounds. The tax applies only to short-term rentals, i.e., rentals for a period of less than one year. The tax is collected by the authority but is otherwise administered in the same way as the optional highway use tax on gross receipts from vehicle rentals. This optional highway use tax is 8% on short-term rentals, so the combined tax within the jurisdiction of the authority would be 13% if the authority levies the full 5%. Each authority may use the proceeds of the tax for its public transportation purposes. Before levying or increasing the tax, the authority must obtain approval from each county in the region.

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. The Authority created under Article 27 is the Piedmont Authority for Regional Transportation, which serves Forsyth, Guilford, Randolph, Davidson, and Alamance Counties.

The 1997 law also authorized the Piedmont Authority for Regional Transportation and any multi-county public transportation authorities organized under pre-existing law to levy a $5 vehicle registration tax identical to the tax already authorized for, and levied by, the existing Triangle Transit Authority. A public transportation authority is an entity created by one or more local government entities under Article 25 of Chapter 160A of the General Statutes to provide public transportation. There are three multi-county public transportation authorities.

The Choanoke Public Transportation Authority consists of Bertie, Halifax, Hertford, and Northampton Counties. The Kerr Area Transportation Authority consists of Franklin, Granville, Person, Vance, and Warren Counties. The Inter-County Public Transportation Authority consists of Camden, Chowan, Currituck, Pasquotank, and Perquimans Counties.

An authority must obtain the approval of each county within its jurisdiction before it can levy the $5 vehicle registration tax. The Division of Motor Vehicles will collect the tax in counties that are entirely located within the authority's jurisdiction. If the authority's jurisdiction includes just part of one or more counties, the authority will collect the registration tax in those parts of counties. The authority may contract with local governments to collect this tax.

Jurisdiction of Piedmont Authority for Regional Transportation. Under prior law, the jurisdiction of a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) included all or part of five contiguous counties whose boards of commissioners have representatives on the board of trustees, and included parts of other contiguous counties if the boards of commissioners of the affected counties consented by resolution. The authority's board of trustees could choose to add a member of the affected county's board of commissioners to the board of trustees. Section 1 of the act provides that if a member of an affected county's board of commissioners has been added to the authority's board of trustees, the authority's jurisdiction includes the entire area of the county. By expanding the jurisdiction of an authority, this change expands the authority's taxing power.

Membership of Piedmont Authority for Regional Transportation. The act expands the membership of a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) to include the chair of the principal airport authority or airport commission of each of the two most populous counties within the authorities jurisdiction. In the case of the Piedmont Authority for Regional Transportation, this means the chair of the Forsyth County Airport Commission and the chair of the Piedmont Triad Airport Authority.

Special Tax Districts. A regional transportation authority (either the Triangle Transit Authority or the Piedmont Authority for Regional Transportation) may levy within its jurisdiction the vehicle rental tax of up to 5% and the vehicle registration tax of up to $5, as described above. The act provides that if a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes (the Piedmont Authority for Regional Transportation) has not levied either tax up to the maximum rate, it may create a special tax district within its jurisdiction consisting of the entire area of one or more counties. The authority may levy within the special tax district the balance of either or both taxes, up to their maximum rates. The proceeds of a tax levied within a special tax district may be used only for public transportation purposes for the benefit of the special district. The levy and administration of a tax within a special district, like that of a tax within the entire jurisdiction of the authority, may not be levied unless there is a public hearing and each county in the special district has approved the tax. In addition, the authority may not levy or increase a tax within the special district unless the board of commissioners of each county in the special district has adopted a resolution approving the levy or increase.

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MOTOR VEHICLE TECHNICAL AMENDMENTS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-452	**HB 280**	**Representative Cole**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER CHANGES TO THE MOTOR VEHICLE LAWS.

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Overview: This act makes numerous changes to the motor vehicle laws and two changes to the tax laws. The tax law changes are:

- **Transit Authority Vehicle Rental Tax.** An expansion of the scope of the transit authority vehicle rental tax to include more types of vehicles.
- **DOR to Share Motor Fuel Tax Information.** An expansion of the Department of Revenue's authority to share motor fuel tax information to help in collecting motor fuel taxes.

Fiscal Impact: Insignificant impact.

Effective Date: October 1, 1999.

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Background & Analysis:

Transit Authority Vehicle Rental Tax. Sections 26 through 28 of this act broaden the scope of the transit authority vehicle leasing tax to include certain property-hauling vehicles, effective October 1, 1999. A regional transit authority may levy a gross receipts tax on a retailer who leases or rents vehicles. The tax rate may not exceed 5% of the gross receipts derived from the short-term (less than 365 continuous days) lease or rental of the vehicles. This tax is added to the lease or rental price and paid by the lessee. This act broadens the scope of this tax from its current scope (U-drive-it passenger vehicles and motorcycles) to include U-drive-it property-hauling vehicles as well. A U-drive-it vehicle is defined in G.S. 20-4.01 as any of the following rented to a person who will operate it: a motorcycle; a property hauling vehicle under 7,000 pounds rented for a term of less than one year (and not hauling products for hire); and a private passenger vehicle rented for a term of less than one year (and not rented to public schools for driver training instruction).

A regional transit authority is a regional public transportation authority created under Article 26 of Chapter 160A of the General Statutes or a regional transportation authority created under Article 27 of Chapter 160A of the General Statutes. The authority created under Article 26 is the Triangle Transit Authority for Wake, Durham, and Orange Counties. The Authority created under Article 27 is the Piedmont Authority for Regional Transportation, which serves Forsyth, Guilford, Randolph, Davidson, and Alamance Counties.

DOR Authorized to Share Motor Fuel Tax Information. The tax secrecy law authorizes the Department of Revenue to exchange taxpayer information with the Division of Motor Vehicles to the extent necessary for these agencies to fulfill their duties. Section 28.1 of this act amends this provision to allow the Department of Revenue to exchange information with the International Fuel Tax Association, Inc., as well, effective October 1, 1999. The International Fuel Tax Association is a nonprofit, membership organization whose mission is to provide oversight, planning, and coordination of activities necessary to promote uniform administration of the International Fuel Tax Agreement (IFTA). The IFTA is an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor fuel. These taxes are frequently referred to as road taxes or highway use taxes and are not to be confused with the motor vehicle titling tax enacted in 1989 that is also referred to as a highway use tax. The road tax is a tax on the amount of fuel a motor carrier uses in its operations in a state. The tax is at the same rate as the state's per-gallon excise tax on motor fuel and a credit is given for excise taxes paid to the state on motor fuel. Thus, the purpose of the tax is to tax motor carriers who drive in a state using fuel purchased in another state.

Under the IFTA, a motor carrier declares one member jurisdiction to be the carrier's base jurisdiction for registering the carrier's vehicles for purposes of the road taxes and reporting the taxes due to all the member jurisdictions. The base jurisdiction then collects the road taxes payable by the motor carrier to every member jurisdiction and remits the taxes collected to the appropriate jurisdictions. By centralizing the payment and collection of road taxes, the agreement greatly simplifies the payment of road taxes by motor carriers and the collection of road taxes by the member jurisdictions.

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MUNICIPAL INCORPORATION PROCESS

Session Law #	*Bill #*	*Sponsor*
S.L. 1999-458	**HB 964**	**Representative Jarrell**

AN ACT TO REVISE THE MUNICIPAL INCORPORATION PROCESS SO AS TO PROVIDE MORE SCRUTINY.

Overview: This act makes four changes to the municipal incorporation process:

- **Changes to Criteria for Municipal Incorporation.**

    - It requires that a petition filed with the Joint Legislative Commission on Municipal Incorporations contain a statement that the proposed municipality will have a budget ordinance with a property tax levy of at least five cents per $100.00 valuation upon all taxable property within its corporate limits and that the proposed municipality will offer four municipal services no later than the first day of the third fiscal year following the date of incorporation. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
    - It changes the criteria for incorporation that the Joint Legislative Commission on Municipal Incorporations considers when making its recommendation to the General Assembly on whether an area should be allowed to incorporate. Among these changes is the repeal of the development criteria in G.S. 120-169.1(a). This repeal is effective August 13, 1999.

- **Distribution of State-Shared Revenues and Local Sales Tax Revenues.**

    - It provides that a municipality, incorporated on or after January 1, 2000, may not receive local sales tax revenues or State-shared tax revenues unless it levies a property tax at a rate of at least five cents per $100.00 valuation upon all taxable property within its corporate limits, collects at least 50% of the property tax due, and provides at least four municipal services.
    - It provides that a municipality, incorporated on or after January 1, 2000, may not receive State-shared revenues or local sales tax revenues unless a majority of the mileage of its streets is open to the public.

The above changes, other than the repeal of the criteria for incorporation in G.S. 120-169.1(a), do not apply to any community that first filed a petition with the Joint Legislative Commission on Municipal Incorporations before July 20, 1999. These changes also do not apply to the Community of Gray's Creek in Cumberland County nor to the Community of Union Cross in Forsyth County if either community files a petition with the Commission before July 1, 2002.

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Fiscal Impact: Unable to determine.

Effective Date: *See Overview section.*

Background & Analysis: In 1985, the General Assembly created the Joint Legislative Commission on Municipal Incorporations. Although a municipality does not need the recommendation of the Commission to be incorporated, it is highly encouraged. Also Rule 35.1 of the permanent rules of the Regular Sessions of the House of Representatives of the

1999 General Assembly requires that a municipality seeking incorporation have an assessment report from the Commission before the House of Representatives may consider it.

Criteria for Municipal Incorporation. Prior to this act the Commission was required to give the proposed area to be incorporated a positive recommendation if the area met all of the following criteria:

- Petition requirements and notice requirements have been met.
- The proposed municipality is not located within one mile of a city of 5,000 to 9,999; within three miles of a city of 10,000 to 24,999; within four miles of a city of 25,000 to 49,999; or within five miles of a city of 50,000 or more. G.S. 120-166(b) sets out four exceptions to this requirement.
- The proposed municipality has a permanent population of at least 100.
- At least 40% of the area is developed for residential, commercial, industrial, institutional, or governmental uses, or is dedicated as open space. This requirement does not apply if the entire proposed municipality is within two miles of the Atlantic Ocean, Albemarle Sound, or Pamlico Sound.
- None of the proposed municipality is located within an existing municipality.
- The proposed municipality can provide at a reasonable tax rate the services requested by the petition and also can provide at a reasonable tax rate the types of services usually provided by similar municipalities.
- The proposed municipality plans to provide at least two municipal services.

The act changes the above criteria for municipal incorporation as follows:

- It adds a new requirement that the proposed municipality have a proposed budget ordinance with a property tax rate of at least five cents per $100.00 valuation upon all taxable property within its corporate limits. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
- It increases the number of services the proposed municipality must plan to provide from two to four. These services must be provided within the third fiscal year of incorporation. The types of services the municipality can offer include police protection, fire protection, solid waste collection or disposal, water distribution, street maintenance, street construction, street lighting, and zoning. This change applies to municipalities for which the Commission makes recommendations on or after August 13, 1999.
- It adds a requirement that the proposed municipality must have a population density of at least 250 persons per square mile. This is in addition to the pre-existing requirement of a permanent population of at least 100 persons. This change does not apply to any community that first filed a petition with the Commission before July 20, 1999.
- It removes the exception from the requirement that at least 40% of the area be developed for urban uses or dedicated as open space. This exception applied to a proposed municipality located within two miles of the Atlantic Ocean, Albemarle Sound, or Pamlico Sound. This change does not apply to any community that first filed a petition with the Commission before July 20, 1999.

- It repeals the development criteria set out in G.S. 120-169.1(a) of the General Statutes because it was in conflict with a pre-existing requirement for municipal incorporation. G.S. 120-169.1(a), enacted by the General Assembly in 1998, prohibited the Commission from making a positive recommendation on the proposed incorporation, unless the entire area met the development criteria for involuntary annexation set out in G.S. 160A-36(c) or G.S. 160A-48(c) of the General Statutes. These two sections of Chapter 160A required a higher percentage of urban use in the proposed municipality than the pre-existing requirement of 40% in G.S. 120-168. The repeal of G.S. 120-169.1(a) became effective August 13, 1999.
- It adds a requirement that the Commission must include in its report the impact on other municipalities and counties of the diversion of already levied local taxes and State-shared revenues to support services in the proposed municipality. This requirement does not apply to any community that first filed a petition with the Commission before July 20, 1999.

<u>Distribution of State-Shared Revenues and Local Sales Tax Revenues</u>. Cities receive the following State-shared taxes: the franchise tax in Article 3 of Chapter 105 on telephone companies, electric power companies, natural gas companies, and regional natural gas districts; the tax on motor fuel and alternative fuel in Articles 36C and 36D of Chapter 105; and the excise tax on malt beverages and wine in Part 4 of Article 26 of Chapter 105. Together these taxes contribute 10% to 25% of a city's general fund revenue. Under prior law, a municipality did not need to meet any conditions to receive local sales tax distributions. However, to receive motor fuel and alternative fuel tax revenue, known as Powell Bill funds, a municipality had to meet the following conditions:

- It has levied a property tax for the current fiscal year of at least five cents per $100.00 valuation upon all taxable property within its corporate limits.
- It has actually collected at least 50% of the total property tax levied for the preceding fiscal year.
- It has adopted a budget ordinance showing revenue received from all sources and showing that funds have been appropriated for at least two of the following services: water, wastewater, garbage collection, fire protection, police protection, street maintenance, or street lighting.

Pursuant to G.S. 136-41.1, the Powell Bill funds are allocated to municipalities based upon the municipality's population and the municipality's mileage of public streets that are not part of the State highway system. A municipality may use Powell Bill funds only for the purpose of maintaining, repairing, constructing, reconstructing, or widening public streets.

Effective for municipalities incorporated on or after January 1, 2000, the act increases the number of services a municipality must offer from two to four in order to receive Powell Bill funds. It also places the same conditions on the other State-shared revenues as well as on local sales tax distributions. Therefore, for a municipality incorporated on or after January 1, 2000, to receive franchise tax revenues, malt beverage and wine tax revenues, and local sales tax revenues, it must meet all of the following conditions:

- It levies a property tax of at least five cents per $100.00 valuation.

- It collected at least 50% of the total property tax levied for the preceding fiscal year.
- Its adopted budget ordinance shows that funds have been appropriated for at least four of the following services – police protection, fire protection, solid waste collection, water distribution, street maintenance, street construction, street lighting, and zoning.

The act further bars the distribution of revenue to municipalities that do not have public streets. Effective for distributions of State-shared revenues and local sales tax revenues made on or after July 1, 1999, a municipality incorporated on or after January 1, 2000, may not receive State-shared revenues or local sales tax revenues unless a majority of the mileage of its streets are open to the public. In recent years at least two municipalities have been incorporated that do not have streets open to the public. They are Grandfather Village in Avery County (S.L. 1987-419) and the newly incorporated Bermuda Run in Davie County (S.L. 1999-94). Since these two municipalities were incorporated before January 1, 2000, this restriction would not apply.