

2001 Tax Law Changes

RETIREMENT HOME TAX CHANGE

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-17	HB 193	Representative Jarrell

AN ACT TO PROVIDE A PROPERTY TAX EXCLUSION FOR CERTAIN QUALIFIED RETIREMENT FACILITIES THAT PROVIDE CHARITY CARE AND/OR COMMUNITY BENEFITS.

OVERVIEW: This act provides a property tax exclusion for certain qualified retirement facilities that provide charity care and/or community benefits. The percentage of the exclusion depends upon the percentage of the facility's resident revenue that is provided in charity care, in community benefits, or in both. This act was the result of a compromise reached by representatives from the continuing care retirement communities (CCRCs), the NC Department of Revenue, the NC Association of County Commissioners, and the NC Tax Assessors and Collectors.

FISCAL IMPACT: There is no fiscal impact on the General Fund. Estimates based on the best information available suggest this act could result in a loss of county revenues of \$1.7 million to \$2.5 million. Fiscal Research believes the actual cost of the exemptions could be higher. As a result, the range listed is actually a minimum estimate.

EFFECTIVE DATE: Effective for taxes imposed for taxable years beginning on or after July 1, 2001. In addition, an application for the benefit provided in this act for the 2001-2002 tax year is timely if it is filed on or before September 1, 2001.

ANALYSIS: Under G.S. 105-278.6, property owned by a nonprofit home for the aged, sick, or infirm is exempt from property tax if used for a charitable purpose. A charitable purpose is defined as "one that has humane and philanthropic objectives; it is an activity that benefits humanity or a significant rather than limited segment of the community without expectation of pecuniary profit or reward." From 1999 to 2001, G.S. 105-278.6A allowed an additional property tax exclusion to certain nonprofit CCRCs that did not meet the definition of "charitable purpose", but did meet all of the following conditions:

- The facility owns the property and uses it for a retirement community that includes a skilled nursing facility or an adult care facility and also includes independent living units. The community's grounds and buildings must be at a single site.
- The facility must be nonprofit and exempt from income tax, and its assets upon dissolution must revert to a 501(c)(3) charitable organization.
- The facility must have an active fund-raising program to assist it in providing services to those who do not have the financial resources to pay fees.

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

This property tax exclusion for CCRCs expired on July 1, 2001.

This act creates a permanent, complete or partial exclusion for CCRCs that provide minimum amounts of charity care and/or community benefits. First, this act modifies the language describing the property that is eligible for the exclusion. This was done to conform this description to the language in the statutes allowing property tax exemptions for property used for religious purposes, for educational purposes, and for religious educational purposes. This provision exempts the buildings, the land they actually occupy, and additional land reasonably necessary for the convenient use of these buildings if the buildings and land meet the conditions for eligibility described below.

Second, this act adds several new definitions to the statute. The new definitions define charity care, community benefits, financial reporting period, resident revenue, and unreimbursed costs.

Third, this act amends the current definition of “retirement facility” in two ways. It deletes the condition that the facility’s grounds and buildings be at a single site. This change will allow a CCRC to expand without requiring the purchase of contiguous land. In addition, it requires that the facility be licensed as a continuing care retirement community by the Department of Insurance. A licensed facility must provide a contract for continuing care that sets out provisions such as the total consideration to be paid and the services to be provided. The licensed facility must also give each prospective resident a detailed disclosure statement, and must maintain operating reserves equal to 50% of the total operating costs projected for the 12-month period following the period covered by the most recent annual statement filed with the Department of Insurance. G.S. 58-64-1 defines “continuing care” as "the furnishing to an individual other than an individual related by blood, marriage, or adoption to the person furnishing the care, of lodging together with nursing services, medical services, or other health related services, under an agreement effective for the life of the individual or for a period longer than one year."

Fourth, the act allows a total property tax exclusion for a retirement facility that satisfies each of the following conditions:

- It meets the new definition of a retirement facility.
- It meets the current conditions for a retirement facility; except that the facility’s governing board does not have to be selected by a charitable nonprofit that is exempt under section 501(c)(3) of the Code.
- It either (a) serves all residents without regard to the residents’ ability to pay, or (b) provides at least 5% of the facility’s resident revenue for the financial reporting period in charity care to its residents, in community benefits, or in both. The financial reporting period is the calendar year or tax year ending before the date the retirement facility applies for exclusion under this section. This is the same reporting period covered in IRS Form 990. The Internal Revenue Code requires 501(c) organizations to file 990s in order to receive tax-exempt status.

Fifth, the act allows a partial property tax exclusion for a retirement facility that satisfies each of the following conditions:

- It meets the new definition of a retirement facility.
- It meets the current conditions of a retirement facility, except that the facility's governing board does not have to be selected by a charitable nonprofit that is exempt under 501(c)(3) of the Code.
- It provides at least 1% of its resident revenue for the financial reporting period in charity care to its residents, in community benefits, or in both.

The partial exclusion is based on a sliding scale. The exclusion is equal to 80% of the assessed value if the facility provides a minimum of 4% of the facility's resident revenue in charity care and community benefits. The amount of the exclusion decreases by 20 percentage points for each percentage point decrease in resident revenue used to provide charity care and community benefits. The minimum partial exclusion is 20% of the assessed value if the facility provides a minimum of 1% of the facility's resident revenue in charity care and community benefits.

Sixth, this act clarifies that the owner of the facility must file annually for the property tax exclusion as required by G.S. 105-282.1. The application must contain the facts that entitle the owner to the exclusion.

LEASE-PURCHASE UP TO THREE PRISONS

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-84	SB 25	Senator Jordan

AN ACT TO CLARIFY THE STATE'S AUTHORITY TO LEASE-PURCHASE THREE CLOSE SECURITY CORRECTIONAL FACILITIES.

OVERVIEW: This act clarifies the procedure and financing for the State's authority to lease-purchase up to three close security correctional facilities. The initial construction loan for the prison must be obtained by the vendor on a private, taxable basis, and the State's acquisition of the constructed prisons will be financed with tax-exempt obligations. The act will save the State millions of dollars by clarifying the authorization of tax-exempt financing.

FISCAL IMPACT: The overall fiscal impact of the act is expected to be as follows:

	<u>FY 2001-02</u>	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>
General Fund Revenues*	0	0	\$800,000 to \$2,981,250	0	0
General Fund Expenditures	0	0	\$2,008,700 to \$6,010,200	\$6,236,980 to \$18,664,538	\$ 6,237,827 to \$18,663,007

* Revenues are investment earnings from the unspent "bond" proceeds in the year of issuance. (certificates of participation). Expenditures are based on the price range of leasing one to three prisons, and a 5.3% interest rate at the time the certificates of participation are issued (assuming a September 1, 2003 issuance date). The actual interest rate will affect fiscal impact.

EFFECTIVE DATE: This act became effective May 17, 2001.

BACKGROUND: In Section 18.20.(a) of S.L. 1999-237, the General Assembly enacted G.S. 148-37(b1) authorizing the Department of Correction to contract with private firms for the construction of prisons totaling up to 3000 cells, to be operated by the State under a lease with a schedule for purchase of the prisons over a period of up to 20 years.¹ The Department of Correction was required to consult with legislative leaders before entering into a contract. This 1999 legislation, effective July 1, intended that the State construction requirements, such as the multiple prime contractors rule, would not apply because the construction would be financed by private parties. It also intended that the State would begin leasing the prisons only after they had been completed, approved, and accepted.

The question of whether the prisons could be financed tax-exempt did not arise until after the 1999 legislation was enacted. The Department of Correction issued a request for proposals (RFP) requiring that the financing must not involve the State's credit (and thus must be taxable), consistent with an interpretation by the Attorney General's Office. After the RFP was issued, it was determined that the State could save millions of dollars if the prisons were financed on a tax-exempt basis. The Justice and Public Safety Subcommittee of the Joint Legislative Commission on Governmental Operations recommended that a new RFP be issued in accordance with proposed legislation to authorize tax-exempt financing.

ANALYSIS: This act clarifies that the initial construction loan must be obtained by the vendor on a private, taxable basis, and that the State's acquisition of the constructed prisons will be financed with tax-exempt obligations. The act provides that after the prisons are completed, approved, and accepted by the State, a nonprofit corporation controlled by the State would purchase the prisons from the vendor and lease them to the State under a lease-purchase agreement. The nonprofit corporation would finance its purchase price for the

¹ Projections of prison population by the Sentencing and Policy Advisory Commission indicate population will exceed prison bed capacity by 2002 and could exceed capacity by at least 3000 beds in 2005, without additional prison beds or changes in prison population.

prisons by selling tax-exempt obligations known as certificates of participation (COPs). The COPs represent interests in the nonprofit corporation's rights to receive the lease payments under the lease-purchase agreement with the State. The COPs are secured by a lien on the property, not by a pledge of the State's full faith and credit. The COPs are paid from the State's lease-purchase payments over the course of 20 years.

In January 2001, the Department of Correction issued a new RFP consistent with the financing arrangement clarified in this act. The RFP anticipated that vendors would provide separate bids for one, two, or three 1000-bed facilities. The bill had to be enacted in order for the contract to be awarded. The deadline for vendors to submit proposals was April 10, 2001, and three proposals were received. The Department of Correction was required to consult with the Joint Legislative Commission on Governmental Operations before making a final award decision. The final award decision was also subject to the approval of the Council of State.²

Under the plan of finance clarified in the act, there are separate contracts for construction, purchase, and lease-purchase of the prisons. The construction contract is between the vendor and the State. It requires the vendor to obtain its own construction financing, which must be derived solely from private funds. Because only private funds would be involved during the construction phase, and because the vendor is at risk for that construction financing until the completed facilities are delivered, requirements for public bidding of construction do not apply. While the facilities are being constructed, title will be in the vendor. The facilities will not be subject to local property taxes during this stage, however, because Section 15.(a) of S.L. 2001-427 enacted an exemption for correctional facilities being constructed on State land. The prisons are required to be built in accordance with plans and specifications developed by the Department of Correction, and the Department of Correction and the State Construction Office will inspect and review the facilities during construction to ensure that they are suitable for use and acquisition by the State.

The purchase agreement will be between the vendor and the State-created nonprofit corporation that will sell the tax-exempt COPs. The nonprofit corporation that sells the COPs is subject to the Public Records Act and the Open Meeting Laws. The purchase will take place only after the facilities are completed and accepted by the State. It is expected that the construction period will last two or two and one-half years. After the nonprofit corporation purchases the facilities, they remain exempt from local property taxes. The nonprofit corporation pays for the purchase with funds derived from the sale of the COPs. It is expected that the COPs will be sold close to the time of purchase, although the State may have the nonprofit corporation sell the COPs earlier if the State Treasurer determines that an earlier sale is to the advantage of the State. Even if the COPs are sold earlier, there will be no payments from the State's General Fund until after the prisons have been accepted and purchased. Because of the State's involvement, interest with respect to the COPs is tax-exempt.

² S.L. 2001-424 (SB 1005) and S.L. 2001-322 (SB 34) authorized the Department of Correction to contract for three prisons if approved by the Council of State. Approvals were received and construction began on two of the prisons in November 2001.

The lease-purchase agreement is between the nonprofit corporation and the State. Under the agreement, which must be approved by the Council of State and the State Treasurer, the State will make lease-purchase payments to the nonprofit corporation, which will use the funds to retire the COPs. The COPs will be secured by a lien on the property and the State's failure to make payments could result in its eviction from the property. The State Treasurer determines the price to be paid for the COPs and the rate of interest to be paid on them. The State will retain the option of refinancing the debt if interest rates fall. The State also retains the option of paying off its obligations and purchasing the property before the end of the lease-purchase period. Under the lease-purchase agreement, the State will own the facilities at the end of the lease term.

EXTEND TAX DEADLINE

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-87	HB 150	Representative Allen

AN ACT TO WAIVE THE PENALTIES FOR FAILURE TO MEET CERTAIN TAX-RELATED DEADLINES BECAUSE OF A PRESIDENTIALLY DECLARED DISASTER.

OVERVIEW: This act waives the penalties for failure to obtain a license, failure to file a return, and failure to pay taxes when due, if these activities should be performed during the period of time federal tax-related deadlines have been extended by the Secretary of the Treasury in an area of the State because of a Presidentially declared disaster.

FISCAL IMPACT: There is no fiscal impact because the act conforms State law to the actual administrative practice of the Department of Revenue.

EFFECTIVE DATE: The act became effective on May 17, 2001.

ANALYSIS: This act adds a new subsection to G.S. 105-249.2 that prohibits the Secretary from assessing any penalties for failure to obtain a business license, failure to file a return, or failure to pay taxes if the license, return, or taxes are due during the time federal tax-related deadlines are extended because of a Presidentially declared disaster. The taxpayer residing or having a business in the affected area is still liable for interest that accrues from the original due date until the date the tax is paid. This proposal codifies the Department of Revenue's current published penalty policy: the occurrence of a disaster is an automatic reason to waive penalties.

BACKGROUND:

Existing State Law

G.S. 105-237 authorizes the Secretary to waive or reduce any penalty. It is the policy of the Department of Revenue that the occurrence of a disaster is an automatic reason to waive penalties, but such a waiver was not previously required under North Carolina law.

In certain specific circumstances penalties must be waived. G.S. 105-249.2 provides that the Secretary of Revenue may not assess a penalty or interest against a taxpayer during any period that federal tax deadlines are postponed under the Code because of the taxpayer's service in a combat zone or the taxpayer's hospitalization because of injuries received while serving in a combat zone. The taxpayer is also granted an extension of time to file a return or take another action concerning a State tax during this period. A key distinction between this provision and the provision regarding Presidentially declared disasters is that this provision also prohibits the Secretary from assessing interest against a taxpayer³.

In addition, G.S. 105-263 authorizes the Secretary to extend the time to file a report or return with the Secretary. An extension for filing a franchise tax return, income tax return, or gift tax return does not extend the time for paying the tax due or the time when a penalty attaches. An extension for filing a report or any other return does extend the time for paying the tax due and the time when a penalty attaches. When an extension for filing a report or return extends the time for paying the tax expected to be due, interest accrues on the tax due from the original due date of the report or return to the date the tax is paid. This provision differs from the provision regarding Presidentially declared disasters in that it does not prohibit the assessment of penalties related to filing a franchise tax return, an income tax return, or a gift tax return.

Existing Federal Law

Section 7508A of the Code authorizes the Secretary of the Treasury to prescribe regulations to postpone certain deadlines for up to 120 days⁴ for a taxpayer affected by a Presidentially declared disaster area.⁵ A "Presidentially declared disaster area" means any disaster which, with respect to the area in which the property is located, resulted in a subsequent determination by the President that the area warrants assistance by the Federal Government under the Disaster Relief and Emergency Assistance Act. Deadlines that may be postponed are the same as ones postponed because of service in a combat zone. They include the deadlines for all of the following:

- Filing of any return of income, estate, or gift tax (except for employment or withholding taxes).
- Payment of any income, estate, or gift tax (except employment or withholding taxes).
- Filing of a Tax Court petition for redetermination of a deficiency or review of Tax Court decision.
- Allowance of a credit or refund.
- Filing of a claim for credit or refund.
- Bringing of any suit on the claim for credit or refund.
- Assessment of any tax.

³ This distinction is also made in the corresponding provisions in the Code, Sections 7508 and 7508A.

⁴ As of January 1, 2001, the reference date for the Code, deadlines could be postponed for up to 90 days, rather than 120 days, for a taxpayer affected by a Presidentially declared disaster.

⁵ Postponement does not apply to the determination of interest on any overpayment or underpayment. However, §6404(h) of the Code requires the IRS to abate the assessment of interest in Presidentially declared disaster areas if the time for filing an income tax return and paying income tax is extended.

- The giving or making of any notice or demand for payment of any tax or with respect to any liability to the United States in respect of any tax.
- The collection by levy or otherwise of any tax liability.
- The bringing of a suit by the U.S. with respect to any tax liability.
- Any other act required or permitted under the related regulations.

Previous disaster responses

After Hurricanes Fran and Floyd, the Department issued press releases granting an extension for tax-related deadlines. The extension allowed after Fran was in conformity with the extension granted by the IRS. However the extension allowed after Floyd was not as long as the IRS extension. After Floyd the State granted an extension to December 15, while the IRS extended the time for returns and payments and for enforcement activities to January 31. This discrepancy resulted in some taxpayers filing their State returns and making payments on the January 31 IRS extension date. These taxpayers were subject to additional interest and penalties. These penalties were waived if the taxpayer notified the Department.

PROPERTY TAX AMENDMENTS

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-139	SB 162	Senator Hartsell

AN ACT TO AMEND VARIOUS PROPERTY TAX LAWS.

OVERVIEW: This act is a recommendation of the Revenue Laws Study Committee. It makes the following changes to the property tax laws recommended to the Committee by the Department of Revenue, the Institute of Government, and the Association of Assessing Officers:

- It clarifies the application process for property tax exemptions and exclusions.
- It gives the assessor the authority to remove a property’s preferential tax classification if the taxpayer does not provide the assessor with the information requested to verify the property’s qualifications for the preferential tax classification. It provides that an owner has 60 days, rather than 30 days, to respond to the assessor's request for information. It also provides that any deferred taxes that were paid as a result of a revocation of present-use value status must be refunded to the taxpayer once the taxpayer has responded to the assessor's request for information unless the information discloses that the property no longer qualifies for the classification.
- It gives all boards of equalization and review the authority to meet after its adjournment date to hear cases related to use value, exempt property, discoveries, and motor vehicle valuation.
- It clarifies the changes allowed in a non-reappraisal year.
- It shortens the waiting period for in rem foreclosures.
- It conforms the interest rate on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes.

FISCAL IMPACT: The act's fiscal impact is expected to be minimal. Most provisions will have no impact. The use value, interest rate, and preferential tax treatment removal provisions could create a small revenue gain for local governments. However, because the primary effect of these sections of the act will be to prod taxpayers to act, no noticeable revenue increase is expected. The ability to change valuations in a non-revaluation year could result in a positive or negative revenue impact, depending on the changes made to the property and its use.

EFFECTIVE DATE: The part of the act that clarifies the changes allowed in a non-appraisal year becomes effective for taxes imposed for taxable years beginning on or after July 1, 2002. The part of the act that shortens the waiting period for in rem foreclosure proceedings became effective July 1, 2001, and applies to in rem foreclosure proceedings begun on or after that date. The part of the act that conforms the interest rate on unpaid motor vehicle taxes with other unpaid property taxes became effective for taxes imposed for taxable years beginning on or after July 1, 2001. The remainder of this act became effective on May 31, 2001.

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

Exemption and Exclusion Application Provisions (Section 1)

The act clarifies when an application for a property tax exemption or exclusion must be made. As a general rule, property tax exemptions and exclusions, and preferential property tax rates and values, must be applied for annually. However, some exemptions and exclusions may apply automatically, while others need to be applied for only once. The Department of Revenue, Property Tax Division, undertook a thorough examination of the exemptions and exclusions and their application process. Section 1 of this act represents its suggestion of the appropriate application time period for all of the property tax exemptions and exclusions. In most instances, the time period remains the same. However, in the following instances, annual application classifications are moved to a single application requirement: severable development rights, real and personal property belonging to the NC Low-Level Radioactive Waste Management Authority or to the NC Hazardous Waste Management Commission, objects of art held by the NC Art Society, property of private water companies, and Brownfields property. In four instances, the application period is changed so that the preferential classification attaches automatically without the property owner needing to apply at all: poultry, livestock, and feed used in the production of poultry and livestock; vehicles subject to the gross receipts tax on short-term rentals; buildings equipped with a solar energy heating or cooling system; and real property that lies within a transportation corridor.

Clarify Changes Allowed in a Non-revaluation Year (Section 2)

Effective for taxes imposed for taxable years beginning on or after July 1, 2002, the assessor may increase or decrease a property's value during a non-revaluation year for the following additional reasons:

- A change in value resulting from a physical change to the land or to the improvements on the land, such as an addition to a structure.
- A change in value resulting from a change in the legally permitted use of the property, such as a zoning change.

Annual Review of Property with Preferential Tax Treatment (Sections 3, and 4)

Under existing law, the assessor must annually review 1/8 of the properties exempt or excluded from taxation to verify that they continue to qualify for their exemption or exclusion. Likewise, the assessor must annually review 1/8 of the properties classified for present-use value to verify that they qualify for the preferential tax value. The law requires the owner to provide the information requested by the assessor to determine the property's qualifications for the exemption or exclusion. However, the law does not penalize the taxpayer if the taxpayer fails to comply with the request. The act provides a consequence if the owner fails to give the requested information to the assessor. If the owner does not without good cause provide the information within 60 days from the date of the assessor's written request, the owner loses the preferential tax classification.

Annual Review of Transportation Maps (Section 5)

The act requires the assessor to annually review the transportation corridor official maps and amendments to them. These properties are currently taxed at 20% of the general tax rate. Under prior law, a taxpayer had to apply for this preferential tax rate. However, under the act, the preferential tax rate will attach to the property automatically (See Section 1). To ensure proper oversight of the preferential classification, the act also provides that the assessor must annually review the transportation corridor official maps.

Allow E&R Board to Meet After Adjournment to Hear Use Value, Exempt Property, Discoveries, and Motor Vehicle Cases (Sections 6 and 7)

The act provides that a county board of equalization and review may meet after its adjournment date to hear appeals relating to motor vehicle property taxes, discoveries, and property reviewed annually to determine its continued qualification for exemption or exclusion. Cabarrus, Lincoln, and Stokes Counties already have this authority under local acts.

Interest Rate on Unpaid Motor Vehicle Taxes (Section 8)

The act conforms the interest rate due on unpaid motor vehicle taxes to the interest rate due on other unpaid property taxes: 2% for the first month following the date the taxes were due and $\frac{3}{4}\%$ for each month thereafter. Under prior law, the amount of interest due on unpaid motor vehicle taxes was $\frac{3}{4}\%$ per month. This amount was not enough to encourage people to pay their tax in a timely manner.

Shorten Waiting Period of In Rem Foreclosures (Section 9)

The act shortens the waiting period of in rem foreclosures from six months to three months. Prior law allowed a property tax judgment to be executed at any time after six months and before two years from the indexing of the judgment. This change allows the judgment to be acted upon within three months of the date the judgment is indexed.

VARIOUS MOTOR FUEL TAX CHANGES

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-205	SB 967	Senator Kerr

AN ACT TO MAKE TECHNICAL AND ADMINISTRATIVE CHANGES TO THE MOTOR FUELS TAX LAW.

OVERVIEW: This act clarifies information sharing, provides a procedure for fuel tax refunds using third party credit cards, modifies refunds for kerosene used for certain non-highway purposes, and makes technical changes to the motor fuel tax laws, as requested by the Department of Revenue.

FISCAL IMPACT: No estimate available. The acceleration of kerosene tax refunds will produce a minor loss of interest revenue to the Highway Fund/Highway Trust Fund, and a corresponding minor gain of interest for the General Fund because of sales tax paid on exempt motor fuels.

EFFECTIVE DATE: This act became effective October 1, 2001, except for the section allowing the sharing of information, which became effective June 18, 2001.

ANALYSIS: First, the act makes an exception to the tax secrecy law to allow the Department of Revenue to provide identifying information about motor carriers whose licenses have been revoked. The information can be provided only to the administrator of a national criminal justice system that serves as an information clearinghouse for use only by criminal justice agencies and public safety organizations. The Department of Revenue currently participates in such a system, the State On-Line Enforcement Network (STOLEN). Sharing information about motor carriers whose licenses have been revoked will promote cooperative efforts under the International Fuel Tax Agreement (IFTA), 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. 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 IFTA greatly simplifies the payment of road taxes by motor carriers and the collection of road taxes by the member jurisdictions.

Second, the act establishes a procedure for administering tax refunds on fuel sold to an exempt entity that uses a third-party exempt credit card to purchase the fuel, effective October 1, 2001. Under existing law, an entity whose use of motor fuel is exempt from tax may obtain a refund of the tax it pays on fuel. In the alternative, a person who sells motor fuel to an exempt entity may obtain a refund of the tax it pays on the fuel if it does not pass the tax on to the exempt entity. The prior law also specified that a supplier may issue a card

or code to the exempt entity that enables the entity to purchase motor fuel at retail without paying the tax. The supplier is liable if such a card is issued to an entity whose use of fuel is not exempt. The exempt entity is liable if it uses the card to purchase fuel for a purpose other than an exempt purpose. The prior law did not cover a third situation: when a credit card company, rather than the supplier, issues the exempt card. When the exempt entity uses the exempt card to purchase motor fuel, the seller does not charge the entity for the tax but subsequently bills the credit card company for the entire sale, including the tax. The credit card company pays the seller and seeks a refund of the tax from the State. Section 3 of the act provides that the credit card company may obtain a refund of the tax in this situation. Section 4 of the act provides that the credit card company is responsible for determining that the entity to which the card is issued is exempt, and provides that the credit card company is liable if the card is issued to an entity that is not exempt. Section 5 of the act authorizes the Secretary of Revenue to require a credit card company to file a bond if the Secretary determines after an audit that a bond is necessary to assure collection of tax due pursuant to the audit.

Third, the act expands the situations in which a monthly rather than an annual refund is allowed for motor fuel tax paid on kerosene, effective October 1, 2001. Under existing law, if a person purchases tax-paid fuel and uses it for a non-highway purpose, the person can get an annual refund of the fuel tax (less the applicable sales tax). In addition, a distributor may obtain a monthly refund for fuel tax it pays on kerosene it dispenses into an end user's storage facility that contains fuel used only for heating. This monthly refund is not net of applicable sales tax, but the distributor collects and remits sales tax on the sale to the end user. The act adds two more exempt purposes to the distributor's monthly refund: drying crops and manufacturing. Heating, drying crops, and manufacturing are the same three purposes designated in the statute allowing dyed (untaxed) diesel fuel to be stored in containers installed in a manner that makes it improbable that the fuel can be used for any purpose other than those three.

Finally, Section 2 of the act corrects a cross-reference and Section 7 makes a technical change to the diesel fuel storage statute.

SPECIAL OBLIGATION BONDS FOR WATER/SEWER

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-238	SB 123	Senator Carpenter

AN ACT TO AUTHORIZE LOCAL GOVERNMENTS TO ISSUE SPECIAL OBLIGATION BONDS FOR WATER AND SEWER PROJECTS.

OVERVIEW: This act expands local governments' existing authority to issue special obligation bonds for solid waste projects to include water and sewer projects.

FISCAL IMPACT: This act will have no direct impact on State or local revenues or expenditures. Once the financing option is used, the local unit will incur debt service requirements. These needs will be funded from the dedicated revenue sources.

EFFECTIVE DATE: This act became effective June 23, 2001.

ANALYSIS: In 1989, the General Assembly authorized local governments to issue special obligation bonds to finance solid waste management projects. This act expands their authority to issue special obligation bonds for the following types of water and sewer projects:

- A water supply system, as defined in G.S. 159G-3.
- A water conservation project, as defined in S.L. 1998-132.
- A water reuse project, as defined in S.L. 1998-132.
- A wastewater collection system, as defined in G.S. 159G-3.
- A wastewater treatment works, as defined in G.S. 159G-3.

A special obligation bond does not require a vote of the people because it does not pledge the taxing power or full faith and credit of the government issuing the bond. The bond is secured by a pledge of designated nontax revenues. The nontax revenues can be fees or they can be taxes that are levied by another unit of government and shared with the local government that proposes to issue the special obligation bonds. For example, a city can pledge its share of local sales and use taxes because the county levies those taxes. A county can pledge landfill fees or State-shared tax revenue, such as deed stamp tax revenue. Special obligation bonds are sometimes more appropriate than installment purchase financing for solid waste projects because lenders are reluctant to take a security interest in solid waste projects due to potential liability for environmental contamination.

MAKE MEALS TAX PENALTIES UNIFORM

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-264	HB 1448	Representative Buchanan

AN ACT TO PROVIDE UNIFORM PENALTIES FOR LOCAL MEALS TAXES.

OVERVIEW: This act makes all local meals tax penalties uniform by applying the existing State sales and use tax penalty charges to meals taxes. This act will improve tax administration by making the tax penalties for each local meals tax uniform.

FISCAL IMPACT: Four counties and one town are currently collecting a meals tax. They are Cumberland County (S.L. 93-413), Dare County (S.L. 91-177), Mecklenburg County (S.L. 89-821 and S.L. 89-922), Wake County (S.L. 91-954 and S.L. 95-458), and the Town of Hillsborough (S.L. 93-449 and S.L. 99-304). Under prior law, Mecklenburg County

collected \$177,000 in penalties in the previous fiscal year. Because 98% of that revenue was from the \$10 per day penalty, which is not in the sales tax law, they could see a revenue decrease. Wake County will not be impacted as they already adhere to the sales tax law on penalties. Dare County collected \$8,090.50 in meals tax penalties in FY 1997-98 and \$7,060.66 in the previous year. No estimate is available on how the act will change this revenue stream. No data is available from Cumberland County or Hillsborough.

EFFECTIVE DATE: The act became effective October 1, 2001.

ANALYSIS: G.S. 105-236 sets out the penalties that apply to State taxes, including sales taxes. It provides that the penalty for failure to file is 5% of the tax due per month, up to a maximum of 25%. The penalty for failure to pay tax is 10% of the tax due. In the case of negligence, there is a 10% penalty, which increases to 25% if the amount of the deficiency is more than 25% of the tax liability.

This act extends the above uniform penalty provisions that apply to State sales and use taxes to all local meals taxes. Because local meals taxes are a type of sales tax and the retailers who collect those taxes also collect sales taxes, the tax system is much simpler if taxpayers do not have to keep up with different penalties for different taxes in different localities. The governing board of a taxing city or county is also given the same authority to waive the penalties for a local meals tax that the Secretary of Revenue has to waive the penalties for State sales and use taxes.

CORRECT **DRY-CLEANING/WHITE GOODS LAWS**

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-265	HB 1062	Representative Gibson

AN ACT TO CORRECT CERTAIN ENVIRONMENTAL LAWS RELATING TO THE DRY-CLEANING SOLVENT CLEANUP ACT OF 1997 AND THE MANAGEMENT OF WHITE GOODS.

OVERVIEW: This act makes two changes to the tax laws concerning the dry-cleaning solvent tax and the white goods tax. The act moves up the effective date of a tax increase on dry-cleaning solvents from October 1, 2001, to August 1, 2001, and it restored a prohibition on the taxation of white goods by local governments that was mistakenly repealed in an earlier session.

FISCAL IMPACT: The act generates an additional \$87,572 for the Dry-Cleaning Solvent Cleanup Fund. This amount represents the revenue estimated to be generated during the months of August and September 2001 by the dry-cleaning solvent tax.

EFFECTIVE DATE: July 4, 2001.

ANALYSIS: This act makes several changes to the laws regarding the management of white goods and the cleanup of properties contaminated with dry-cleaning solvent. Two of the changes are finance related.

The General Assembly enacted the Dry-Cleaning Solvent Cleanup Act of 1997 to facilitate the cleanup of contamination at dry-cleaning facilities. The 1997 Act provides that owners of dry-cleaning facilities, after satisfying applicable deductibles and co-payments, may seek reimbursement from the Dry-Cleaning Solvent Cleanup Fund (Fund) for costs associated with the cleanup of contaminated dry-cleaning sites. The Fund is funded by a tax on dry-cleaning solvent and by an earmarking of 15% of the revenue generated from the sales tax on dry-cleaning and laundry services. In S.L. 2000-19, the General Assembly increased the tax on the solvent, effective October 1, 2001, from \$5.85 to \$10 per gallon of dry-cleaning solvent that is chlorine-based and from \$0.80 to \$1.35 per gallon of dry-cleaning solvent that is hydrocarbon-based. This act moves up the effective date of the increase in the tax rate on dry-cleaning solvent from October 1, 2001, to August 1, 2001.

The act also restores a prohibition on the taxation of white goods by local governments that was mistakenly repealed by legislation in 1998. Since no local governments have taken advantage of this oversight to create their own white goods tax, there is no fiscal impact from these sections. These sections became effective retroactively.

ELECTRONIC LISTING FOR PROPERTY TAXES

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-279	SB 365	Senator Reeves

AN ACT TO PROVIDE FOR ELECTRONIC LISTING OF BUSINESS PERSONAL PROPERTY FOR AD VALOREM TAXES AND TO ALLOW COUNTIES TO EXTEND THE LISTING PERIOD FOR ELECTRONIC LISTING.

OVERVIEW: This act authorizes counties to allow electronic listing of business personal property and to extend from January 31 to until June 1 the deadline for listing business personal property electronically.

FISCAL IMPACT: Because the act is permissive, it is not known what impact it may have on counties.

EFFECTIVE DATE: July 13, 2001.

ANALYSIS: This act allows the board of county commissioners to adopt a resolution authorizing the electronic listing of business personal property. If the county commissioners

adopt such a resolution, then the assessor must publish this information, including the timetable and procedures for electronic listing, in the notice informing taxpayers of the listing process. The act provides that the listing may be signed electronically. An abstract submitted by electronic listing would be considered filed when received in the office of the assessor.

In 2000, the General Assembly enacted Article 11A of Chapter 66 of the General Statutes, to encourage government agencies to provide electronic access to their services, and Article 11B of Chapter 66 of the General Statutes, to provide for the development of centralized Web portals to allow citizens to access State government services. In 2000, the General Assembly also enacted the Uniform Electronic Transactions Act (UETA), Article 40 of Chapter 66 of the General Statutes. In general, UETA provides a legal framework for electronic transactions and gives electronic signatures and records the same validity and enforceability as manual signatures and paper-based transactions, without changing any of the substantive rules of law that would otherwise apply. UETA applies only to transactions in which each party has agreed to conduct the transaction electronically. UETA sets forth four fundamental provisions:

- A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.
- A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.
- Any law that requires a writing will be satisfied by an electronic record.
- Any signature requirement in the law will be met if there is an electronic signature.

This act also authorizes counties to extend the listing period for business personal property listed electronically. Under existing law, a county may, for good cause, give a taxpayer an extension until April 15 to list property. An April 15 deadline is often difficult for taxpayers to meet because the general income tax deadline is also April 15. Under this act, if a county allows electronic listing of business personal property, it may extend the period for electronic listing until as late as June 1. Counties may be reluctant to extend the electronic listing deadline as late as June 1 because this deadline might prevent a county from meeting its budget-making responsibilities in a timely manner. The Local Government Budget and Fiscal Control Act require local governments to have a balanced budget. The tax rate for the upcoming fiscal year, and the appropriations, must be set in the budget ordinance. In order to determine the appropriate tax rate, the tax base must be determined. The budget ordinance must be adopted no later than July 1 and it must be presented to the board at least 10 days prior to its adoption. In fact, many local governments adopt their budget ordinances by mid-June.

PROPERTY TAX HOMESTEAD EXCLUSION

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-308	HB 42	Representative Allred

AN ACT TO PROVIDE PROPERTY TAX REDUCTIONS BY AUTHORIZING LOCAL GOVERNMENTS TO REDUCE PROPERTY TAXES IN LIGHT OF THE GOVERNOR'S UNANTICIPATED RELEASE OF WITHHELD REIMBURSEMENTS AND BY EXPANDING HOMESTEAD PROPERTY TAX RELIEF FOR ELDERLY AND DISABLED HOMEOWNERS.

OVERVIEW: This act amends the property tax homestead exclusion and gives local governments the authority to lower their property taxes as a result of unanticipated revenues. Sections 1 and 2 of the act amend the property tax homestead exclusion in three ways:

- It expands the homestead exclusion amount from \$20,000 to the greater of \$20,000 or 50% of the tax value of the property. (Recommendation of the Revenue Laws Study Committee)
- It increases the income eligibility amount from \$15,000 to \$18,000, and for every year thereafter, it adjusts the income amount by a percentage equal to the cost of living adjustment (COLA) percentage used to increase social security benefits for the preceding calendar year. (Recommendation of the Revenue Laws Study Committee)
- It extends the time allowed for a person to submit an application for the exclusion from April 15 until June 1.

The act does not provide for any local government reimbursement. Section 3 of the act gives local governments the authority to lower their property tax rates as a result of unexpected revenues received after July 1, 2001. This authority expires October 1, 2001.

FISCAL IMPACT: There is no fiscal impact on the General Fund. The overall estimated impact on local governments due to changes in the property tax homestead exclusion is as follows:

(\$ million)

<u>FY 2002-02</u>	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-05</u>
0	(11.8)	(12.0)	(12.2)	(12.5)

No estimate is available for Section 3 of the act, which grants local governments the authority to reduce property tax rates until October 1, 2001.

EFFECTIVE DATE: Sections 1 and 2 of the act become effective for taxes imposed for taxable years beginning on or after July 1, 2002. Section 3 of the act became effective July 1, 2001, and expires October 1, 2001.

HOMESTEAD EXCLUSION ANALYSIS: The homestead exclusion is a partial exclusion from property taxes for the residence of a person who (1) is either age 65 or older or totally and permanently disabled and (2) has an income of not more than \$15,000. The current exclusion from property taxes is \$20,000. This exclusion amount was last increased in 1996, when it was increased from \$15,000 to \$20,000. The income eligibility amount was last increased in 1996, when it was increased from \$11,000 to \$15,000. The income used to determine the income eligibility amount includes moneys received from every source other than gifts or inheritances received from a spouse, lineal ancestor, or lineal descendant. For married applicants residing with their spouses, the income of both spouses is included, whether or not the property is in both names.

Prior to 1987, local governments absorbed most of the cost of the homestead exclusion. From 1987 to 1991, the State reimbursed counties and cities for 50% of their losses from the homestead exclusion. In 1991, the General Assembly froze the amount of reimbursements made to local governments to the amount each city and county was entitled to receive in 1991. That amount is approximately \$7.9 million. No additional reimbursement was provided when the exclusion amount was increased in 1993. The State reimbursed counties and cities for 50% of the loss they incurred for two years when the exclusion amount and the income eligibility amount were increased in 1996.

This act changes the property tax homestead exclusion in three ways:

- increases the homestead exclusion amount for eligible property owners whose homes are appraised at a value greater than \$40,000. The act provides that the homestead exclusion amount is \$20,000 or 50% of the tax value of the home whichever is greater. This was a recommendation of the Revenue Laws Study Committee.
- increases the income eligibility amount from \$15,000 to \$18,000. For every year thereafter, it indexes the income eligibility amount of \$18,000 by a percentage equal to the cost-of-living adjustment (COLA) percentage used to increase social security benefits for the preceding calendar year. The automatic COLAs for social security benefits are announced in October of each year. The COLAs are based on increases in the Consumer Price Index for Urban Wage Earners and Clerical Workers from the third quarter of the prior year to the corresponding quarter of the current year in which the COLA is effective. The COLA for 2000 was 3.5%. The Revenue Laws Study Committee had recommended that the income eligibility amount of \$15,000 be indexed by a percentage equal to COLA.
- extends the time a person has to apply for the homestead exclusion from April 15 to June 1. Under the existing law, a person must file for preferential property tax classifications during the regular listing period, which ends January 31.⁶ However, an application for the homestead exclusion may be made and must be accepted at any time prior to April 15. This act extends this period until June 1.

During the 2001 Session, a total of six homestead bills were introduced.⁷

⁶ A board of county commissioners may accept an untimely application upon a showing of good cause by the applicant. G.S. 105-307

⁷ HB 11 would have raised the income eligibility amount to \$25,000. HB 50 and SB 90 would have authorized a constitutional amendment to be considered by voters to give counties the option of further increasing the homestead exclusion amount and the income eligibility amount. SB 298 would have raised the income

Authorization for Local Governments to Reduce Property Tax Rate: The act gives local governments the authority to lower their property tax rates as a result of unexpected revenues received after July 1, 2001.⁸ This is a one-time change that expired October 1, 2001. This change was proposed after Governor Mike Easley placed the \$95 million April inventory tax reimbursement in escrow because of the budget shortfall and then unexpectedly released the reimbursement to the local governments effective June 30, 2001.⁹ Local governments cannot make a change in their property tax rates after July 1 without legislative authorization, because G.S. 159-13 requires that they adopt a budget ordinance no later than July 1.

ENFORCE TAX COMPLIANCE & EQUALITY

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-327, as amended by S.L. 2001-427	HB 1157	Representatives Hackney

AN ACT TO COMBAT TAX FRAUD, ENHANCE CORPORATE COMPLIANCE WITH TAXES ON TRADEMARK INCOME, ASSURE THAT FRANCHISE TAX APPLIES EQUALLY TO CORPORATE ASSETS, AND CONFORM CORPORATE DIVIDEND TREATMENT TO THE GENERALLY ACCEPTED FORMULA USED IN OTHER STATES.

OVERVIEW: This act makes three corporate tax law changes:

- It clarifies that income from using trademarks in this State is taxable to this State and provides a reporting option for royalty payments between related parties.¹⁰

eligibility amount and the homestead exclusion amount to \$25,000. HB 102, recommended by the Revenue Laws Study Committee, would have adjusted the income eligibility amount by the same percentage as the COLA percentage and the exclusion amount to \$20,000 or 50% of the value of the property, whichever is greater. HB 42 initially would have increased the income eligibility amount and homestead exclusion amount to \$30,000 for the first year, and then indexed these amounts for each year thereafter using the Consumer Price Index.

⁸ Only one county exercised this authority. Anson County lowered its property tax rate from 90¢ to 87¢ on the \$100 of appraised value of property subject to taxation.

⁹ S.L. 2001-424 repeals all of the State reimbursement payments to local governments, effective beginning with the 2003-04 fiscal year. State reimbursements are amounts distributed to local units to compensate them for revenue lost as a result of the removal by the General Assembly of property from the local sales and use tax base, the local property tax base, or the intangibles tax base. State reimbursements consist of reimbursements for the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exemption" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps.

¹⁰ The Senate initially considered this part of the act in SB 1058, introduced by Sen. Kerr. It was a recommendation of the Governor's Loophole Study Commission and the Governor. The Senate included it as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

- It provides that franchise tax will apply equally to corporate assets held by affiliated LLCs so that a corporation cannot avoid paying franchise tax on its assets by transferring them to an affiliated LLC. It also restates the fraud penalty for willful evasion of franchise tax on these assets.¹¹
- It piggybacks the federal dividends received deduction for State corporate income tax purposes.¹²

The act also requires the Department of Revenue to report to the Revenue Laws Study Committee on its implementation of this act by December 1, 2001.¹³ The Department must also report on the effects of this act to the Committee by May 1, 2002, and December 1, 2002.

FISCAL IMPACT: The fiscal impact of this act is as follows:

(\$millions)

	<i>FY 01-02</i>	<i>FY 02-03</i>	<i>FY 03-04</i>	<i>FY 04-05</i>	<i>FY 05-06</i>
LLC's	\$10.5	\$11.0	\$11.4	\$11.7	\$12.2
Royalty Provision	20.0	21.0	21.8	22.4	23.3
Subsidiary Dividends	30.8	32.3	33.6	34.5	35.9
Total	\$61.3	\$64.3	\$66.8	\$68.6	\$71.4

EFFECTIVE DATE: The LLC franchise tax provision is effective for taxes due on or after January 1, 2002. The other two changes are effective for tax years beginning on or after January 1, 2001.

ANALYSIS:

Royalty Reporting Option

This part of the act enhances corporate compliance with taxes on trademark income by partially closing a loophole that allows a corporation to avoid North Carolina tax on income from using intellectual property in this State when the corporation transfers the intellectual property to a related company in another state. This provision solves the problem as it relates to trademarks and trade names, but does not address other types of intellectual property, such as patents, or other types of intangible assets. The provision is effective beginning with the 2001 taxable year.

The act creates a new statute in the Corporate Income Tax Act addressing trademark payments between related members. It states that royalties received for the use of

¹¹ The Revenue Laws Study Committee recommended legislation on this issue – SB 242 introduced by Sen. Dalton. It was also a recommendation of the Governor's Loophole Study Commission and the Governor. As a result of study and talks during the session, this act addresses the loophole differently. The Senate included this provision as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

¹² The Governor's Loophole Study Commission and the Governor recommended this provision to the General Assembly. The Senate included it as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

¹³ The Revenue Laws Study Committee did not meet prior to December 1, 2001, because the 2001 Legislative Session did not end until December 6, 2001. The Department of Revenue sent a memorandum to the Committee's chairs, Sen. John Kerr and Rep. Paul Luebke, on November 30, 2001, reporting on the Department's implementation of the act.

trademarks in this State are income derived from doing business in this State and thus are subject to North Carolina income tax. Some corporations have argued that an out-of-state investment company's receipt of royalty income from the use of trademarks in this State does not subject the investment company to North Carolina income tax on the royalties. Some corporations have relied on such an argument to create an arrangement to avoid North Carolina tax on their North Carolina income.

For example, a corporation may have substantial profits from operating retail stores or manufacturing facilities in North Carolina. As part of its business, it uses trademarks on these stores or on the goods it manufactures. The operating corporation creates a subsidiary in another state and transfers its trademarks to the subsidiary. It owes the subsidiary royalties for the use of the trademarks in North Carolina. If the operating corporation is late paying these royalties, it also owes the subsidiary late fees. The operating corporation deducts against its North Carolina income the royalties and late fees it owes the subsidiary. The subsidiary likely pays little or no tax to another state on these receipts because the receipts may be exempt or apportioned away from that state. The subsidiary's receipts are paid back to the operating corporation as dividends but remain free of North Carolina tax because subsidiary dividends are deductible. As a result of this arrangement, although the operating corporation may generate substantial profits from its retail or manufacturing activities in the State, it ends up paying little or no North Carolina tax on these profits by deducting the royalties and late fees it passes through its subsidiary in another state.

This provision addresses these arrangements first by restating that a company's receipts from royalty payments for the use of trademarks in North Carolina are income from doing business in North Carolina. Then it provides adjustments to assure full and fair accountability of this income in relationship to where it is actually earned. In cases where the recipient of the North Carolina royalty income is unrelated to the payer, the recipient is required to pay tax on the income to North Carolina. In cases where the recipient and the payer are related, they have an option on how the income is reported to North Carolina. Either the payer can deduct the North Carolina royalty payments on its North Carolina return and the recipient can include them on its North Carolina return, or the payer can add them to its North Carolina income and the recipient can deduct them on its North Carolina return.¹⁴

Equalize Franchise Tax on Corporate Affiliated LLCs

This part of the act closes a loophole that existed in the State's corporate tax laws. Prior to the enactment of this provision, a corporation could avoid paying franchise tax on its assets by transferring them to an affiliated limited liability company (LLC).¹⁵ Under North Carolina law, LLCs are not subject to the franchise tax.¹⁶ In 1997, the North Carolina law regarding

¹⁴ See *Geoffrey, Inc. v. South Carolina Tax Com'n*, 437 S.E.2d 13 SC, 1993, cert. denied by U.S. Supreme Court, 114 S.Ct. 50 (1993). The South Carolina Supreme Court held that (1) royalty income of a foreign corporation, obtained from trademark licenses issued to an affiliate, could be taxed without violating due process clause and (2) tax could be imposed without violating interstate commerce clause.

¹⁵ A limited liability company is a business entity that is essentially a hybrid of a partnership and a corporation. Like a corporation, an LLC limits the liability of its owners. Like a partnership, an LLC is usually not subject to entity-level taxation.

¹⁶ The State franchise tax is among the oldest taxes in North Carolina. It is a tax on S Corporations and C Corporations for the privilege of doing business in the State. The tax rate is \$1.50 per \$1,000 of value of the

LLCs was changed to allow for a single-member LLC. This change had the unintended consequence of opening a loophole in North Carolina tax law. It enabled a corporation subject to North Carolina franchise tax to set up an LLC and transfer assets to the LLC in a tax-free transfer.¹⁷ The assets then held by the LLC would not be subject to the franchise tax. Thus, the corporation could avoid a significant portion of its franchise tax liability by transferring assets into a wholly owned LLC subsidiary without affecting its income tax liability.

This part of the act closes this loophole by requiring a corporation to include in its franchise tax base some or all of the assets of an LLC if (1) the corporation is a member of the LLC and (2) the corporation (and/or members of its affiliated group) is entitled to receive 70% or more of the LLC's assets upon dissolution. If the corporation is entitled to receive 100% of the LLC's assets upon dissolution, the corporation includes 100% of the LLC's assets in its franchise tax base. If the corporation is entitled to receive less than 100% of the LLC's assets, then the corporation includes in its franchise tax base only that percentage of the LLC's assets that it would be entitled to receive upon dissolution. If a corporation is required to include an LLC's assets in its franchise tax base, it is allowed to exclude its investment in the LLC from its franchise tax base. This provision is effective beginning with the 2002 tax year.

In the act, the General Assembly stated its intent to apply the franchise tax equally to assets held by corporations and assets held by corporate-affiliated limited liability companies. To this end, the act provides that a taxpayer who fraudulently underpays the franchise tax on assets it transfers to an affiliated LLC is guilty of a Class H felony, the existing law penalty for tax fraud.

Conform North Carolina's Subsidiary Dividend Deduction to the Generally Accepted Treatment Used in Other States

This part of the act repeals North Carolina's dividends received deduction and instead piggybacks the federal law. The act also equalizes the tax treatment of domestic and foreign source dividends by providing that dividends of foreign corporations may be deducted from taxable income to the extent they are included in federal taxable income.¹⁸ Adopting the federal approach simplifies tax administration and compliance. To the extent North Carolina income tax law conforms to federal law, tax administration and compliance are simplified because the taxpayer is required to make fewer adjustments to taxable income in order to calculate State net income. This part of the act became effective beginning with the 2001 tax year.

Prior to this tax law change, a corporation could deduct all dividends received from corporations in which it owned more than 50% of the outstanding voting stock from its

greatest of (1) apportioned net book value of the corporation; (2) 55% of appraised value of real and tangible personal property in NC; or (3) total actual investment in tangible property in NC.

¹⁷ S.L. 2001-508 simplified this transfer by permitting the board of directors of a corporation to transfer corporate assets to a wholly owned limited liability company, limited partnership, registered limited liability partnership, or any other unincorporated entity *without the approval of the shareholders*.

¹⁸ Under federal law, foreign dividends are generally included in income and the taxpayer is allowed a credit for foreign tax paid.

State taxable income. Under the federal approach, a parent company may continue to receive a 100% deduction if it owns 80% or more of the stock of a subsidiary. If a parent company owns more than 50% but less than 80% of a subsidiary, the amount of its deduction is reduced from 100% under prior law to 80% under this act. If a company owns 50% or less of another company, it has no dividends deduction under North Carolina law prior to this act but will get a dividend deduction of either 70% or 80% under the act. Thus some parent companies should gain under the act and some should lose. If a parent company is subject to the federal cap limiting deductible dividends to 70% or 80% of its taxable income, the limit will reduce the amount it can deduct for North Carolina purposes.

The federal deduction is a gross deduction. However, under G.S. 105-130.5(c)(3), the dividend deduction for US companies under North Carolina tax law is net of related expenses. S.L. 2001-427 amended this act to clarify that foreign source dividends must also be net of related expenses so that they would be treated the same for State income tax purposes as domestic source dividends.¹⁹

MODIFY PARTNERSHIP TAX CREDIT

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-335	HB 146	Representative Luebke

AN ACT TO MODIFY THE PASS-THROUGH DISTRIBUTION OF PARTNERSHIP INCOME TAX CREDITS.

OVERVIEW: This act corrects and clarifies the law governing allocation of partnerships' tax credits, so that any dollar amount limitation on a credit allowed to a partnership applies to the total credit. The limited amount is then allocated by the partnership among the partners on a proportional basis. The original bill was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: There is no available data to determine the General Fund revenue gain that will result from this act.

EFFECTIVE DATE: The act became effective beginning in the 2002 tax year, except that its effect on real property donation credits is delayed until 2005.

ANALYSIS: Generally, partnerships are treated under North Carolina law as under federal law. Both North Carolina and federal law recognize that a partnership is a separate entity. When the partnership is entitled to a tax credit, the partnership allocates the credit among its partners on a proportional basis. The partners can then claim the amount of credit allocated to them. This is done because the partnership itself is not a taxable entity. Under prior North

¹⁹ G.S. 105-130.5(c)(3) does not apply to adjustments made under G.S. 105-130.5(a) or (b). Since the deduction for foreign source dividends is contained in G.S. 105-130.5(b), the proviso in G.S. 105-130.5(c)(3) requiring that the expenses be netted does not apply. See also the summary for S.L. 2001-427, HB 232.

Carolina law, a partnership that passed an income tax credit through to its partners would be subject to all limitations on the credit, except for two²⁰:

1. The limitation that the credit may not exceed the amount of the income tax imposed on the taxpayer.
2. A cap on the otherwise allowable amount of the credit, expressed as a specific maximum dollar amount or a specific percentage of the tax imposed on the taxpayer.

Federal law does not recognize the second of these, the exemption from a specific dollar amount limitation. Additionally, North Carolina law does not recognize such an exemption for S corporations²¹. Thus, this provision of North Carolina law regarding taxation of partnerships was inconsistent with both federal law regarding taxation of partnerships and North Carolina law regarding taxation of S corporations.

This act removes the partnership's exemption from the specific dollar amount limitation. This makes North Carolina law consistent with federal law on this point as well as consistent with North Carolina law regarding S corporations. Limited liability companies are treated like partnerships under North Carolina law for income tax purposes. Thus, this change also applies to limited liability companies.

The change affects relatively few tax credits. The following tax credits have specific dollar amount limitations:

- Worker training (G. S. 105-129.11)
- Investing in central administrative office property (G. S. 105-129.12)
- Investing in business property (G. S. 105-129.16)
- Investing in renewable energy property (G. S. 105-129.16A)
- Real property donations (G. S. 105-151.12)
- Conservation tillage equipment (G. S. 105-151.13)
- Construction of a poultry composting facility (G.S. 105-151.25)

The act delays until 2005 the imposition on partnerships and limited liability companies of the dollar amount limitation on the credit allowed for real property donations. The credit for real property donations is allowed when a person makes a qualified donation of an interest in real property that is useful for public beach access, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. The credit is equal to 25% of the fair market value of the donated property interest. To be eligible for the credit, the interest in property must be donated to and accepted by the State, a local government, or a body that is both organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions under the Internal Revenue Code. The credit amount may not exceed \$250,000.

²⁰ All limitations on the tax credit also apply to each partner individually.

²¹ An S corporation is a business entity that is similar in most respects to a partnership for tax purposes.

STREAMLINED SALES AND USE TAX AGREEMENT

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-347, as amended by S.L. 2001-489.	SB 144	Senator Kerr

AN ACT TO ENABLE NORTH CAROLINA TO ENTER THE STREAMLINED SALES AND USE TAX AGREEMENT.

OVERVIEW: S.L. 2001-347 establishes the Uniform Sales and Use Tax Administration Act. Most of the provisions in the Act are provisions the General Assembly enacted last year.²² The act also simplifies North Carolina's sales and use tax laws by adopting many of the uniform provisions required under the Act to be adopted before the State can participate in the Streamlined Sales and Use Tax Agreement. The purpose of this Agreement is to develop a substantially simplified sales tax system that can better accommodate interstate commerce and thereby help equalize the playing field between remote (catalog and internet) vendors and Main Street merchants. The act is a recommendation of the Revenue Laws Study Committee.

Nineteen other states and the District of Columbia enacted legislation in 2001 authorizing participation in the Streamlined Sales and Use Tax Agreement: Arkansas, Florida, Illinois, Indiana, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Nebraska, Nevada, North Dakota, Oklahoma, Rhode Island, Tennessee, Texas, Utah, Wisconsin, and Wyoming.

FISCAL IMPACT: The changes are expected to create a small but unquantifiable revenue increase.

EFFECTIVE DATE: Part 1 of this act, establishing the Uniform Sales and Use Tax Administration, became effective August 8, 2001. Part 1 expires January 1, 2006, unless one of the following occurs: (i) 15 states have signed the Streamlined Sales and Use Tax Agreement, or (ii) states representing a combined resident population equal to at least ten percent (10%) of the national resident population, as determined by the 2000 federal decennial census, have signed the Agreement. Part 2 of the act, shifting mill machinery and mill machinery parts and accessories from a sales tax to a privilege tax of the same rate, becomes effective January 1, 2006. The remainder of Part 2 of this act became effective January 1, 2002.

BACKGROUND: In 2000 the Revenue Laws Study Committee recommended, and the General Assembly enacted, legislation to enable North Carolina to participate in the Streamlined Sales Tax Pilot, which is part of the Streamlined Sales Tax Project. The Project

²² S.L. 2000-120 began the first step in simplifying and streamlining the sales and use tax collection system for remote and in-state retailers. It authorized the Secretary of Revenue to enter into the Streamlined Sales Tax Agreement and made statutory changes to enable North Carolina to enter the Agreement.

is an initiative created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration for all types of commerce. The Project is focused on improving sales and use tax administration systems for both Main Street and remote sellers for all types of commerce. By July 2001, at least 32 of the 45 states that have a sales and use tax were participating in the project and another six states were observing. A "Participating" state is one where the Governor has signed an Executive Order or the legislature has passed legislation authorizing state personnel to participate in the discussion of the Project. "Observer" states represent those states that have expressed an interest in the Project's mission but have not received the executive or legislative authorization to become a Participating state. North Carolina is one of the most active of the participating states involved in the Project. This State, along with Kansas, Michigan, and Wisconsin, are the four states involved in the Streamlined Sales Tax Pilot.

The key features of the Streamlined Sales Tax System include:

- **Uniform definitions within tax bases.** – Legislatures still choose what is taxable and exempt but will use the common definitions.
- **Simplified exemption administration for use- and entity-based exemptions.** – Sellers are relieved of the "good faith" requirements that exist in current law and will not be liable for uncollected tax. Purchasers will be responsible for incorrect exemptions claimed.
- **Rate simplification.** – States will be responsible for the administration of all state and local taxes and the distribution of the local taxes to the local governments. State and local governments will use common tax bases and accept responsibility for notice of rate and boundary changes. States will be encouraged to simplify their own state and local tax rates.
- **Uniform sourcing rules.** – The states will have uniform sourcing rules for all property and services.
- **Uniform audit procedures.** – Sellers who participate in one of the certified Streamlined Sales Tax System technology models will either not be audited or will have a limited scope audit, depending on the technology model used.
- **Paying for the system.** – To reduce the financial burdens on sellers, states will assume the responsibility for implementing the Streamlined Sales Tax System.

The North Carolina General Assembly made several changes in the 2000 Regular Session of the 1999 General Assembly in anticipation of the Streamlined Sales Tax Project. These changes included the following: simplified exemption administration, uniform audit procedures, certification of software and tax collectors, uniform sourcing rule, limitation of local government rate changes to twice a year, and payment provisions. S.L. 2001-347 builds upon this earlier legislation. It continues to raise issues that need to be resolved if North Carolina is to enter into the Streamlined Sales Tax Agreement. As the model legislation continues to be developed, the State will need to address other issues raised by it.

ANALYSIS: **Part 1** of the act establishes the Uniform Sales and Use Tax Administration Act. It authorizes the Secretary of Revenue to enter into the Streamlined Sales and Use Tax

Agreement. However, the Secretary may not enter into the Agreement unless the Agreement requires each state to abide by the following requirements:

- Uniform State Rate
- Uniform Standards
- Uniform Definitions
- Central Registration
- No Nexus Attribution
- Consumer Privacy
- Monetary Allowances
- State Compliance Certification
- Local Sales and Use Tax Limitations

Section 1.1 recodifies many of the provisions the General Assembly enacted last year on this issue into the Uniform Sales and Use Tax Administration Act established in this act. Section 1.2 repeals provision that is incorporated into the Act, which is created under Section 1.3.

Part 2 of the act makes conforming changes by beginning the process of establishing uniform rates, standards, and definitions that are required to enter into the Streamlined Sales and Use Tax Agreement.

Conforming Changes: Uniform Definitions

Sections 2.1 through 2.5 add or amend the following definitions to the State's sales and use tax laws: candy, delivery charges, dietary supplements, food, food sold through a vending machine, purchase price, soft drink, prepared food, retail sale, and sales price. Sections 2.18 through 2.22 conform the definition of prepared food used in the local prepared meals tax acts with the one amended by Section 2.3. Use of the defined terms results in the following changes to the State's sales and use tax laws:

- What food is exempt from sales tax.– The act, as amended by Sections 3.(a) and 3.(b) of S.L. 2001-489, maintains the current exemption for foods that may be purchased with food stamps. The food stamp program applies to food purchased for home consumption. The act, as amended, provides that candy, prepared food, and soft drinks are taxed unless they are purchased for home consumption and would be exempt if purchased under the Federal Food Stamp Program.²³ Alcoholic beverages, dietary supplements, and food sold through a vending machine also continue to be taxed under G.S. 105-164.13B, as amended in S.L. 2001-489.²⁴
- Delivery charges – Under the uniform act, all delivery charges are included in the sales price of an item and therefore subject to tax. Under prior law, delivery charges may or may not have been included as part of the sales price, depending upon where the title to the property passed to the purchaser. Under this act, all delivery charges are included in the definition of "sales price" and are subject to tax. Section 2.11 repeals the law concerning freight and delivery transportation charges.
- Installation charges – Under the uniform act, installation charges are included in the sales price. The act includes them in the definition of “sales price”, but Section

²³ Section 2.13 of the act arguably broadened the sales tax exemption for prepared foods to include all take-out food items from restaurants and fast food chains and all catered food. These food items are taxable under current law. An exemption for take-out food items would have resulted in a General Fund loss of approximately \$60 million a year.

²⁴ Section 2.2 of the act excluded alcoholic beverages from the definition of food in the uniform act. Because local meals tax laws are linked to the sales tax definitions, this language would have inadvertently exempted prepared alcoholic beverages (beer, wine, and mixed drinks) from the local meals taxes.

2.12 maintains the current exemption by specifically providing that installation charges are exempt from sales and use tax.

- Food purchased from vending machines – Under the uniform act, food purchased from vending machines is considered food. Prior to the act, North Carolina taxed food purchased from vending machines, because it was not considered food for home consumption. However, the State’s definition of sales price provided that any tangible item purchased through a vending machine, other than closed container soft drinks or tobacco products, would be taxed at 50% of its sales price. Section 2.13 of the act, as amended in Section 3.(b) of S.L. 2001-489, provides that food purchased through a vending machine is subject to tax. However, Section 2.12 maintains the 50% exemption by specifically listing it as an exemption from the sales and use tax.
- Certain deposits – Prior to the act, certain deposits on beverage containers and certain deposits on aeronautic, automotive, industrial, marine, or farm replacement parts were not subject to sales and use tax because they were not considered part of the sales price, as that term was defined. These deposits are considered part of the sales price under the uniform definition in Section 2.5. However, Section 2.12 maintains the exemption by adding these deposits to the list of items exempt from sales and use tax.

Section 2.6 conforms the definition of "use" for sales and use tax purposes to the definition used in neighboring states. The change in the definition provides that the use tax is applicable to the distribution of direct mail catalogs printed out-of-state to in-state residents by a business that has nexus with the State. The definition in the act is consistent with the U.S.

Supreme Court's decision in *D.H. Holmes v. McNamara*, 486 U.S. 24 (1988).

Section 2.7 recodifies some of the current definitions so that the definitions added by this act can be placed in the correct alphabetical order.

Conforming Changes: Uniform Sourcing Rules

Section 2.9 adopts the sourcing rule established in the Streamlined Sales and Use Tax Agreement. Under prior law, the sale of a product was determined by the location of the retailer's business. Under the act, the sale of a product is determined by the location where the purchaser receives the product.

- If the purchaser receives the product at a business location, then the sale is sourced to that business location.
- If the purchaser receives the product at a location specified by the purchaser and the location is not a business location of the seller, then the sale is sourced to the location where the purchaser receives the product.
- If the seller does not know the address where a product is received, then the sale is sourced to either the business or home address of the purchaser, the billing address of the purchaser, or the address of the seller.

This sourcing rule does not apply to telecommunications services.²⁵

²⁵ See S.L. 2001-430, as amended by S.L. 2001-424 and S.L. 2001-487, for the tax treatment of telecommunications services.

Sections 2.10, 2.15, and 2.16 provide that the uniform sourcing rule established in Section 2.9 applies to the State use tax and to the local sales and use tax acts. The rule will impact the distribution of the 1 cent²⁶ local sales and use tax revenue distributed on a point-of-origin basis.²⁷ Under prior law, G.S. 105-467 stipulated that the situs of a transaction was the retailer's place of business. Under the sourcing rule, a retailer does not need to maintain sales tax records indicating where a product is shipped. However, under the destination-sourcing rule, a retailer will have to submit sales tax reports indicating the counties where a product is shipped so that the tax revenue from that sale can be correctly distributed to that county. It is unknown what impact the uniform sourcing rule will have on the distribution of the 1 cent local sales and use tax revenue.²⁸

Conforming Changes: Uniform Rate

The Uniform Sales and Use Tax Administration Act requires a state to have a limited number of sales and use tax rates. The states have until 2005 to simplify their rates. This act begins the process of simplifying North Carolina's rates by exempting mill machinery and mill machinery parts and accessories from the sales and use tax and imposing in its place a privilege tax on these items. The privilege tax rate would be the same as the current sales and use tax rate: 1% of the sales price of the machinery, part, or accessory purchases, subject to a maximum tax of \$80. This change in the law means that retailers are not responsible for collecting and remitting the tax.

Section 2.8 repeals the current sales and use tax rate of 1%, \$80 cap on mill machinery and mill machinery parts and accessories. Section 2.12 adds mill machinery and mill machinery parts and accessories to the list of exemptions from the sales and use tax. Section 2.17 establishes the privilege tax on mill machinery. These changes in Sections 2.8, 2.12, and 2.17, do not become effective until January 1, 2006.

Conforming Changes: Administration of Returns

The Streamlined Sales Tax Agreement provides that a taxpayer would file only one return a month. Under prior law, taxpayers who were consistently liable for at least \$20,000 a month in State and local sales and use taxes were required to pay the tax and file a return twice a month. Section 2.14 provides that the taxpayer must pay the tax owed twice a month, but only needs to file the return once a month. The monthly return must cover both semi-monthly payments.

²⁶ 1.5 cent for Mecklenburg County.

²⁷ Article 39 of Chapter 105. The two ½ cent local sales and use taxes, Articles 40 and 42 of Chapter 105, are distributed on a per capita basis.

²⁸ Prior to March 1, 1988, North Carolina used a destination-based sourcing rule for the situs of the 1 cent local sales and use tax. In S.L. 1987-832, the General Assembly stipulated that the situs of a sale was considered to be the retailer's place of business. This change in situs from the purchaser's county to the seller's county would have resulted in a shift of revenues by certain counties. To hold counties harmless, the General Assembly adjusted the two ½ cent taxes which are distributed on a per capita basis. Although this act returns the sourcing of a sale to the purchaser's county, it does not repeal the adjustment factors in G.S. 105-486. This correlation between the adjustment factors and the local sourcing rule was not raised in the discussion of this act.

DOR DEBT COLLECTION CHANGES

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-380	SB 353	Senator Kerr

AN ACT TO PROVIDE A PERMANENT MECHANISM FOR THE COLLECTION OF TAX DEBTS.

OVERVIEW: Since 1999, the General Assembly has authorized a pilot program for the collection of tax debts owed by nonresidents and a study of the Department of Revenue's delinquent collection practices. "Project Collect Tax", an initiative of the Department to collect at least \$100 million in overdue taxes in the 2001-03 biennium, is an outgrowth of these efforts. This act enables the Department to execute its "Project Collect Tax" by making the following changes in the tax laws:²⁹

- It makes permanent the Department's authority to use collection agencies to collect out-of-State tax debts.
- It authorizes the Department to use collection agencies to collect in-State tax debts for two years.
- It imposes a collection assistance fee of 20% on all tax debts that remain unpaid for 90 days after they become final.
- It allows the Department to use the receipts from the collection assistance fee to provide the resources needed for "Project Collect Tax".

FISCAL IMPACT: This act enables the Department of Revenue to launch its "Project Collect Tax" to reduce its \$370 million backlog in accounts receivables. The Department plans to bring in \$50 million in additional revenue in FY 2001-02 and the same amount in FY 2002-03. This additional revenue was included in the Current Operations and Capital Improvements Appropriations Act of 2001, S.L. 2001-424.

EFFECTIVE DATE: Except as noted in the analysis, the act became effective on August 20, 2001.

ANALYSIS:

Outsourcing Tax Debts

In 1999, the General Assembly provided the Department of Revenue a source of funds to contract for the collection of tax debts owed by nonresidents and foreign entities for the 1999-2000 biennium. A tax debt is the amount of tax, interest, and penalties due for which a final notice of assessment has been mailed to the taxpayer after the taxpayer no longer has the right to contest the debt. In September 2000, the Department, in conjunction with the Office of the State Auditor, began outsourcing some of its out-of-state tax debts. Between September 2000 and May 2001, it collected in excess of \$12 million in out-of-state receivables using a combination of outsourcing and in-house collection techniques.

²⁹ The General Assembly also appropriated funds for 52 new positions in the Department of Revenue and 12 contract positions for Project Collect Tax.

The cost of contracting for the collection of these tax debts was retained from the taxes collected. The actual cost of collection for the Department of Revenue on the outsourced tax debts was what the contractor charged the Department to collect the debt. The contractor charged a percentage of the amount collected. That percentage averaged 20% of the tax debt. As the number of tax debts outsourced to a contractor increases, the percentage amount charged to the Department to collect the debt is expected to decrease.

This act substitutes a broader debt collection program for the pilot program. Under this program:

- The Department of Revenue may outsource out-of-state tax debts permanently and may outsource in-state tax debts for two years.³⁰
- The cost of collecting tax debts that are at least 90 days overdue is shifted from the State's general revenues to the delinquent taxpayer, by providing that the taxpayer must pay a collection assistance fee of 20% of the overdue tax debt.³¹

The act provides permanent authority for the Department of Revenue to outsource tax debts as long as it continues its practice of notifying the taxpayer prior to submitting the debt to a collection agency. The taxpayer has 30 days after the notice is sent to pay the tax debt. If the debt remains unpaid at the end of the 30 days, then the debt may be outsourced to a collection agency. The collection agencies that contract to collect tax debts are prohibited from revealing confidential tax information. If a contractor reveals tax information, it is subject to a misdemeanor penalty, its contract is terminated, and it is barred from contracting again for five years.

The act also establishes a system under which the cost of collecting overdue tax debts is to be borne by the delinquent taxpayers, not by the taxpayers who pay their taxes on time. The act provides that a collection assistance fee is imposed if the Department gives the taxpayer 30 days' notice and the taxpayer does not pay the debt within that period. The 30-day fee notice cannot be mailed until at least 60 days after the final assessment for the tax debt, with the result that the fee applies only to tax debts that remain unpaid for 90 days or more after final assessment. The fee does not apply to a tax debt if the taxpayer entered into an installment agreement within 90 days after the final assessment and remains current with payments under the agreement. In addition, the Secretary of Revenue may waive the fee in other situations to the same extent as if the fee were a penalty.

The collection assistance fee is 20% of the overdue tax debt and is a receipt of the Department. The proceeds of the fee are credited to a special, non-reverting account to be

³⁰ Section 8 of the act provides that the authority to outsource tax debts owed by North Carolina taxpayers sunsets October 1, 2003. During this two-year period, the Department would like to outsource low priority in-state tax cases to a collection agency. The Department anticipates referring income tax assessments with a value of \$25.00 to \$500.00 in initial referrals.

³¹ The act states the General Assembly's findings that the Department of Revenue's cost of collecting overdue tax debts equals or exceeds 20% of the tax debts and that the cost of collecting overdue tax debts is currently borne by taxpayers who pay their taxes on time. It is the General Assembly's intent that the collection assistance fee will pass that cost on to delinquent taxpayers who owe overdue tax debts.

used only for collecting overdue tax debts.³² The Department of Revenue may apply the fee proceeds to pay contractors for collecting tax debts and to pay the fee charged by the federal government for collecting tax debts by offset. The remaining proceeds of the fee may be spent for collecting overdue tax debts only pursuant to appropriation by the General Assembly.

The Department of Revenue must report periodically on its debt collection activities to the Joint Legislative Commission on Governmental Operations and to the Revenue Laws Study Committee.³³ The reports must include a breakdown of the amount and age of tax debts collected by collection agencies on contract, tax debts collected by the Department through warning letters, and tax debts otherwise collected by Department personnel. They must also include a long-term collection plan, a timeline for implementing each step of the plan, a summary of steps taken since the last report and their results, and any other data requested.

The act makes several conforming changes:

- The State submits some tax debts for collection through the U.S. Department of the Treasury Offset Program. Under prior law, the Department of Revenue imposed a \$15.00 collection assistance fee on each tax debt collected through the federal Treasury Offset Program. Because this act imposes a collection assistance fee on all overdue tax debts, the act repeals the fee that applied to debts submitted to the federal Treasury Offset Program, in order to avoid a double fee.
- It deletes a redundant provision allowing the Secretary of Revenue to contract for debt collection.
- It adds a provision to the Tax Secrecy Law allowing the Secretary of Revenue to provide the necessary information to collection agencies to allow them to identify the taxpayers and the amount of the overdue tax debts to be collected.
- It provides funds to pay debt collectors for debts outsourced in the 2000-2001 fiscal year but not collected until after July 1, 2001. The existing law provided authority to pay debt collectors for outsourced debts during the 2000-2001 fiscal year but, because of the time required to collect tax debts, some debts outsourced during the 2000-2001 fiscal year were not collected until after July 1, 2001. For these debts, this act provides that the debt collector may be paid from the proceeds collected.

Centralize and Automate Debt Collection System

In 1999, the General Assembly authorized the Department of Revenue and the Office of the State Controller to conduct a study of the Department's delinquent collection practices. The Office of the State Controller's existing contract with PricewaterhouseCoopers (PwC) was modified and PwC conducted the study. PwC recommended that the Department centralize its collection process, make technology upgrades such as telefile and predictive telephone calling, and implement an automated case management tool with debt scoring and performance measures. PwC projected that the impact of this recommendation would be an increase of delinquent tax collections by \$11 million to \$30 million annually. To implement

³² The Current Operations and Appropriations Act of 2001, S.L. 2001-424, Section 14D.1, provides that the proceeds of the fee are to be transferred to a separate Fund Code in the Department of Revenue's budget.

³³ The reports must be submitted quarterly beginning November 1, 2001, and semiannually beginning November 1, 2002.

this recommendation, the Department will enter into a performance-based contract where the person who provides the automated system would be paid from the proceeds of the system based upon some variable that pertains to how well the system works. Last year, the General Assembly authorized the Secretary of Revenue to use General Fund revenues collected in fiscal year 2000-2001 to obtain assistance in developing a request for proposals for the performance-based contract. However, with the fiscal crisis the State was experiencing, the Office of State Budget and Management asked the Department to delay this effort until after July 1, 2001. The act allows the Department of Revenue to spend up to \$500,000 from the collection assistance fee account during the 2001-2002 fiscal year to develop and bid the contract.³⁴

CAR PROPERTY TAX CREDIT

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-406	HB 1431	Representative Hackney

AN ACT TO PREVENT DOUBLE TAXATION OF MOTOR VEHICLES WHOSE TAX YEAR CHANGES DUE TO A CHANGE IN REGISTRATION.

OVERVIEW: This act prevents double property taxation on a motor vehicle whose tax year changes due to a change in registration.

FISCAL IMPACT: There is no General Fund impact due to this act. A few counties that did not already offer a tax release or credit in this situation may see a minimal fiscal impact.

EFFECTIVE DATE: September 14, 2001.

ANALYSIS: Under existing law, a taxpayer may receive a release or refund of property taxes paid on a motor vehicle if the taxpayer surrenders the motor vehicle's registration plates because the person has transferred the vehicle to a new owner or because the person has moved out-of-state and registered the vehicle in that state. However, before this act went into effect, the law did not address the situation when a person surrenders a motor vehicle's registration plates for other reasons and later re-registers the vehicle, occasionally resulting in double taxation. For example, a person leaves the country for an extended period of time and does not wish to keep the motor vehicle insured while away. The person can surrender the vehicle's registration plates and cancel the vehicle's insurance. The person has already paid that year's property taxes on the vehicle. Upon returning to the country, the person must register the motor vehicle again and obtain new registration plates. The registration triggers a new property tax bill and a new property tax year. If the vehicle's new registration

³⁴ The Current Operations and Appropriations Act of 2001, S.L. 2001-424, Section 14D.2, requires the Department of Revenue to report to the Joint Legislative Commission on Governmental Operations monthly on its progress in developing the RFP. The Department must consult with the Commission before it can issue the RFP.

is obtained before the vehicle's original registration would have expired, then the taxpayer is paying property taxes twice on the vehicle for those months remaining in the vehicle's original tax year.

This act allows the county tax collector to give a taxpayer a credit against the taxes owed on a motor vehicle if both of the following conditions are met:

- The tax year for the vehicle changes because of a change in the vehicle's registration year for a reason other than the transfer of its registration plates to another vehicle.
- The vehicle's new tax year begins before the expiration of the vehicle's original tax year.

The amount of the credit is equal to 1/12 of the amount of taxes paid on the vehicle for its original tax year times the number of full calendar months remaining in the original tax year as of the first day of the new tax year. The credit is given in the form of a release against the taxpayer's taxes for the new tax year. To obtain the credit, the taxpayer must apply within 30 days after the taxes for the new tax year are due and must provide the county tax collector information establishing the vehicle's original tax year, the amount of taxes paid on the vehicle for that year, and the reason for the change in registration.

MULCH BLOWER FUEL TAX REFUNDS

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-408	HB 170	Representative Walend

AN ACT TO ALLOW A FUEL TAX REFUND FOR OFF-ROAD FUEL USE BY MULCH-BLOWING EQUIPMENT.

OVERVIEW: This act allows a commercial vehicle that delivers and spreads mulch and similar materials and that uses a power takeoff to deliver or unload the materials to receive a partial annual refund of the motor fuel taxes paid on the fuel consumed by the vehicle.

FISCAL IMPACT: With only three companies and eight trucks that qualify for this refund, the cost to the Highway Fund and Highway Trust Fund is approximately \$2,000 per year. There is a \$200 to \$300 gain to the General Fund from sales tax.

EFFECTIVE DATE: Applies to motor fuel consumed on or after January 1, 2001.

ANALYSIS: G.S. 105-449.107(b) allows annual refunds of motor fuel and alternative fuel taxes for certain vehicles with power attachments fueled by motor fuel. This reflects the policy that the motor fuel tax is intended to apply only to fuel used for highway purposes and that the sales tax applies to fuel used for other purposes. Before this act went into affect, only the following vehicles were allowed an annual partial refund of the motor fuel and alternative fuel taxes paid on fuel consumed by the vehicles:

- A concrete mixing vehicle.
- A solid waste compacting vehicle.

- A bulk feed vehicle that delivers feed to poultry or livestock and uses a power takeoff to unload the feed.
- A vehicle that delivers lime or fertilizer in bulk to farms and uses a power takeoff to unload the lime or fertilizer.
- A tank wagon that delivers alternative fuel or motor fuel or another type of liquid fuel into storage tanks and uses a power takeoff to make the delivery.

The annual partial refund of the fuel taxes is equal to 33 1/3% of the following: (i) the flat cents-per-gallon rate in effect for the year for which a refund is claimed, plus (ii) the average of the two variable cents-per-gallon rates in effect during that year, less (iii) the amount of sales and use tax due on the fuel. This formula assumes that one-third of the fuel that is used by the vehicle is used in its mixing, compacting, or unloading operations as distinguished from propelling the vehicle on the roads.

This act allows an additional type of vehicle to qualify for the refund: a commercial vehicle that delivers and spreads mulch, soils, composts, sand, sawdust, and similar materials and uses a power takeoff to unload, blow, and spread the materials. The same formula is used to determine the amount of the refund.

REVENUE LAWS TECHNICAL CHANGES

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-414	SB 165	Senator Hartsell

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

OVERVIEW: This act makes numerous technical and clarifying changes to the revenue laws and related statutes. The original bill was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: No State or local fiscal impact.

EFFECTIVE DATE: The Goodness Grows license plate change is effective retroactively to August 2, 2000. The streamlined sales tax conforming changes are effective January 1, 2002. The remainder of the act became effective September 14, 2001.

ANALYSIS: The following table provides a section-by-section summary of the act:

SECTION	G.S./S.L.	EXPLANATION
1	SL 2000-56	Corrects an incorrect section number reference in a session law.
2	GS 105-111	Repeals an obsolete statute (Duties of Secretary of Revenue relating to privilege licenses).

SECTION	G.S./S.L.	EXPLANATION
3-5	GS 105-113.21(a) GS 105-113.39 GS 105-113.85	Conform the discount statutes for the excise taxes on tobacco products and the excise taxes on beer and wine to a uniform rule that requires both timely filing and timely payment. Sections 3 and 4 clarify that a distributor of tobacco products must send a timely payment as well as filing a timely report to receive the 4% discount. Section 5 deletes a gender-specific phrase and clarifies that a wholesaler or importer of wine or malt beverages must send a timely payment and file a timely report to receive the 4% discount.
6	GS 105-129.3A(c)	Corrects an incorrect cross-reference.
7	GS 105-129.4(b)	Clarifies that the Bill Lee Act's wage standard test must be measured based on all full-time jobs, including those subject to seasonal layoffs.
8	GS 105-129.8(a)	Corrects an incorrect word and conforms terminology.
9	GS 105-129.13(c)	Adds missing words.
10	GS 105-129.19	Designates the Revenue Laws Study Committee rather than the Legislative Research Commission to receive a Department of Revenue report on tax credits.
11	GS 105-151.21(b)(1)	Conforms a cross-reference to a statute that has been recodified.
12	GS 105-163.013(g)	Designates the Revenue Laws Study Committee rather than the Legislative Services Commission to receive the Secretary of State's report on businesses that have registered as a qualified grantee business or a qualified business venture.
13	GS 105-163.41	Clarifies that corporate estimated tax payments are based on net tax due minus allowable credits.
14	G.S. 105-164.3(4)	Repeals the sales tax definition of "cost price", which is no longer needed because S.L. 2001-347 defines the term "purchase price" to replace the term "cost price". Effective January 1, 2002.
15-19	GS 105-164.6(a) GS 105-164.12B(a) GS 105-164.12B(f) GS 105-164.16(a) GS 105-164.23	Change the term "cost price" to "purchase price" to conform to the change made by S.L. 2001-347. Effective January 1, 2002.
20	GS 105-164.27A(d)	Supplies missing word.
21-22	GS 105-164.32 GS 105-187.16	Change the term "cost price" to "purchase price" to conform to the change made by S.L. 2001-347. Effective January 1, 2002.
23	GS 105-228.90	Adds reference in Chapter 105 to the timber tax levied in Chapter 113A of the General Statutes, which is collected by the Department of Revenue.
24	GS 105-249.2	Adds subheadings.

SECTION	G.S./S.L.	EXPLANATION
25	GS 143B-218.1	Recodifies a reporting requirement into Chapter 105 of the General Statutes.
26	GS 105-256	Adds cross-references to reporting requirements codified outside of Chapter 105 of the General Statutes.
27	GS 105-449.60(41)	Corrects misspelling.
28	GS 105-446(c)	Deletes duplicate phrase.
29-30	GS 105-467 Chapter 1096 of the 1967 Session Laws	Conforms the local sales tax definition of food with the changes made by S.L. 2001-347. Effective January 1, 2002.
31	GS 20-87(6)	Changes \$3 motorcycle charge from "tax" to "fee" and provides that any revenue from the motorcycle fee, in addition to any other funds appropriated for this purpose, shall be used to implement the Motorcycle Safety Instruction Program.
32	GS 20-79.7(b)	Corrects the distribution amounts of a \$25 license fee. (Fees for the "Goodness Grows" license plate were set at \$25; however, the distribution amount was inadvertently set at \$20.) Effective retroactively to August 2, 2000.
33	GS 69-25.4	Clarifies that a fire protection district is a unit of local government. Article V, Section 2(5) of the NC Constitution allows the General Assembly to authorize units of local governments to levy taxes on property. Article 3A of Chapter 69 of the General Statutes authorizes a fire protection district to levy property taxes, subject to a referendum; however, it does not define what a fire protection district is. Article 3A was enacted in 1951, prior to the rewrite of the Constitutional provision in 1969. This section explicitly provides that a fire protection district is a municipal corporation organized for a special purpose.
34-44	GS Ch. 96	Conforms Employment Security law's references to Internal Revenue Code, clarifies wording, and conforms structure of G.S. 96-12.01
45-46	GS Ch. 116	Clarifies internal cross-references in Chapter 116D (Higher Education Bonds).
47	GS 143B-221	Repeals a statute that no longer serves its given purpose. The statute sets out how the Department of Revenue would be initially organized. The Department is no longer organized under this statute; it is organized under the general provisions for the organization of State agencies in G.S. 143B-10.
48—50	GS Ch. 159	Clarifies that a municipality participating in a joint venture or undertaking may issue revenue bonds to finance its portion of the undertaking.

SECTION	G.S./S.L.	EXPLANATION
51	GS 160A-215.1(e)	Supplies a missing word.
52	S.L. 97-380	Repeals the session law that established the Forsyth-Guilford Metro. Baseball Park District and provided for a referendum on a baseball park. (The voters defeated the proposal, and the entity has no assets or liabilities.)
53	Effective Dates	Except as follows, the act became effective September 14, 2001: <ul style="list-style-type: none"> • <i>Section 32 (dealing with the "Goodness Grows" license plate fee distribution) is effective retroactively to August 2, 2000.</i> • <i>Sections 14 through 19, 21, 22, 29, and 30 (conforming changes necessitated by S.L. 2001-347) became effective January 1, 2002.</i>

REALLOCATE CLEAN WATER BOND FUNDS

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-416	SB 247	Senator Kerr

AN ACT TO REALLOCATE THE PROCEEDS OF THE CLEAN WATER BONDS AND TO DEFER THE ISSUANCE OF THE CLEAN WATER BONDS, NATURAL GAS BONDS, AND PUBLIC SCHOOL BUILDING BONDS UNTIL AFTER JANUARY 1, 2002.

OVERVIEW: This act does two things:

- It reallocates \$74.1 million of Clean Water Bonds proceeds remaining in a loan program administered by DENR to related grant programs administered by the Rural Economic Development Center and for related administrative expenses. Converting loan funds to grant funds will reduce loan repayments that would have otherwise been credited to the General Fund.
- It provides that Clean Water Bonds, Natural Gas Bonds, and Public School Building Bonds cannot be issued during the period September 1, 2001, and January 1, 2002. Delaying the issuance of the bonds until after January 1, 2002, moves their repayment costs into the 2002-03 fiscal year. The act provides that payments to local governments or payments to match federal funds that otherwise would have been made from the proceeds of Clean Water Bonds issued during the period September 1, 2001, and January 1, 2002, may be paid from General Fund cash balances.

FISCAL IMPACT: The act does not impact the first year of the biennium. It reduces General Fund revenue by \$2.5 million in fiscal year 2002-03, \$5.1 million in fiscal year 2003-04, \$7.6 million in fiscal year 2004-05, and \$7.5 million in fiscal year 2005-06. The Department of Natural and Economic Resources and the Rural Economic Development

Center administer the loans and grants affected. The enactment of this act does not affect the budget requirements of either entity.

EFFECTIVE DATE: September 22, 2001.

ANALYSIS:

Reallocation of Clean Water Bond Proceeds

S.L. 1998-132, the Clean Water Bond Act, authorized the issuance of \$800 million in Clean Water Bonds. The voters approved the bonds in November 1998. Of the \$800 million, \$300 million was designated for loans to local governments, administered by DENR, to be used for water supply systems, water conservation projects, water reuse projects, wastewater collection systems, and wastewater treatment works. Repayments of the loans are credited to the General Fund. The remaining \$500 million of Clean Water Bond proceeds was allocated for various grant programs and to match federal wastewater or water assistance funds. S.L. 1998-132 provided that the \$800 in Clean Water Bonds could be reallocated by the General Assembly between the various loan and grant programs designated in the act. S.L. 2000-156 withdrew \$200 million of the \$300 million loan funds and reallocated the funds for four grant programs that were established in the Clean Water Bonds Act: High Unit Cost grants administered by DENR and Unsewered Community, Supplemental, and Capacity grants, administered by the Rural Economic Development Center. The 2000 legislation also adjusted the annual caps on the amount of Supplemental and Capacity grants that can be issued each year.

This act shifts the remaining, uncommitted \$71.4 million of the \$300 million loan funds and reallocates the funds as follows:

- \$35.6 million for Unsewered Community Grants. Unsewered Community Grants are grants administered by the Rural Economic Development Center for units of local government serving small, rural communities not served by centralized sewer systems for wastewater collection and treatment. These funds are expected to be granted over four years, with two grant cycles each year.
- \$35.6 million for Supplemental Grants. Supplemental Grants are grants administered by the Rural Economic Development Center to help local governments match other grant or loan funds. The act also makes a conforming change to the annual cap on these Supplemental grants, so that the additional \$35.6 will be granted over four years, with two grant cycles each year.
- \$200,000 for administrative expenses of the Rural Economic Development Center in making grants of bond funds. The funds are remitted to the Center as soon as possible after July 1, 2001. The act requires the Rural Center to include with its annual reports to the Joint Legislative Commission on Governmental Operations details on how these funds have been spent.

The Rural Center may change the allocation of funds between Unsewered Community grants and Supplemental grants if it determines that there has been a change in the relative needs for the two types of grants. The Rural Center must consult with the Joint Legislative Commission on Governmental Operations at least 30 days before making a reallocation. The act also requires the Rural Center to include in its annual report to the Commission a description of the criteria and point system it uses to award grants. The Rural Center must

report to the Commission at least 60 days before changing the criteria or point system for awarding grants.

Defer Issuance of Certain Bonds

The act provides that no Clean Water Bonds, Natural Gas Bonds, or Public School Building Bonds may be issued before January 1, 2002. These bonds were scheduled to be issued in September 2001. The issuance of these bonds creates General Fund debt service requirements. The reallocation of some of the Clean Water Bonds from loans to grants, as authorized by this act, increases debt service on those bonds. Delaying issuance of the bonds until January 1, 2002, or a later date moves the fiscal impact of their issuance into the 2002-2003 fiscal year.

The act provides that payments to local governments or payments to match federal funds that otherwise would have been made from the proceeds of Clean Water Bonds issued during the period between September 1, 2001, and January 1, 2002, may be paid from General Fund cash balances. The Director of the Budget may not use more than \$50,000,000 in General Fund cash balances for this purpose. The General Fund must be repaid from the Clean Water Bond proceeds after the Clean Water Bonds are issued for any costs covered with General Fund cash balances.

THE APPROPRIATIONS ACT OF 2001

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-424, as amended by S.L. 2001-476, 2001-497, and 2001-489	SB 1005	Senator Plyler

AN ACT TO MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES.

OVERVIEW, FISCAL IMPACT, AND EFFECTIVE DATES:

<i>Section #</i>	<i>Description and Effective Dates</i>	<i>Fiscal Impact</i>
34.13	Increase State Sales Tax Increases the State sales tax by ½ cent for the period October 16, 2001 to July 1, 2003.	The General Fund revenue gain is as follows: FY 2001-02 \$246.3 million FY 2002-03 \$398.7 million FY 2003-04 \$ 27.8 million

Section #	Description and Effective Dates	Fiscal Impact														
34.14	<p>Local Option Sales Tax Authorizes an additional ½ cent local sales tax effective July 1, 2003. This local option tax can be enacted by a special election or by a vote of the county commissioners. Effective July, 1, 2003, provides hold harmless payments to those local governments whose gain from a half cent local sales tax increase is less than 100% of their loss from the repealed state tax reimbursements.</p>	<p>If all 100 counties approve the ½ sales tax, the local revenue gain is as follows:</p> <table> <tr> <td>FY 2003-04</td> <td>\$419.8 million</td> </tr> <tr> <td>FY 2004-05</td> <td>\$441.2 million</td> </tr> <tr> <td>FY 2005-06</td> <td>\$462.8 million</td> </tr> </table> <p>Hold harmless payments begin in FY 2003-04 and have the following General Fund impact:</p> <table> <tr> <td>FY 2003-04</td> <td>-\$23.3 million</td> </tr> <tr> <td>FY 2004-05</td> <td>-\$19.1 million</td> </tr> <tr> <td>FY 2005-06</td> <td>-\$15.6 million</td> </tr> </table>	FY 2003-04	\$419.8 million	FY 2004-05	\$441.2 million	FY 2005-06	\$462.8 million	FY 2003-04	-\$23.3 million	FY 2004-05	-\$19.1 million	FY 2005-06	-\$15.6 million		
FY 2003-04	\$419.8 million															
FY 2004-05	\$441.2 million															
FY 2005-06	\$462.8 million															
FY 2003-04	-\$23.3 million															
FY 2004-05	-\$19.1 million															
FY 2005-06	-\$15.6 million															
34.15	<p>Local Government Reimbursements Effective July 1, 2003, repeals the State reimbursement to local governments for property tax losses related to the repeal of taxes on inventories and intangibles, as well as some of the tax loss associated with the homestead exclusion. Also repealed is the reimbursement for sales taxes that are no longer paid on items purchased with food stamps.</p>	<p>This will produce a General Fund revenue gain of \$333.4 million per year beginning in FY 2003-04.</p>														
34.16	<p>Sales Tax Holiday Effective January 1, 2002, creates a Sales Tax Holiday -- a temporary, three-day sales tax exemption each August for clothing, sports and recreational equipment, school supplies, computers, printers, and educational software.</p>	<p>The provision produces the following General Fund revenue loss:</p> <table> <tr> <td>FY 2002-03</td> <td>-\$8.4 million</td> </tr> <tr> <td>FY 2003-04</td> <td>-\$7.7 million</td> </tr> <tr> <td>FY 2004-05</td> <td>-\$8.1 million</td> </tr> <tr> <td>FY 2005-06</td> <td>-\$8.4 million</td> </tr> </table> <p>And the following local government revenue loss:</p> <table> <tr> <td>FY 2002-03</td> <td>-\$3.7 million</td> </tr> <tr> <td>FY 2004-05</td> <td>-\$4.9 million</td> </tr> <tr> <td>FY 2005-06</td> <td>-\$5.1 million</td> </tr> </table>	FY 2002-03	-\$8.4 million	FY 2003-04	-\$7.7 million	FY 2004-05	-\$8.1 million	FY 2005-06	-\$8.4 million	FY 2002-03	-\$3.7 million	FY 2004-05	-\$4.9 million	FY 2005-06	-\$5.1 million
FY 2002-03	-\$8.4 million															
FY 2003-04	-\$7.7 million															
FY 2004-05	-\$8.1 million															
FY 2005-06	-\$8.4 million															
FY 2002-03	-\$3.7 million															
FY 2004-05	-\$4.9 million															
FY 2005-06	-\$5.1 million															
34.17	<p>Equalize Taxation of Satellite TV and Cable TV Effective January 1, 2002, imposes a 5% State tax on the gross receipts derived from providing direct-to-home satellite TV service to subscribers.</p>	<p>The tax will generate the following General Fund revenue gain:</p> <table> <tr> <td>FY 2002-03</td> <td>\$9.8 million</td> </tr> <tr> <td>FY 2003-04</td> <td>\$21.7 million</td> </tr> <tr> <td>FY 2004-05</td> <td>\$24.1 million</td> </tr> <tr> <td>FY 2005-06</td> <td>\$25.3 million</td> </tr> </table>	FY 2002-03	\$9.8 million	FY 2003-04	\$21.7 million	FY 2004-05	\$24.1 million	FY 2005-06	\$25.3 million						
FY 2002-03	\$9.8 million															
FY 2003-04	\$21.7 million															
FY 2004-05	\$24.1 million															
FY 2005-06	\$25.3 million															

<i>Section #</i>	<i>Description and Effective Dates</i>	<i>Fiscal Impact</i>														
34.18	<p>New Income Tax Bracket Effective for taxable years beginning on or after January 1, 2001, and expiring for taxable years beginning on or after January 1, 2004. Creates new 8.25% tax bracket for taxable incomes over the following amounts:</p> <table> <tr> <td>\$200,000</td> <td>Married filing jointly</td> </tr> <tr> <td>\$160,000</td> <td>Head of household</td> </tr> <tr> <td>\$120,000</td> <td>Single</td> </tr> <tr> <td>\$100,000</td> <td>Married filing separately</td> </tr> </table>	\$200,000	Married filing jointly	\$160,000	Head of household	\$120,000	Single	\$100,000	Married filing separately	<p>The new rate is estimated to affect 9,848 single filers, 52,463 married couples, and 1,148 heads of households. The General Fund revenue gain is as follows:</p> <table> <tr> <td>FY 2001-02</td> <td>\$125.5 million</td> </tr> <tr> <td>FY 2002-03</td> <td>\$102.9 million</td> </tr> <tr> <td>FY 2003-04</td> <td>\$61.6 million</td> </tr> </table>	FY 2001-02	\$125.5 million	FY 2002-03	\$102.9 million	FY 2003-04	\$61.6 million
\$200,000	Married filing jointly															
\$160,000	Head of household															
\$120,000	Single															
\$100,000	Married filing separately															
FY 2001-02	\$125.5 million															
FY 2002-03	\$102.9 million															
FY 2003-04	\$61.6 million															
34.19	<p>Eliminate Marriage Tax Penalty for Standard Deduction Changes standard deduction for married filing jointly taxpayers from \$5,000 to \$5,500 in tax year 2002 and then to \$6,000 in tax year 2003.</p>	<p>It is estimated that this change will benefit 762,340 couples in tax year 2002. The General Fund revenue loss is as follows:</p> <table> <tr> <td>FY 2001-02</td> <td>\$9.7 million</td> </tr> <tr> <td>FY 2002-03</td> <td>\$32.0 million</td> </tr> <tr> <td>FY 2003-04</td> <td>\$45.0 million</td> </tr> <tr> <td>FY 2004-05</td> <td>\$45.8 million</td> </tr> <tr> <td>FY 2005-06</td> <td>\$46.5 million</td> </tr> </table>	FY 2001-02	\$9.7 million	FY 2002-03	\$32.0 million	FY 2003-04	\$45.0 million	FY 2004-05	\$45.8 million	FY 2005-06	\$46.5 million				
FY 2001-02	\$9.7 million															
FY 2002-03	\$32.0 million															
FY 2003-04	\$45.0 million															
FY 2004-05	\$45.8 million															
FY 2005-06	\$46.5 million															
34.20	<p>Increase Tax Credit for Children Increases the tax credit for children from \$60 to \$75 per child in tax year 2002 and then to \$100 in tax year 2003.</p>	<p>It is estimated that this change will benefit 18,354 single tax filers, 496,286 married couples, and 411,648 heads of households. The General Fund revenue loss is as follows:</p> <table> <tr> <td>FY 2002-03</td> <td>-\$19.8 million</td> </tr> <tr> <td>FY 2003-04</td> <td>-\$54.8 million</td> </tr> <tr> <td>FY 2004-05</td> <td>-\$55.0 million</td> </tr> <tr> <td>FY 2005-06</td> <td>-\$55.3 million</td> </tr> </table>	FY 2002-03	-\$19.8 million	FY 2003-04	-\$54.8 million	FY 2004-05	-\$55.0 million	FY 2005-06	-\$55.3 million						
FY 2002-03	-\$19.8 million															
FY 2003-04	-\$54.8 million															
FY 2004-05	-\$55.0 million															
FY 2005-06	-\$55.3 million															
34.21	<p>Eliminate Children's Health Insurance Credit Repeals the Children's Health Insurance Credit effective for tax year 2001.</p>	<p>In 1999, 117,972 taxpayers filed for \$18.9 million in Child Health Insurance credits. \$18.9 million is used as the General Fund revenue gain each year from repeal of the credit.</p>														
34.22	<p>Equalize Taxation of HMOs and Medical Service Companies Taxes the gross premiums of HMOs and Medical Service Companies (Blue Cross/Blue Shield and Delta Dental) at 1.1% in 2003 and at 1% for every year thereafter, as amended by S.L. 2001-489.</p>	<p>The General Fund revenue gain is as follows:</p> <table> <tr> <td>FY 2002-03</td> <td>\$28.2 million</td> </tr> <tr> <td>FY 2003-04</td> <td>\$30.6 million</td> </tr> <tr> <td>FY 2004-05</td> <td>\$33.2 million</td> </tr> <tr> <td>FY 2005-06</td> <td>\$35.9 million</td> </tr> </table>	FY 2002-03	\$28.2 million	FY 2003-04	\$30.6 million	FY 2004-05	\$33.2 million	FY 2005-06	\$35.9 million						
FY 2002-03	\$28.2 million															
FY 2003-04	\$30.6 million															
FY 2004-05	\$33.2 million															
FY 2005-06	\$35.9 million															

<i>Section #</i>	<i>Description and Effective Dates</i>	<i>Fiscal Impact</i>																				
34.23	<p>Spirituos Liquor Sales Tax and Excise Tax Imposes a 6% State sales tax on spirituous liquor effective December 1, 2001.</p> <p>Reduces the excise tax on spirituous liquor sold in ABC stores from 28% to 25% effective February 1, 2002.</p>	<p>The tax will be collected on retail sales at 392 Alcoholic Beverage Control (ABC) Commission stores in the State. Actual liquor sales in FY 1999-00 were \$367.7 million and are anticipated to increase 3.82% per year. The following General Fund revenue gain is expected:</p> <table> <tr> <td>FY 2001-02</td> <td>\$11.9 million</td> </tr> <tr> <td>FY 2002-03</td> <td>\$24.7 million</td> </tr> <tr> <td>FY 2003-04</td> <td>\$25.6 million</td> </tr> <tr> <td>FY 2004-05</td> <td>\$26.6 million</td> </tr> <tr> <td>FY 2005-06</td> <td>\$27.6 million</td> </tr> </table> <p>The General Fund revenue loss is as follows:</p> <table> <tr> <td>FY 2001-02</td> <td>-\$3.5 million</td> </tr> <tr> <td>FY 2002-03</td> <td>-\$10.9 million</td> </tr> <tr> <td>FY 2003-04</td> <td>-\$11.4 million</td> </tr> <tr> <td>FY 2004-05</td> <td>-\$12.0 million</td> </tr> <tr> <td>FY 2005-06</td> <td>-\$12.6 million</td> </tr> </table>	FY 2001-02	\$11.9 million	FY 2002-03	\$24.7 million	FY 2003-04	\$25.6 million	FY 2004-05	\$26.6 million	FY 2005-06	\$27.6 million	FY 2001-02	-\$3.5 million	FY 2002-03	-\$10.9 million	FY 2003-04	-\$11.4 million	FY 2004-05	-\$12.0 million	FY 2005-06	-\$12.6 million
FY 2001-02	\$11.9 million																					
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FY 2003-04	-\$11.4 million																					
FY 2004-05	-\$12.0 million																					
FY 2005-06	-\$12.6 million																					
34.24	<p>No Tax Break for Luxury Cars Deletes the \$1,500 cap on the 3% Highway Use Tax for non-commercial vehicles effective October 1, 2001. Also exempts from the Highway Use Tax all fire trucks and rescue vehicles purchased by volunteer fire departments and rescue squads.</p> <p>S.L. 2001-489 provided that the repeal of the \$1,500 highway use tax cap did not apply to vehicle titles issued pursuant to a sale or a contract entered into before October 1, 2001. S.L. 2001-497 restored the \$1,500 highway use tax cap for recreational vehicles that do not qualify as commercial vehicles, effective retroactively as of October 1, 2001.</p>	<p>The net revenue gained from these changes will be transferred from the Highway Trust Fund to the General Fund in the following amounts:</p> <table> <tr> <td>FY 2001-02</td> <td>\$1.7 million</td> </tr> <tr> <td>FY 2002-03</td> <td>\$2.4 million</td> </tr> <tr> <td>FY 2003-04</td> <td>\$2.6 million</td> </tr> <tr> <td>FY 2004-05</td> <td>\$2.7 million</td> </tr> <tr> <td>FY 2005-06</td> <td>\$2.9 million</td> </tr> </table> <p>The amendments in S.L. 2001-489 and S.L. 2001-497 did not reduce the amounts transferred to the General Fund from the Highway Trust Fund. Therefore, the cost of restoring the cap on recreational vehicles will be borne by the Highway Trust Fund. The loss to the Highway Trust Fund for FY 2001-02 is expected to be \$632,000 and \$909,000 for FY 2002-03.</p>	FY 2001-02	\$1.7 million	FY 2002-03	\$2.4 million	FY 2003-04	\$2.6 million	FY 2004-05	\$2.7 million	FY 2005-06	\$2.9 million										
FY 2001-02	\$1.7 million																					
FY 2002-03	\$2.4 million																					
FY 2003-04	\$2.6 million																					
FY 2004-05	\$2.7 million																					
FY 2005-06	\$2.9 million																					
34.25	<p>Uniform Telecommunications Tax at 6% Effective January 1, 2002.</p>	See Summary of S.L. 2001-430.																				

ANALYSIS:

INCREASE STATE SALES TAX BY ONE-HALF CENT UNTIL JULY 1, 2003

Section 34.13 increases the State sales tax from 4% to 4.5%, effective October 16, 2001. The tax increase is repealed July 1, 2003. The State sales tax rate was last increased in 1991 from 3% to 4%.

LOCAL OPTION SALES TAX/ HOLD HARMLESS

Sec. 34.14 authorizes all counties of the State to levy a one-half cent sales tax. Like the State sales tax, this new tax would not apply to food. As with the existing statewide local options sales taxes, the county could choose to levy the tax by resolution after 10 days' public notice and a public hearing, or could choose to submit the question to the voters in a special election held after 30 days' public notice. The earliest the new tax could become effective in a county is July 1, 2003.

The net proceeds of the tax would first be allocated among the counties. One-half would be allocated on a point-of-origin basis and one-half would be allocated on a per capita basis. Each county's allocation would then be divided between the county and the municipalities in the county using the same formula by which the existing local sales taxes are divided in that county. As with the existing local sales taxes, the State's costs of collecting and administering the new tax come from the local tax proceeds.

Sec. 34.14 also provides an annual hold-harmless distribution from the State's General Fund to counties and cities to ensure that none of them would lose money when the local government reimbursements repealed in Sec. 34.15 of the act are netted against the estimated proceeds of the sales tax if it were levied in each county as of July 1, 2003. The hold-harmless distribution provides that if a county's or city's estimated proceeds of a half-cent tax would be less than 100% of the amount it would have gotten under the repealed reimbursements, it will receive reimbursement for the difference. If a county's or city's estimated gain from the half-cent tax exceeds 100% of its repealed reimbursement amount, it does not receive a hold-harmless payment from the State. The hold-harmless payment is the same whether or not the new tax is levied in the county. The Department of Revenue will make the hold-harmless distribution annually, drawing the funds from State sales tax collections. The hold-harmless payments must be made by September 15 of each year, beginning in 2003.

LOCAL GOVERNMENT REIMBURSEMENTS

Section 34.15 repeals all of the State's reimbursement payments to local governments, effective beginning with the 2003-2004 fiscal year. State reimbursements are amounts distributed to local units to compensate them for revenue lost as a result of the removal by the General Assembly of property from the local sales and use tax base, the local property tax base, or the intangibles tax base. State reimbursements consist of reimbursements for the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps.

SALES TAX HOLIDAY

Section 34.16 provides that certain purchases made during the first weekend in August of each year are exempt from the State and local sales and use tax, beginning in August 2002.³⁵

The exempt purchases include the following:

- Clothing with a sales price of \$100 or less per item.
- School supplies with a sales price of \$100 or less per item.
- Computers, printers and printer supplies, and education computer software with a sales price of \$3,500 or less per item. The term "computer" means a central processing unit and any peripherals sold with it and any computer software installed at the time of purchase.
- Sport or recreational equipment with a sales price of \$50 or less per item.

Exclusions from the list of exemptions include:

- Clothing accessories or equipment. Clothing accessories are defined as "incidental items worn on the person or in conjunction with clothing including jewelry, cosmetics, eyewear, wallets, and watches.
- Protective equipment.
- Furniture
- Items on layaway.
- Items used in trade or business
- Rentals.

New York became the first state to enact a sales tax holiday in 1996. By 2000, Florida, Texas, Iowa, Maryland, Connecticut, Pennsylvania, and South Carolina had enacted sales tax holidays. Oklahoma enacted a sales tax holiday in 2001. The District of Columbia held two sales tax holiday in 2001; one in August and one in late November and early December. The period of time during which certain purchases are exempt from sales and use tax varies from state to state, as do the purchases that are exempt.

EQUALIZE TAXATION OF SATELLITE TV AND CABLE TV

Section 34.17 establishes a 5% State sales tax on the gross receipts derived from providing satellite TV services, effective January 1, 2002. The gross receipts are not subject to the local 2% sales tax. Currently, cable TV may be subject to a local franchise tax of up to 5%. Satellite TV is not subject to a local franchise tax. This part of the act equalizes the tax treatment between satellite TV and cable TV by providing that both are subject to a 5% tax on their gross receipts. The equalization of the taxation of cable TV and satellite TV was part of the Governor's recommended tax loophole closings.

The State's taxation of entertainment varies depending upon the type of entertainment. This section begins taxing two similar types of entertainment at the same rate. However, other forms of entertainment will continue to be taxed differently. For example, live

³⁵ S.L. 2001-476 excluded "clothing accessories" and "protective equipment" from the Sales Tax Holiday, included "sports and recreation equipment" in the Sales Tax Holiday, incorporated definitions from the Streamlines Sales Tax Project, and made other technical and conforming changes.

entertainment is subject to a 3% gross receipts tax while movies are subject to a 1% gross receipts tax and video rentals are subject to a 6.5% State and local sales tax.

NEW TAX BRACKET FOR INCOME OVER \$200,000

Section 34.18 adds a new tax bracket that imposes an additional ½ % income tax on certain North Carolina taxable income for three years. Under prior North Carolina law, tax was imposed at the following rates on individuals' North Carolina taxable income (NCTI):

<i>Tax Rate</i>	<i><u>NCTI married filing jointly</u></i>	<i><u>NCTI heads of household</u></i>	<i><u>NCTI unmarried individuals</u></i>	<i><u>NCTI married filing separately</u></i>
6.0%	Up to \$21,250	Up to \$17,000	Up to \$12,750	Up to \$10,625
7.0%	Over \$21,250 and up to \$100,000	Over \$17,000 and up to \$80,000	Over \$12,750 and up to \$60,000	Over \$10,625 and up to \$50,000
7.75%	Over \$100,000	Over \$80,000	Over \$60,000	Over \$50,000

This section creates a fourth tax bracket with a marginal tax rate of 8.25% on taxable income over \$200,000 for married couples filing jointly, over \$160,000 for heads of household, over \$120,000 for unmarried individuals, and over \$100,000 for married individuals filing separately. This change will affect approximately 2% of North Carolina taxpayers. The new bracket will be in effect only for the 2001, 2002, and 2003 tax years.

As of the end of the 1999 tax year, 43 states imposed a tax on individual income. Up to ten states had a marginal rate of tax that equals or exceeds 8.5%.³⁶ None of these states are located in the Southeast. The highest marginal tax rates on individual income in the four states that border North Carolina ranged from 5.75% to 7% in 1999.

ELIMINATE THE MARRIAGE TAX PENALTY FOR THE STANDARD DEDUCTION

Section 34.19 will reduce North Carolina income taxes on married couples who claim the standard deduction by increasing the amount of the standard deduction.³⁷ Since 1989, the basic standard deduction for a single person in North Carolina has been \$3,000 while that for a married couple filing jointly has been \$5,000. Section 34.19 of this act increases the standard deduction for married couples from \$5,000 to \$6,000, so that it will be twice that of a single taxpayer. The increase in the deduction is phased in over the 2002 and 2003 tax years. The standard deduction for married persons filing separately is one-half that for a married couple filing jointly, so this act phases it up from \$2,500 to \$3,000 over the 2002 and 2003 tax years.

³⁶ California (9.3%), the District of Columbia (9.5%), Hawaii (8.75%), Iowa (8.98%), Maine (8.5%), and Montana (11%) all had marginal rates that equaled or exceeded 8.5%. Massachusetts had three flat rates of taxation that are applied to different sources of income. One of these rates is 12%. North Dakota had a marginal rate of 12%, though most taxpayers use an alternate calculation based on federal tax liability (14% of federal tax liability). Finally, Rhode Island and Vermont had an income tax calculated as a percentage of federal tax liability (26.5% for RI and 25% for VT). In 1999, the highest federal marginal tax rate was 39.6%.

³⁷ Roughly 70% of North Carolina taxpayers claim the standard deduction.

The so-called marriage tax penalty is the result of a tax system that recognizes that a married couple's living expenses are less than the expenses of two single people living separately but more than the expenses of one single person. In addition, if one spouse is not employed full-time, a married couple's income would be less than that of two comparable single people who work full-time, but more than that of one single person. The tax law addresses these situations through the tax brackets, the personal exemptions, and the standard deduction. The result of these tax provisions is that a married couple with only one spouse working experiences a tax reduction when they marry, a married couple where one spouse earns substantially more than the other experiences no tax reduction or increase when they marry, and a married couple with both spouses earning roughly the same amount experiences a tax increase when they marry.

INCREASE TAX CREDIT FOR CHILDREN

The 1995 General Assembly enacted a tax credit of \$60 per child for taxpayers who have dependent children and have family adjusted gross income below \$100,000 for a married couple and \$80,000 for a head of household. Section 34.20 increases the tax credit to \$75 for the 2002 tax year and \$100 for the 2003 tax year.

The credit is in addition to the federal and state tax credits or exclusions for child care expenses. The credit is allowed for each dependent child for whom the eligible taxpayer could take a federal personal exemption under section 151(c)(1)(B) of the Internal Revenue Code. That Code section allows an exemption for each dependent child who either is less than 19 years old at the end of the taxable year or is a student and is less than 24 years old at the end of the taxable year. A child is a son, stepson, daughter, or stepdaughter. A dependent child is a child over half of whose support was provided by the taxpayer.

ELIMINATE THE CHILDREN'S HEALTH INSURANCE CREDIT

In 1998, the General Assembly enacted a refundable individual income tax credit for certain taxpayers who purchase health insurance for their dependent children. The credit was equal to the amount of premiums paid, up to \$300 for those taxpayers with incomes below 225% of the Federal Poverty Level and up to \$100 for those taxpayers above the 225% threshold. Taxpayers who had their health insurance premiums deducted from their income before it is taxed did not qualify for the credit. Taxpayers whose adjusted gross income was higher than \$100,000 (joint return) did not qualify for the credit.

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

The 1998 legislation established a Health Insurance Program for Children. To be eligible for the program, the person must be ineligible for other government-sponsored health insurance, be under the age of 19 and enrolled in school, be uninsured for six months prior to application, be in a family that meets the income requirements, be a State resident, and

pay the required premium amount. The premium amounts vary depending upon the family's income from zero to \$5 per child per month with a \$15 per month family unit cap to \$10 per child per month with a \$28 per month family unit cap. A family who loses coverage under the Program due to an increase in income may purchase extended coverage through the Program for one year by paying the full premium costs.

In addition to creating a Health Insurance Program for Children, the General Assembly enacted a tax credit for taxpayers who purchase health insurance for their children to help bridge the gap between assisted health insurance costs under the Health Insurance Program and unassisted health insurance costs as a family begins earning too much income to qualify for the Program. The credit was not allowed for the reduced premiums paid under the Program; it was allowed for premiums paid to purchase extended coverage under the Program. Section 34.21 repeals this credit, effective for taxable years beginning on or after January 1, 2001.

EQUALIZE TAXATION OF HMOS AND MEDICAL SERVICE COMPANIES

Section 34.22 imposes a uniform gross premiums tax on Health Maintenance Organizations and on Article 65 corporations. As amended by S.L. 2001-489, the tax rate is 1.1% for taxable years beginning on or after January 1, 2003 and 1% for taxable years beginning on or after January 1, 2004.³⁸

Under current law, Article 65 corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, pay a gross premiums tax of 0.5%. HMOs do not pay a gross premiums tax; however, they are subject to the State's corporate income and franchise tax levies. Other insurance providers pay a gross premiums tax of 1.9%. Companies that pay a gross premiums tax are automatically exempt from corporate income and franchise taxes.

This section subjects all insurance carriers to the gross premiums tax in lieu of the State's corporate income and franchise taxes. All 50 states impose a gross premiums tax on insurance companies; 23 states extend the tax to HMOs. The extension of the tax base to include gross premiums on insurance contracts issued by HMOs was part of the Governor's recommended tax loophole closings.

SPIRITUOUS LIQUOR SALES TAX AND EXCISE TAX

Section 34.23 imposes a 6% sales tax on spirituous liquor, effective December 1, 2001, and reduces the excise tax on spirituous liquor from 28% to 25%, effective February 1, 2002. Under prior law, mixed beverages were subject to sales tax but spirituous liquor (liquor sold in ABC stores) was exempt. The statute levying the 28% excise tax on liquor sold in ABC stores stated that the excise tax was in lieu of sales tax.

This section repeals the sales tax exemption for spirituous liquor and provides that liquor sold in ABC stores is subject to a 6% State sales tax, effective December 1, 2001. If the liquor is sold to a mixed beverage permittee or guest room cabinet permittee for resale, the

³⁸ Originally, the tax rate would have been 0.833% for the 2002 tax year and 1% for taxable years beginning on or after January 1, 2003. The General Assembly modified the tax rates at the request of the HMO and medical service corporation industry because they had already sent their customers rate notices for the 2002 tax year that did not include the 0.83% rate for the 2002 tax year.

permittee may apply for a certificate of resale under existing law and not be subject to the sales tax. Mixed beverages will continue to be subject to sales tax at a combined State and local rate of 6.5%.

Spirituous liquor and mixed beverages are defined in the ABC law as follows:

- "Spirituous liquor" or "liquor" means distilled spirits or ethyl alcohol, including spirits of wine, whiskey, rum, brandy, gin and all other distilled spirits and mixtures of cordials, liqueur, and premixed cocktails, in closed containers for beverage use regardless of their dilution.
- "Mixed beverage" means either of the following:
 - a. A drink composed in whole or in part of spirituous liquor and served in a quantity less than the quantity contained in a closed package.
 - b. A premixed cocktail served from a closed package containing only one serving.

The 28% (reduced in this act to 25%) excise tax levied on liquor sold in ABC stores is levied on the price of liquor calculated as the sum of the following components:

- The distiller's price.
- The State ABC warehouse freight and bailment charges.
- A markup for local ABC boards.

NO TAX BREAK FOR LUXURY CARS/NO FIRE & RESCUE VEHICLE TAX

Section 34.24 deletes the \$1,500 cap on the 3% highway use tax on all non-commercial vehicles except recreational vehicles.³⁹ It also exempts from the highway use tax fire trucks and rescue vehicles owned by volunteer fire departments and volunteer rescue squads. To qualify for the exemption, the volunteer fire department or rescue squad must not be a part of a unit of local government, must have no more than two paid employees, and must be exempt from State income tax under G.S. 105-130.11. The vehicles that may be exempt from the tax are: an emergency services vehicle, a fire truck, a pump truck, a tanker truck, a ladder truck used to suppress fire, and a four-wheel drive vehicle intended to be mounted with a water tank and hose and used for forest fire fighting. An ambulance is not a Class A or B commercial vehicle and so would be subject to the full 3% tax if it were not exempted by this section. The remaining fire and rescue vehicles would be considered Class A or Class B commercial vehicles and would be subject to the \$1,000 maximum highway use tax if not exempted by this act.

These changes became effective for certificates of title issued on or after October 1, 2001.⁴⁰ The estimated net revenue gain from these two tax changes will be credited from the

³⁹ This act removed the \$1,500 cap on all non-commercial vehicles. S.L. 2001-497 (House Bill 72) reinstated the \$1,500 cap for recreational vehicles that are not subject to the \$1,000 cap. A recreational vehicle is defined as "a motorized or towable vehicle that combines transportation and temporary living quarters for travel, recreation, and camping."

⁴⁰ This effective date was amended by S.L. 2001-489 (House Bill 748) so that it did not apply to certificates of title issued as a result of a purchase made before October 1, 2001, or made pursuant to a contract entered into or awarded before October 1, 2001.

Highway Trust Fund to the General Fund each year on July 1. This transfer reflects the fact that before 1989, sales tax on motor vehicles was a General Fund revenue source.

The General Assembly enacted the highway use tax in 1989 as a revenue source for the Highway Trust Fund. The highway use tax is payable when a certificate of title is issued for a motor vehicle. The tax is 3% of the retail value of a motor vehicle, formerly subject to a maximum tax of \$1,500 for automobiles and other vehicles that weigh no more than 26,000 pounds and a maximum tax of \$1,000 for Class A or Class B commercial vehicles that weigh more than 26,000 pounds. In general, the commercial vehicles subject to the \$1,000 maximum tax are truck tractors and large trucks and, to drive them, a person must have the appropriate class of commercial driver's license. The maximum tax of \$1,500 on all other motor vehicles meant that a vehicle valued at an amount over \$50,000 did not pay the highway use tax at a full 3% rate because the cap was reached once the vehicle's value reached \$50,000. The highway use tax is in addition to the \$35.00 fee that is charged for the issuance of a title and the \$10.00 or \$20.00 fee that is charged for the transfer or issuance of a license plate.

The highway use tax replaced the former sales tax on motor vehicles. Sales tax revenue is credited to the General Fund. Revenue from the highway use tax is credited to the Highway Trust Fund. Each year, \$170 million is transferred from the Highway Trust Fund to the General Fund. This amount was chosen by the General Assembly in 1989 because it was the amount of sales tax revenue the General Fund received from the sale of motor vehicles before the repeal of the sales tax on motor vehicles.

PROVIDE UNIFORM TAXATION OF TELECOMMUNICATIONS AT 6%

S.L. 2001-430 established one tax at one rate for all telecommunications services. The rate set in that act is 4.5%. Section 34.25 of this act changes the rate from 4.5% to 6% effective January 1, 2002. Under prior law, local telecommunications were subject to a 3.22% gross receipts franchise tax and a 3% sales tax, intrastate long distance was subject to a 6.5% sales tax, and interstate long distance was not taxed at all. Under S.L. 2001-430, all telecommunication services are subject to a State sales tax at a uniform rate.⁴¹

BUDGET REVENUE PROVISIONS

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-427	HB 232	Representative Allen

AN ACT TO SET THE INSURANCE REGULATORY CHARGE, THE PUBLIC UTILITY REGULATORY FEE, AND THE ELECTRIC MEMBERSHIP CORPORATION REGULATORY FEE; INCREASE THE NONRESIDENT FEE FOR SEARCHING PUBLIC ARCHIVES; UPDATE THE REFERENCE TO THE INTERNAL

⁴¹ For further discussion of changes to taxation of telecommunications, see the summary of S.L. 2001-430 – Simplify Taxes on Telecommunications.

REVENUE CODE; ACCELERATE PAYMENT OF WITHHOLDING TAXES; ACCELERATE PAYMENT OF SALES AND UTILITY TAXES; AUTHORIZE CERTAIN COUNTIES TO ACQUIRE PROPERTY FOR PUBLIC SCHOOLS; PROVIDE GENERAL ASSEMBLY OVERSIGHT OF AGENCY FEES; EXEMPT FROM FUEL TAX FUEL USED BY COMMUNITY COLLEGES; MAKE CLARIFYING CHANGES IN THE SUBSIDIARY DIVIDEND PROVISIONS; AUTHORIZE THE COMMISSIONER OF LABOR TO ESTABLISH CERTAIN FEES; MAKE TECHNICAL AND CLARIFYING CHANGES TO THE FRANCHISE TAX; ACCELERATE PAYMENT OF LOCAL SALES AND USE TAX REVENUE TO LOCAL GOVERNMENTS; AND ACCELERATE PAYMENT OF THE REVENUE GENERATED BY THE STATE EXCISE TAX ON CONVEYANCES TO THE STATE AND EXEMPT PRISONS LOCATED ON LAND OWNED BY THE STATE AND BUILT PURSUANT TO A CONTRACT WITH THE STATE FROM PROPERTY TAX.

OVERVIEW:

This act contains the following fee and budget-related items:

- Sets the insurance regulatory charge at 6.5% for the 2001 calendar year.
- Sets the utilities regulatory fee at 0.1% for the 2001-2002 tax year and the public utility regulatory fee imposed on electric membership corporations at \$200,000.
- Increases the nonresident search fee from \$10 to \$25.
- Updates the reference to the Internal Revenue Code from January 1, 2000, to January 1, 2001.
- Accelerates the payment of withholding taxes.
- Accelerates the payment of sales and utility taxes.
- Authorizes Bertie, Chatham, Clay, Rutherford, Transylvania, and Yadkin Counties to use certificates of participation to acquire property for public schools.
- Provides that agencies may not establish or increase a fee without consulting with the Joint Legislative Commission on Governmental Operations.
- Exempts community colleges from paying the motor fuels tax.
- Clarifies that foreign source dividends are treated the same for State income tax purposes as domestic source dividends.
- Authorizes the Commissioner of Labor to establish elevator and amusement device inspection fees.
- Makes a technical and clarifying change to the franchise tax statute.
- Accelerates distribution of local sales and use tax revenue to local governments.
- Accelerates payment of the revenue generated by the State excise tax on conveyances to the State.
- Exempts prisons located on land owned by the State and built pursuant to a contract with the State from property tax.

ANALYSIS, EFFECTIVE DATE, AND FISCAL IMPACT: The following is a section-by-section summary of the act, setting out the analysis, effective date, and fiscal impact of each section:

Insurance Regulatory Charge (Section 1)

This section reduces the insurance regulatory charge from 7% to 6.5% for the 2001 calendar year. This fee is assessed on the premiums tax paid by insurers. The charge is expected to generate \$23.82 million for the 2001-2002 fiscal year. This Section became effective September 28, 2001.

Regulatory Fee for Utilities Commission (Section 2(a))

This section sets the tax rate for the public utility regulatory fee for the 2001-2002 tax year at 0.1%. This rate must be set by the General Assembly each year. This rate is slightly higher than the 0.09% rate in effect 2000-2001 fiscal year. Increasing this fee for fiscal year 2001-02 to fund the operations of the Utilities Commission and the Public Staff is expected to produce \$10.5 million in fiscal year 2001-02. This Section became effective July 1, 2001.

North Carolina Electric Membership Corporation Fee (Section 2(b))

The section sets at \$200,000 the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale, as provided in G.S. 117-16. This is the same rate that was in effect for the 2000-2001 fiscal year. The North Carolina Electric Membership Corporation is the only electric membership corporation that fits this description. 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. This Section became effective July 1, 2001.

Increase Nonresident Search Fee (Section 3)

This section allows the Department of Cultural Resources to increase the fee cap from \$10 to \$25 for searches of archived public records pursuant to a written request by a nonresident. The increased fee will generate approximately \$50,000 to \$60,000 each year. This Section became effective January 1, 2002.

Update Internal Revenue Code Reference (Section 4)

This section rewrites the definition of the Code to change the reference date from January 1, 2000, to January 1, 2001. Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State tax law previously tracked federal law. The section further provides that the federal tax law changes that could increase an individual's or a corporation's State taxable income for the 2000 tax year will not become effective for the 2000 tax year but will instead apply only to taxable years beginning on or after January 1, 2001. This provision is necessary because Article 1, Section 16, of the North Carolina Constitution prohibits the legislature from passing a law that will retroactively increase the tax liability of any taxpayer.

Four Congressional bills were enacted in calendar year 2000 that have an impact on State individual and corporate income tax law. Public Law 106-230 requires organizations to disclose political activities. Public Law 106-554 makes changes in low income housing tax

credits, HUD renewal communities, HUD empowerment zones, brownfield remediation, corporate computer donations, and medical savings accounts. Public Law 106-573 reverses

a prohibition of using accrual method in reporting income. Public Law 106-591 repeals foreign sales corporations. The estimated General Fund impact is as follows:

FY 2001-02	- \$3.37 million
FY 2002-03	- \$3.82 million
FY 2003-04	- \$3.40 million
FY 2004-05	- \$3.59 million
FY 2005-06	- \$5.13 million

Accelerate Payment of Withholding Taxes (Section 5)

Under prior law, those employers liable for less than \$500 a month in employee wage withholding were given the option to pay quarterly. Subsections (a) and (b) of Section 5 change the \$500 threshold to \$250, so that those employers liable for \$250 to \$500 a month will pay monthly but employers liable for less than \$250 a month may still choose to pay quarterly. These subsections became effective January 1, 2002, and apply to payments of withheld income taxes made on or after that date. The Secretary of Revenue is required to review the thresholds for the accelerated payment of withheld taxes to evaluate the efficiency, burden, and level of compliance and to report the findings to the Revenue Laws Study Committee. The estimated General Fund impact is as follows:

FY 2001-02	\$57.12 million (nonrecurring)
	\$.88 million (recurring)
FY 2002-03	\$ 1.85 million
FY 2003-04	\$ 2.00 million
FY 2004-05	\$ 2.16 million
FY 2005-06	\$ 2.33 million

Accelerate Payment of Sales and Utility Taxes (Section 6)

This Section increases the number of taxpayers required to submit semi-monthly sales tax payments and accelerates the payment schedules for the sales tax on telecommunications and electricity and for the excise tax on piped natural gas:

- Subsection (a) changes the threshold for paying sales taxes semi-monthly from \$20,000 a month to \$10,000 a month. Subsection (b) allows the Secretary to require sales tax returns to be filed electronically. Semi-monthly payers are required to pay by electronic funds transfer. The returns would continue to be due monthly. The estimated General Fund impact is as follows:

FY 2001-02	\$9.72 million (nonrecurring)
	\$.21 million (recurring)
FY 2002-03	\$.45 million
FY 2003-04	\$.48 million
FY 2004-05	\$.50 million
FY 2005-06	\$.52 million

- Subsections (c) and (e) make the payment schedule for electricity and telephone sales taxes the same as regular sales taxes.⁴² This requires some of the state's largest utilities to shift from monthly to semi-monthly payments of sales taxes owed on electricity and telephone. The estimated General Fund impact is as follows:

FY 2001-02	\$15.3 million (nonrecurring)
	\$.85 million (recurring)
FY 2002-03	\$ 1.77 million
FY 2003-04	\$ 1.84 million
FY 2004-05	\$ 1.91 million
FY 2005-06	\$ 1.99 million

- Subsection (f) requires piped gas excise taxes to be paid on a semi-monthly schedule rather than the current monthly schedule. The estimated General Fund impact is as follows:

FY 2001-02	\$14.5 million (nonrecurring)
FY 2002-03	\$ 1.87 million
FY 2003-04	\$ 1.95 million
FY 2004-05	\$ 2.02 million
FY 2005-06	\$ 2.11 million

- Subsection (g) requires the Secretary to review the thresholds in G.S. 105-163.6 for accelerated payment of withheld taxes to evaluate the efficiency, burden, and level of compliance. The Secretary is also required to take steps to assure taxpayer compliance and report to the Revenue Laws Study Committee by April 1, 2002. This review and enforcement action were necessitated because some employers who are required to remit State income taxes on an accelerated basis (within 3 days after the payroll date) are continuing to send the money in monthly. The estimated General Fund impact from enforcement of the accelerated payment is \$12.6 million for FY 2001-02. This is a one-time revenue gain. Subsection (h) authorizes the Revenue Laws Study Committee to study the reporting requirements for electric power companies and the method by which the franchise tax on these companies is distributed to cities to determine simpler ways to achieve the goals of the current requirements and distribution method.

Section 6 became effective January 1, 2002.

Certificates of Participation (COPS) for Certain Counties (Section 7)

This Section adds Bertie, Chatham, Clay, Rutherford, Transylvania, and Yadkin Counties to the list of counties authorized to acquire school property on behalf of their boards of education. The 2001 General Assembly earlier enacted S.L. 2001-76 granting this authority to Anson, Craven, McDowell, Montgomery, and Pamlico Counties. Eighty-one counties

⁴² Section 6.(e) of the act was repealed in S.L. 2001-487, because the franchise tax on telecommunications was replaced with a uniform gross receipts sales tax in S.L. 2001-430. However, under the act, as amended, the payment schedule for telephone sales taxes will still be the same as regular sales taxes. G.S. 105-164.16, as amended in Section 6 (a) of the act, sets out the general rule for payment of sales and use taxes, and this general rule now includes sales and use taxes on utilities.

currently have this authority. This Section became effective September 1, 2001. No General Fund Impact is expected.

General Assembly Oversight of Agency Fees (Section 8)

This Section provides that an agency may not establish or increase a fee or charge unless one of the following conditions has been met:

- The General Assembly has set the fee or charge amount and the purpose of that fee or charge by statute.
- The General Assembly has given the agency general authority to establish or increase a fee or charge by statute and the agency has consulted with the Joint Legislative Commission on Governmental Operations before establishing or increasing that fee or charge.

This section became effective September 1, 2001.

Community College Fuel Tax Exemption (Section 9)

This Section exempts community colleges from paying the motor fuels tax, effective January 1, 2002. Allowing community colleges to buy non-tax paid fuel directly from suppliers will decrease revenues in the Highway Fund and Highway Trust Fund by approximately \$50,000 a year.

Clarifying Changes in the Subsidiary Dividend Provisions (Section 10)

This Section amends S.L. 2001-327 to clarify that foreign source dividends are treated the same for State income tax purposes as domestic source dividends. Under S.L. 2001-327, North Carolina piggybacks the federal dividends received deduction for State corporate income tax purposes. This deduction pertains to dividends of domestic (US) corporations. The federal deduction is a gross deduction, but under G.S. 105-130.5(c)(3) the expenses are required to be netted.

To equalize the tax treatment of domestic and foreign source dividends, S.L. 2001-327 provided in G.S. 105-130.5(b) that dividends of foreign corporations could also be deducted from taxable income to the extent they are included in federal taxable income. Because the deduction for foreign source dividends is contained in G.S. 105-130.5(b), the provision in G.S. 105-130.5(c)(3) requiring that the expenses be netted does not apply. This Section clarifies that the dividends of domestic and foreign source dividends are to be taxed the same by providing that the deduction for foreign source dividends is also net of related expenses. This Section became effective for taxable years beginning on or after January 1, 2001. There is no fiscal impact.

Labor Commissioner Fee Authority (Section 11)

Subsection (c) of this Section gives the Commissioner of Labor the authority to set the fees for the inspection and issuance of certificates of operation for the devices in Subsections (e) and (f) of this Section. This fee-setting ability will put the Department of Labor in a position to make its Elevator and Amusement Device Division fee-supported. Under prior law, these fee amounts were specifically set by statute and varied based upon factors such as the cost of the installation or alteration, the number of building floors, and the type of amusement device. Subsection (c) became effective September 28, 2001.

Subsection (e) of this Section provides in G.S. 95-110.5(20) that the fee for inspecting elevators, dumbwaiters, escalators, moving walks, personnel hoists, stairway chair lifts, wheelchairs lifts, manlifts, and special equipment may not exceed \$200. Subsection (e) became effective September 28, 2001.

Subsection (f) of this Section provides in G.S. 95-111.4(19) that the fee for inspecting amusement devices may not exceed \$250. Subsection (f) became effective September 28, 2001.

Subsection (d) of this Section specifies that all fees collected under G.S. 95-110.5 and G.S. 95-111.4 may be used only for inspection and certification purposes. Subsection (d) became effective September 28, 2001.

To establish the fees in G.S. 95-110.5(20) and G.S. 95-111.4(19), the Commissioner must go through the rule-making process. Under the administrative procedure act, a recent act of the General Assembly authorizes the agency to adopt temporary rules. The adoption of a temporary rule establishing the fee amounts is subject to the requirements of Section 8 of this act.⁴³

Subsection (a) of this section repeals the current statutory fee amounts when the rules establishing the fee amounts in Subsections (e) and (f) become effective.

The fees proposed by the Commissioner of Labor will yield an additional \$1 million in FY 2001-02 and \$1.6 million in 2002-03.

Technical and Clarifying Changes to the Franchise Tax (Section 12)

In 1996, the General Assembly repealed the corporate income tax credit for qualified business investments, effective for investments made on or after January 1, 1997, because it was advised by the Attorney General's Office that the credit unconstitutionally favored businesses headquartered and operating in North Carolina. Prior to its repeal, the corporate income tax credit could have been claimed against the franchise tax and a reference to this credit was in the franchise tax law. When the corporate credit was repealed, a conforming change to the franchise tax statute was not made. The act makes this conforming change. It also adds standard language to the remaining credit referenced in G.S. 105-122(d1)⁴⁴ clarifying that the credit is not a refundable tax credit. Section 12 became effective September 28, 2001.

Accelerate Payment of Local Sales and Use Tax Revenues (Section 13)

The local governments have a 2% sales and use tax rate. Unlike other local taxes, this local tax is collected by the State and distributed to the counties and municipalities quarterly.

⁴³ Section 8 of the act provides that an agency must consult with the Joint Commission on Governmental Operations before a rule establishing or increasing a fee amount may become effective.

⁴⁴ A corporation may claim a credit against its franchise tax liability equal to one-half of the amount of excise tax it paid on piped natural gas during the taxable year.

Section 13 provides that the distribution must be made monthly, effective July 1, 2003. The State's loss of interest on these funds will be as follows:

FY 2003-04	- \$9.6 million
FY 2004-05	- \$10.1 million
FY 2005-06	- \$10.6 million

Accelerate Payment of Excise Tax on Conveyances (Section 14)

The State levies an excise tax on each deed, instrument, or writing by which any interest in real property is conveyed to another person. The amount of the tax is \$1.00 on each \$500 of the consideration or value of the interest or property conveyed. The tax must be paid to the county register of deeds before an instrument may be recorded. One-half of this amount is retained by the county and credited to the county's general fund. The remainder is remitted to the State quarterly. Of the amount remitted to the State, 75% is credited to the Parks and Recreation Trust Fund and 25% is credited to the Natural Heritage Trust Fund.

Section 14 of the act requires that the portion of the tax revenue due to the State must be remitted monthly, as opposed to quarterly. This section becomes effective July 1, 2003, and applies to amounts collected on or after that date. No fiscal estimate is possible.

Prison Property Tax Exemption (Section 15)

Section 15 exempts a correctional facility that is located on State land, but constructed pursuant to a contract with the State, from local property taxes. This includes construction in progress and any leasehold interest in the land owned by the State upon which the correctional facility is located.

S.L. 2001-84, effective May 17, 2001, authorized the Department of Administration and Department of Correction to award a contract for the construction of up to three new close custody prisons. Governmental Operations recommended two prisons but did not designate sites. This recommendation was accepted by the Council of State. S.L. 2001-424 (SB 1005) and S.L. 2001-322 (SB 34) authorized construction of three prisons after acceptance by the Council of State.

The vendor will finance the prison construction. S.L. 2001-84 then authorizes the State to set up a Special Non-Profit Corporation to issue certificates of participation to purchase the prisons upon completion and then lease the prisons to the State. The Department of Correction (DOC) will operate the prisons. The Request for Proposal issued by DOC indicated that the State would be responsible for the property tax, rather than the vendor. Section 3 of S.L. 2001-84 exempts the State from paying property tax during the period the State is leasing the prisons from the Special Non-Profit Corporation. The Department of Correction indicates that construction began in November 2001 for two prisons and will begin on the third prison in winter, 2002. Completion dates for all three prisons are expected to be in fiscal year 2003-04. The sites for the three prisons are Alexander, Scotland and Anson Counties.

Section 15 became effective for taxable years beginning on or after July 1, 2001.

The State will save the following tax payments:

FY 2001-02	\$ 700,000
FY 2002-03	\$1,680,000
FY 2003-04	\$ 980,000

SIMPLIFY TAXES ON TELECOMMUNICATIONS

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-430, as amended by S.L. 2001-424 and S.L. 2001-487	HB 571	Representative Allen

AN ACT TO SIMPLIFY THE COLLECTION OF TELECOMMUNICATIONS TAXES.

OVERVIEW: This act, as amended, simplifies the collection of telecommunications taxes, by (1) combining multiple tax rates into one uniform rate equal to 6%⁴⁵, (2) broadening the tax base by eliminating exemptions for interstate calls and telephone membership corporations, (3) taxing prepaid phone cards at the point of sale instead of at the point of use, (4) adjusting the tax on the gross receipts from pay phones, (5) setting a call center tax cap of \$50,000 a year, and (6) replacing the 3.09% franchise tax distribution to municipalities with a distribution of 18.26% of the new revenue total (less the previous freeze amount).

FISCAL IMPACT: The overall fiscal impact of the act is as follows:

(\$millions)

	<i>FY 2001-02</i>	<i>FY 2002-03</i>	<i>FY 2003-04</i>	<i>FY 2004-05</i>	<i>FY 2005-06</i>
New Rate (6.0%) & Interstate	34.4	87.9	87.9	87.9	87.9
Coin Telephones	0.4	1.6	1.6	1.6	1.6
Prepaid Phone Cards	* See Assumptions and Methodology *				
<i>Call Centers</i>	* See Assumptions and Methodology *				
TOTAL	34.8	89.5	89.5	89.5	89.5

EFFECTIVE DATE: The act became effective January 1, 2002, and applies to taxable services reflected on bills dated on or after January 1, 2002.

BACKGROUND: Until this act, the General Assembly had not revised the tax structure for telecommunications since 1987. Since that time, changes in the

⁴⁵ This act originally set the uniform rate at 4.5%. Section 34.25(a) of SL 2001-424 changed the uniform rate to 6%.

telecommunications industry had occurred that were not contemplated by the 1987 tax law changes.

Under former law, two taxes applied to telecommunications services. The applicability of the tax varied depending upon the identity of the provider and the type of service. One of these taxes was a gross receipts franchise tax equal to 3.22% of the gross receipts derived by the provider for the provision of local telecommunications services. The second tax was a sales tax. The rate of sales tax varied: it was 3% for local telecommunications and 6.5% for intrastate long-distance calls (toll telecommunications services or private telecommunications services that both originated from and terminated in the State). By definition, the taxes did not apply to interstate long-distance calls. Telephone membership corporations had been exempt from the sales tax on telecommunications for many years and coin-operated pay telephone calls, where the call is paid for by a coin, were exempted from the sales tax in 1998.

Under the prior law distribution of part of the tax revenue to cities, a city would receive 3.09% of the gross receipts franchise tax that was collected from sales of local telecommunications service within the city, subject to a freeze deduction and a hold-harmless provision. Cities did not receive a percentage of the sales tax revenues. This distribution had become increasingly complicated to administer. The advent of cellular phones had made the task of deciding whether a call is attributable to a particular city very difficult.

During the 1990s, prepaid calling cards had become increasingly popular and easy to use. They could be purchased at retail stores and other places. However, they were not taxable as tangible personal property under the State and local sales tax like most items sold in the stores where the cards were most often purchased. Because the card represented a telecommunications service, the gross receipts franchise tax and the telecommunications sales tax were imposed on the “air time” and the tax rate differed depending on the type of call. To correctly levy the tax, telephone companies had to track the minutes used by the cardholder and the type of call placed by the cardholder.

ANALYSIS: This act addresses some of the difficulties in the existing tax structure:

- It taxes prepaid telephone calling arrangements as personal property at the point of sale.
- It applies one tax at one rate to telecommunications services.
- It taxes all telecommunications services equally by eliminating exemptions for, interstate telecommunications service, coin telephone calls, and telephone membership corporations.
- It establishes a sourcing rule for mobile telecommunications.
- It preserves the revenue stream to cities while simplifying the distribution formula.

Sections 1 and 6 of the act add definitions for use in taxing telecommunications. The definition for “prepaid telephone calling arrangement” is consistent with the definition used in other states. Many of the definitions are similar to the ones previously used in G.S. 105-120. The act defines some new terms: “service address”, and “mobile telecommunications service”. Those definitions are consistent with the definitions in the

federal Mobile Telecommunications Act and in the draft legislation being developed by a working group established by the National Conference of State Legislatures.

Section 2 repeals the definition of “utility” from the sales tax statutes because it is no longer needed. With the separate taxation of telecommunications and piped natural gas, the only industry remaining in the definition of “utility” is electricity. The act rewrites the sales tax statutes pertaining to electricity so that the term is not needed. (Sections 3, 7, and 8)

Section 4 originally set a uniform tax rate of 4.5% for all telecommunications services, except prepaid telephone calling arrangements. The 4.5% rate was chosen as a revenue neutral rate for the General Fund. Section 34.25(a) of SL 2001-424 changed the uniform rate to 6%.

Section 5 taxes prepaid telephone-calling arrangements as personal property at the point of sale and identifies the point of sale. Consequently, it sets the tax rate for prepaid telephone calling arrangements at the general State rate of 4% (after the 2001 half-cent expires in 2003) plus the applicable local rates, which are expected to be 3% in Mecklenburg County and 2 ½% in all other counties beginning in 2003.

Section 6 is the heart of the act. It sets forth the taxation of telecommunications:

- It adopts a sourcing rule for mobile telecommunications service that is substantially the same as the sourcing rule in the federal Mobile Telecommunications Act. Mobile telecommunications service is provided in this State if the customer’s service address is in this State. A service address for mobile telecommunications service may be determined by the provider based upon the customer’s telephone number, the mailing address to which the bills are sent, or a street address provided by the customer.
- It addresses the taxation of telecommunications service that is bundled with a service that is not taxable. In those cases, a proportion of the gross receipts from the total charges is taxable based on the unbundled price of each service or based on an allocation of revenue to each service.
- It taxes all telecommunications service, including interstate telecommunications service and service provided through a telephone membership corporation. When the General Assembly last changed the telecommunications tax laws in 1987, it was unclear whether states could constitutionally tax interstate telecommunications. However, in 1989, the U.S. Supreme Court removed this uncertainty in Goldberg v. Sweet, 488 U.S. 252, 109 S.Ct. 582, when it held that states can tax interstate telecommunications.
- It replaces the 3.22% franchise tax on local telecommunications and the 3% and 6.5% sales tax on local telecommunications with a uniform gross receipts sales tax on telecommunications.
- It eliminates the tax exemption for telecommunications service provided by means of public coin-operated pay telephones and paid for by coin. (See Section 4) It excludes from tax the receipts of a pay telephone provider from the sale of pay telephone service because the provider pays the sales tax on its purchase of those services.
- It taxes interstate private lines as follows:
 - 100% of the charge imposed at each channel termination point in this State.

- 100% of the charge imposed for the total channel mileage between each channel termination point in this State.
- 50% of the charge imposed for the total channel mileage between the first channel termination point in this State and the nearest channel termination point outside this State.
- It caps the tax on call centers at \$50,000 a year. The cap applies to a person who purchases interstate telecommunications service that originates outside the State and terminates in this State and who has a direct pay permit issued by the Secretary of Revenue. A direct pay permit authorizes the holder to purchase telecommunications service without paying tax to the seller and authorizes the seller to not collect any tax on a sale to a permit holder. The permit holder pays the tax directly to the Department. (Section 9)

Section 10 establishes a new distribution formula that replaces the 3.09% distribution to cities from the telephone gross receipts franchise tax with a distribution from the sales tax on telecommunications service established under this act. The new distribution formula eliminates the need for telephone companies to separately track and report local versus other calling services and the need to determine where wireless falls in the local/nonlocal mix of calls.

Under the new distribution formula, each quarter the Secretary of Revenue must first deduct from the net amount of the tax to be distributed to the cities the amount of \$2,620,948. This is the amount by which the distribution to the cities of the gross receipts franchise tax on telephone companies was required to be reduced in fiscal year 1995-96. After the required deduction, the Secretary must distribute the remaining net tax proceeds to the cities. Cities incorporated before January 1, 2001, will receive a proportionate share based on the amounts they received from the gross receipts franchise tax on telephone companies. Cities incorporated on or after January 1, 2001, and cities served by telephone membership corporations will receive a per capita share.⁴⁶

Section 11 makes a conforming change to the local franchise tax distribution formula by eliminating references to the gross receipts franchise tax on telephone companies and by clarifying that the freeze deduction applies only to the receipts attributable to electric power companies and natural gas companies.

Section 12 repeals the 3.22% gross receipts franchise tax on telephone companies. The tax is repealed because it is merged into the uniform tax on telecommunications services established in this act.

Sections 13 and 14 conform the local sales tax statutes by adding prepaid telephone calling arrangements to the local sales tax base.

Section 15 requires the Department of Revenue to report to the Revenue Laws Study Committee in October 2003 and October 2007 on the amounts collected under this act and

⁴⁶ The provision for cities served by telephone membership corporations was added by section 67 of S.L. 2001-487.

on the distributions made to cities. The Department, in consultation with the League of Municipalities, may recommend changes to the distribution formula.

Sections 16 and 17 preserve the prohibition on county and city taxes on telecommunications services that is now contained in G.S. 105-120(d).

Section 18, as amended⁴⁷, requires the Utilities Commission to reduce the rates set for telecommunications services to reflect the repeal of G.S. 105-120 and the resulting liability of local telecommunications companies for the new uniform sales tax. The North Carolina Supreme Court upheld the Utilities Commission's authority to reduce rates under its rulemaking procedure to reflect a tax reduction that affects an industry uniformly in State ExRel. Utility Commission v. Nantahala Power & Light Company, 236 N.C. 190 (1990).

Section 19 directs the Revenue Laws Study Committee to recommend to the 2002 Session of the General Assembly any changes necessary to conform North Carolina's tax laws with the federal Mobile Telecommunications Sourcing Act.

PASS-THROUGH ENTITY/HOUSING TAX CREDIT

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-431	SB 181	Senator Harris

AN ACT TO ALLOW A PASS-THROUGH ENTITY TO ALLOCATE A HOUSING TAX CREDIT TO ANY OF ITS OWNERS AT THE DISCRETION OF THE PASS-THROUGH ENTITY.

OVERVIEW: This act amends the low-income housing tax credit in two ways:

- It allows a pass-through entity to allocate the low-income housing credit to any of its owners at its discretion. In effect, it allows developers of low-income housing to sell federal and State low-income housing tax credits to separate investors. The credit amount may not exceed the owner's adjusted basis in the pass-through entity. If the credit is ever forfeited, the forfeiture applies to the owners in the same proportion as the credit was allocated.
- It expands the credit by allowing it to be taken against the gross premiums tax on insurance companies.

FISCAL IMPACT: The fiscal impact of this act is not known because it is not known whether the changes to the credit allowed under this act will increase the use of the State tax credit. In calendar year 2000, only 70% of the low-income housing projects receiving the

⁴⁷ Section 119 of S.L. 2001-487 amended Section 18 of this act to clarify that the Utilities Commission has some flexibility in lowering rates, rather than being limited to lowering only basic local line rates by the exact amount of the reduced tax burden.

federal tax credit also requested the State tax credit. Under federal law, each state receives a tax credit of a specified per capita amount.⁴⁸ The State's tax credit is a percentage of the federal tax credit. Therefore, there is a ceiling on the total amount of State tax credit that can be claimed.

EFFECTIVE DATE: Effective for taxable years beginning on or after January 1, 2001, and applies to buildings that are placed in service on or after January 1, 2001.

ANALYSIS: In the Tax Reform Act of 1986, Congress created the Low Income Housing Tax Credit program to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The IRS allocates the per capita low-income housing tax credits to state housing agencies such as the North Carolina Housing Finance Agency (NCHFA). The NCHFA reviews housing project proposals and awards the tax credits to project developers based on selection criteria designed to reward projects that will serve the lowest income tenants for the longest periods. The federal credit requires that the low-income housing be used for that purpose for at least 30 years. If that requirement is not met, all or part of the taxpayer's credit is recaptured.

In S.L. 1999-360, North Carolina authorized a State income tax credit equal to a percentage of a taxpayer's federal tax credit for low income housing constructed in North Carolina.⁴⁹ The credit is equal to 75% of the federal credit for low-income housing located in Tier one or Tier two counties and for housing located in a county affected by a hurricane in 1999.⁵⁰ The credit is equal to 25% of the federal credit for low-income housing located in other counties. In addition to the federal requirements, low-income housing located in a Tier three, four, or five county must meet the following State eligibility requirements:

- Housing located in a Tier three or Tier four county must have at least 40% of its residential units rent restricted and occupied by individuals whose income is 50% or less of median gross income.
- Housing located in a Tier five county must have at least 40% of its residential units rent restricted and occupied by individuals whose income is 35% or less of median gross income.

The State tax credit must be taken over a five-year period, beginning when the federal credit is first claimed for the building.⁵¹ The federal credit is taken over an eleven-year period. If any part of the federal credit is recaptured, 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.⁵²

A project developer awarded the low-income housing tax credits sells the State and federal credits to an investment group to acquire financing for a project. The investment group

⁴⁸ In 2000, Congress increased the per capita credit to \$1.50 in 2001 and \$1.75 in 2002, and then indexed the credit to the CPI beginning in 2003.

⁴⁹ The credit expires for buildings allocated federal credits on or after January 1, 2006.

⁵⁰ The General Assembly modified the credit in S.L. 2000-56 to make housing in a county affected by a hurricane in 1999 eligible for the 75% State tax credit. This modification of the credit expires July 1, 2005.

⁵¹ The federal credit is first claimed either when the building is placed in service, or the next year, at the taxpayer's election.

⁵² This situation could occur if the taxpayer sold its interest in the low-income housing.

financing the projects may consist of pass-through entities.⁵³ Under federal law, 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 a disproportionate share of the income, loss, or credits of the partnership. Generally, under North Carolina law, the pass-through entity is required to allocate a tax credit among its owners in the same proportion that other items, such as the low-income housing credit, are allocated under the Internal Revenue Code.

Prior to this act, an investment group had to purchase both the State and federal credits. This restriction limited the number of investors able to use the State tax credit primarily to in-state groups. This act allows the State credits to be allocated in a different manner than the federal credits. It allows a pass-through entity to allocate the credit among any of the entity's owners, in the entity's discretion, as long as the amount of credit allocated does not exceed the owner's adjusted basis in the pass-through entity. In effect, this act allows developers of low-income housing to sell federal and State low-income housing tax credits to separate investors. It is similar to the bifurcation or separate sale of federal and State historic tax credits approved in the 1999 Session of the General Assembly in S.L. 1999-381.⁵⁴ Most housing finance experts agree that this act will increase the competition for State tax credits and that this competition will affect the price paid for a credit put up for bid. However, it is unknown whether these changes will increase the participation of developers in the State credit program. The statutory mandates on the number of rent controlled units in a project appear to prevent the 100% utilization of the State tax credit and this act does not change those restrictions.⁵⁵

Under this act, when an allocation is claimed by a pass-through entity, the pass-through entity and its owners must include a statement with their tax return that shows both the allocations made and the allocation that would otherwise have been required.⁵⁶ 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 from the date the federal credit is first claimed so that the owner's interest is reduced to less than 2/3 of its interest at the time the federal credit is first claimed, 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's pass-through entity to the extent the entity does not receive cash or property. Under existing law, any forfeiture of the credit triggers the taxpayer's liability for all past taxes avoided plus interest. The past taxes and interest are due 30 days after the credit is forfeited.

⁵³ A pass-through entity is an entity 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. Examples of pass-through entities include partnerships, LLCs, and Subchapter S corporations.

⁵⁴ See the summary for S.L. 2001-476, *Pass-Through Entity Allocation Extension*.

⁵⁵ All 7 projects in Tier one and two counties and all 6 projects in Tier three and flood relief counties utilized the 75% State tax credit. However, only 12 of the 23 projects in Tier four and five counties utilized the 25% State tax credit.

⁵⁶ See G.S. 105-131.8 and G.S. 105-269.15.

Lastly, this act makes the State tax credit for low-income housing attractive to insurance companies by allowing the credit to be applied against the gross premiums tax. Prior to this act, the credit for low-income housing was allowed only against the franchise tax or the income tax. Insurance companies pay gross premiums tax in lieu of income and franchise tax.

COUNTIES COLLECT DELINQUENT TAXES BEFORE RECORD DEEDS

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-464, as amended by S.L. 2001-513	HB 108	Representative Haire

AN ACT TO AUTHORIZE ALLEGHANY, ANSON, BEAUFORT, CABARRUS, CAMDEN, CHEROKEE, CHOWAN, CURRITUCK, FORSYTH, GRAHAM, GRANVILLE, HARNETT, HAYWOOD, JACKSON, LEE, MADISON, MONTGOMERY, PASQUOTANK, PERQUIMANS, PITT, STANLY, SWAIN, VANCE, WARREN, AND YADKIN COUNTIES TO REQUIRE THE PAYMENT OF DELINQUENT PROPERTY TAXES BEFORE RECORDING DEEDS CONVEYING PROPERTY.

OVERVIEW: This act authorizes the county commissioners in 25 different counties to require the register of deeds to refuse to register a deed unless the county tax collector has certified that no delinquent taxes are due on the property. S.L. 2001-513 gives this same authority to the county commissioners in an additional 10 counties.

FISCAL IMPACT: The fiscal impact on local governments is unknown. The act provides counties with a potential tool to assist them with the collection of delinquent property taxes.

EFFECTIVE DATE: This act became effective November 16, 2001. S.L. 2001-513 became effective January 4, 2002.

ANALYSIS: Since 1963, the General Assembly has prohibited the register of deeds in several counties from recording deeds unless the tax collector certifies that no delinquent taxes are due: Avery County (1963); Mitchell County (1987); Ashe County (1993); the Towns of Newland, Spruce Pine, and Alleghany County (1997); the Town of Banner Elk (1998); and the Town of Bakersville (1999).

This act gives the county commissioners in 25 counties the authority to adopt a resolution requiring the county tax collector to certify that no delinquent taxes that the collector is

charged to collect are due on the property before a deed transferring the property can be recorded. Those 25 counties are: Alleghany⁵⁷, Anson, Beaufort, Cabarrus, Camden, Cherokee, Chowan, Currituck, Forsyth, Graham, Granville, Harnett, Haywood, Jackson, Lee, Madison, Montgomery, Pasquotank, Perquimans, Pitt, Stanley, Swain, Vance, Warren, and Yadkin Counties. S.L. 2001-513 gives the same authority to the following 10 counties: Carteret, Cleveland, Davidson, Gaston, Iredell, Martin, Person, Rockingham, Rowan, and Washington Counties. Unlike the previous local acts, the authority given by these two acts is permissive. To use this collection tool, the board of county commissioners must adopt a resolution on the matter. The resolution may describe the form the certification must take.

GRAPE GROWERS COUNCIL FUND

AN ACT TO INCREASE THE AMOUNT OF WINE TAX PROCEEDS EARMARKED ANNUALLY FOR THE GRAPE GROWERS COUNCIL.

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-475	SB 970	Senator Kerr

OVERVIEW: This act expands the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council by increasing the earmarking to 100% of the excise tax and raising the cap from \$175,000 to \$350,000.

FISCAL IMPACT: The act doubles the amount of tax revenue that may be distributed to the North Carolina Grape Growers Council from \$175,000 to \$350,000.⁵⁸ It is anticipated that the Council will receive an additional \$109,382 in fiscal year 2001-02 and an additional \$147,936 in fiscal year 2002-03 before reaching the \$350,000 cap in fiscal year 2003-04. The additional funds that will go to the Council would, under prior law, be divided between the State's General Fund and the counties and cities in which the sale of wine is authorized.⁵⁹ Therefore, the gain in revenues to the Council is accompanied by a corresponding reduction in the revenues distributed to the State and the applicable counties and cities.

EFFECTIVE DATE: October 1, 2001.

ANALYSIS: Under prior law, 94% of the net proceeds of the excise tax collected on unfortified wine bottled in North Carolina during the previous quarter and 95% of the net proceeds of the excise tax collected on fortified wine bottled in North Carolina during the

⁵⁷ Alleghany County currently has the authority. This act includes Alleghany County because it allows the county commissioners to decide what form the certification may take, something the original authorization does not expressly address.

⁵⁸ The prior \$175,000 cap did not come into play until the final quarter of the 1999-2000 fiscal year.

⁵⁹ Under G.S. 105-113.82, the Secretary of Revenue must annually distribute the net amount of excise taxes collected on fortified and unfortified wine, less the amount of net proceeds distributed to the North Carolina Grape Growers Council, to local governments. Local governments receive 62% of the net amount of excise taxes collected on unfortified wine and 22% of the net taxes collected on fortified wine. The remainder is credited to the General Fund.

previous quarter were credited to the Department of Agriculture. The amount credited could not exceed \$175,000 per fiscal year. The act changes the distribution amount to 100% of each tax on wine bottled in North Carolina, and raises from \$175,000 to \$350,000 the annual cap on the amount to be distributed.

The Department of Agriculture must continue to allocate these funds to the North Carolina Grape Growers Council to be used to promote the North Carolina grape and wine industry and to contract for research and development services to improve viticultural and enological practices in North Carolina. If any of the earmarked funds are not expended during the fiscal year, they do not revert to the General Fund but remain available to the Grape Growers Council.

BILL LEE ACT CHANGES

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-476, as amended by S.L. 2001-487	SB 748	Senator Hoyle

AN ACT TO AMEND THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT; TO APPLY A GRADUATED TAX RATE TO SALES OF ELECTRICITY TO MANUFACTURERS BASED ON ANNUAL VOLUME OF ELECTRICITY USED; TO APPLY DEFINITIONS FROM THE STREAMLINED SALES TAX PROJECT TO THE SALES TAX HOLIDAY; AND TO PROVIDE A FOUR-YEAR EXTENSION ON THE EXEMPTION FROM BIDDING LAW REQUIREMENTS FOR THE PIEDMONT TRIAD INTERNATIONAL AIRPORT AUTHORITY.

OVERVIEW: This act makes numerous changes to the William S. Lee Quality Jobs and Business Expansion Act, modifies the sales tax rate that applies to electricity used by manufacturers, modifies definitions in the new sales tax holiday to conform to the streamline legislation, and extends the bidding law exemption for the Piedmont Triad Airport Authority.

EFFECTIVE DATES AND FISCAL IMPACT:

<i>Provision</i>	<i>Effective Date</i>	<i>Fiscal Impact</i>
Makes numerous clarifications and changes to the definitions regarding eligible businesses under the Bill Lee Act. Expands the law to allow a taxpayer to qualify for credits if:	The clarifications regarding businesses eligible for credits under the Bill Lee Act	FY 2003-04 -\$.2 million FY 2004-05 -\$1.1 million FY 2005-06
<ul style="list-style-type: none"> • It has an establishment whose primary activity is in computer 		

<i>Provision</i>	<i>Effective Date</i>	<i>Fiscal Impact</i>
<p>services.</p> <ul style="list-style-type: none"> • It has an establishment whose primary activity is an electronic shopping and mail order house. • It has an establishment whose primary activity is warehousing and is located in a tier 1, 2, or 3 county, serves at least 5 counties, and is located in a separate site. • The primary business is manufacturing, warehousing or wholesale trade and the jobs, investment, or activity with respect to which a credit is claimed are used in any of those types of businesses. 	<p>became effective November 29, 2001. Those clarifications do not reflect a change in the law regarding eligible businesses.</p> <p>The expansion of businesses eligible for credits under the Bill Lee Act are effective for taxable years beginning on or after January 1, 2001.</p>	<p>-\$2.5 million</p> <p>(maximum impact of -\$4.5 million in 2006-07)</p>
<p>Increases the population thresholds used in determining county tier designations. Gives low population counties more favorable tier designations.</p>	<p>This provision became effective November 29, 2001, and applies to designations made on or after that date.</p>	<p>FY 2003-04 -\$.2 million</p> <p>FY 2004-05 -\$.4 million</p> <p>FY 2005-06 -\$.6 million</p> <p>(maximum impact of -\$.9 million in 2006-07)</p>
<p>Extends tax credits to customer service centers and electronic mail order houses located in tier 3 areas.</p>	<p>Effective for taxable years beginning on or after January 1, 2001.</p>	<p>FY 2002-03 -\$.3 million</p> <p>FY 2003-04 -\$.6 million</p> <p>FY 2004-05 -\$.9 million</p> <p>FY 2005-06 -\$1.2 million</p> <p>(maximum impact of -\$1.2 million in 2005-06)</p>
<p>Clarifies when credits expire under the act.</p>	<p>Effective November 29,</p>	

<i>Provision</i>	<i>Effective Date</i>	<i>Fiscal Impact</i>
	2001.	
Makes changes to the wage standard.	Effective for taxable years beginning on or after January 1, 2002.	
Amends safety and health and environmental standards.	The major change to the safety and health standards is effective for taxable years beginning on or after January 1, 2000. Conforming changes are effective for taxable years beginning on or after January 1, 2002.	
Extends the carryforward for research and development credits from 5 years to 15 years.	Effective for taxable years beginning on or after January 1, 2002.	No impact until FY
Shortens the period in which credits under the Lee Act may be claimed.	Effective for taxable years beginning on or after January 1, 2001.	
Eliminates the Department of Commerce's role in certification of applications and changes in fees and reports.	As amended by S.L. 2001-487, effective for business activities that occur on or after January 1, 2002, and for activities occurring before that date for	

<i>Provision</i>	<i>Effective Date</i>	<i>Fiscal Impact</i>
	which no application has been filed by January 1, 2003. Special interim procedures are used for businesses activities occurring before January 1, 2002 for which an application is filed before January 1, 2003.	
Clarifies the machinery and equipment threshold.	Effective for taxable years beginning on or after January 1, 2002, and applies to machinery and equipment put in service after that date.	
Eliminates a clawback provision regarding the credit for central office and aircraft facility property.	Effective for taxable years beginning on or after January 1, 2001.	
Creates a new 30% tax credit for the purchase or lease of real property. The tax credit must be taken over 7 years and has a 20-year carryforward. The taxpayer must invest at least \$10 million within 3 years and create 200 jobs within 2 years.	Effective for taxable years beginning on or after January 1, 2002, and applies to property that is first used in an eligible business on or after that date.	FY 2003-04 -\$ 4.7 million FY 2004-05 -\$ 9.4 million FY 2005-06 -\$14.3 million (maximum impact of - \$18.7 million in 2006-07)
Extends the FedEx bidding law exemptions.	Effective November 29, 2001.	
Reduces the sales tax on electricity sold to	As amended by	FY 2002-03

<i>Provision</i>	<i>Effective Date</i>	<i>Fiscal Impact</i>
manufacturers from 2.83% to the following: (As amended by S.L. 2001-487.) Over 5,000 and up to 250,000 megawatts = 2.25% beginning July 1, 2005. Over 250,000 and up to 900,000 megawatts – 2% beginning July 1, 2005 Over 900,000 megawatts - .17% beginning January 1, 2002.	S.L. 2001-489, this section becomes effective in part on January 1, 2002, and in remainder on July 1, 2005.	-\$.8 million FY 2003-04 -\$.8 million FY 2004-05 -\$.8 million FY 2005-06 -\$7.0 million
Sales tax holiday amendments.	Effective January 1, 2002, and applies to sales made on	
Extension of special allocation rules for pass-through entities for the historic rehabilitation credit.	Effective November 29, 2001.	

ANALYSIS:

The William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset. The Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, for worker training, and for research and development. Counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. The Act requires the Department of Commerce and the Department of Revenue to report periodically on the credits allowed by the Act.

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 Bill 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. In 1999, the General Assembly expanded existing tax incentives for businesses, added new tax incentives and tax reductions for specific businesses, and made related changes. The General Assembly also extended the 2002 sunset to 2006.

During the 2000 Session, the General Assembly further modified the Bill Lee Act and related economic development laws by enacting application fee changes, extending credit carryforwards, requiring wage standards for grants, prohibiting funding for defaulting grantees, expanding credits, amending the tier designation formula, and making technical corrections.

This act makes the following changes to the Bill Lee Act:

Eligible business rules and definitions.

Sections 1 and 6 of this act make numerous clarifications and changes to the definitions regarding eligible businesses under the Act.

Section 1(a) clarifies that a taxpayer is eligible for a credit under the Bill Lee Act only if the primary business of the taxpayer is an eligible business under the Act. There had been some confusion on the part of taxpayers as to whether a taxpayer whose primary business is not an eligible business but who nonetheless engaged in eligible business activities at a certain location was eligible for credits under the Act. This clarification is consistent with the interpretation of the Act by the Department of Revenue⁶⁰. This is a clarifying amendment and does not change existing law. Section 1(a) became effective when it became law, November 29, 2001.

Section 1(b) amends the definitions to remove the requirements regarding primary business from the definitions. These requirements are moved to the eligible business statute, G.S. 105-129.4(a), in Section 6(a) of the act. Section 1(b) also amends the definition of "data processing" by splitting it into two definitions, "computer services" and "data processing", and restricting it so that in order for a taxpayer to be engaged in one of these activities, the services must be provided primarily to entities that are not related entities⁶¹. In addition, Section 1(b) provides a new definition of data processing that does not explicitly refer to the NAICS definition. Section 1(b) is effective for taxable years beginning on or after January 1, 2001.

Section 6(a) of the act amends G.S. 105-129.4(a), effective for taxable years beginning on or after January 1, 2001, to relax the eligible business requirements as follows:

- Computer services. The law is expanded to allow a taxpayer to qualify for credits if it has an establishment whose primary activity is in computer services. Under previous law, a taxpayer was eligible for a credit for this industry only if the primary business of the taxpayer was in that industry.
- Electronic mail order house. The law is expanded to allow a taxpayer to qualify for credits if it has an establishment whose primary activity is an electronic shopping and mail order house. Under previous law, a taxpayer was eligible for a credit for an electronic mail order house only if the primary business of the taxpayer was an electronic shopping and mail order house.
- Warehousing. Under previous law, a taxpayer was engaged in warehousing only if the primary business of the taxpayer was warehousing. The law is expanded to include a taxpayer whose primary business is not an eligible business if it has an establishment whose primary activity is warehousing and it meets each of the following conditions:
 - The establishment is located in an enterprise tier one, two, or three area.

⁶⁰ G.S. 105-264 imposes the duty of interpreting the tax laws upon the Secretary of Revenue.

⁶¹ Section 1(b) incorporates the definition of related entity found in G.S. 105-130.7A. G.S. 105-130.7A was enacted into law earlier this session in House Bill 1157 – Enforce Tax Compliance and Equality/No Fraud.

- The establishment is at a site separate from other subdivisions of the taxpayer.
- The establishment serves at least 25 establishments in at least five different counties in one or more states.
- Multiple businesses. The law is expanded to allow a taxpayer to claim credits under the Bill Lee Act if the primary business of the taxpayer is manufacturing, warehousing, or wholesale trade, and the jobs, investment, or activity with respect to which a credit is claimed are used in any of those types of business. Under previous law, a taxpayer could claim a credit under the Act only if the jobs, investment, or activity with respect to which a credit was claimed were used within the primary business of the taxpayer.

In each of these cases, it has been argued that a taxpayer whose primary business is in another industry might nonetheless engage in significant activities in one of these areas. Section 6(a) allows such a taxpayer to be eligible for credits under the Bill Lee Act.

Tier designation formula change

Section 3 of this act makes two changes to the tier designation formula. In general, counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. In 1999, the General Assembly amended the tier designation formula to give a more favorable tier designation to certain lower-population counties. Under previous law there are three exceptions for lower-population counties:

1. A county that had a population of less than 10,000 and more than 16% of its population below the federal poverty level was designated an enterprise tier one area.
2. A county that had a population of less than 50,000 and more than 18% of its population below the federal poverty level was given a tier designation one level lower than it otherwise would have received.
3. A county that had a population of less than 25,000 could not be designated higher than an enterprise tier three area.

This act increases the population thresholds that are used in 1. and 3. above from 10,000 to 12,000 and from 25,000 to 35,000, respectively. The Department of Commerce reports that the counties that are affected by the first change are Alleghany and Jones. The counties affected by the second change are Alexander, Dare, Davie, Macon, and Transylvania. This section became effective when it became law, November, 29, 2001, and applies to tier designations that are made on or after that date.

Call center

In 1999, the General Assembly amended the Bill Lee Act so that certain electronic mail order houses and certain customer service centers were eligible for credits under the Bill Lee Act. The first incentive extends all of the Bill Lee Act credits to electronic mail order houses that create at least 250 jobs and that are located in an enterprise tier one or two area. The second incentive extends all of the Bill Lee Act credits to certain customer service centers located in an enterprise tier one or two area. 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 prevents telemarketing operations from qualifying.

This act (Section 6) expands the number of taxpayers eligible for credits under the Bill Lee Act by including customer service centers and electronic mail order houses located in enterprise tier three areas. This change is effective for taxable years beginning on or after January 1, 2001.

Clarification of expiration of credits

In 2000, the General Assembly amended the Bill Lee Act to clarify that if a taxpayer ceased to engage in an eligible business, credits under the Act would expire and the taxpayer would not be allowed to take any further installments of the credit. Expiration of a credit, however, does not prevent a taxpayer from taking any carryforwards of previous installments of the credit. In several instances, an eligible business is defined not only by industry type, but also by the number of jobs created or the enterprise tier designation of the location. It was not entirely clear what the effect would be on a taxpayer's credits if the taxpayer was still involved in an eligible industry, but the number of employees dropped below the applicable threshold or the enterprise tier designation of the location rose above the applicable threshold.

Section 6 of this act clarifies that credits under the Bill Lee Act expire if the number of jobs at a central administrative office drops below 40 or if the number of jobs at an electronic mail order house drops below 250. Section 6 further clarifies that a change in the tier designation of the location of a customer service center or an electronic mail order house does not result in expiration of the credits. These changes became effective when the act became law, November 29, 2001.

Section 6 also clarifies the period of time during which a central administrative office may meet the requirement that it create at least 40 jobs.

Wage standard

To be eligible for the credits under the Bill Lee Act, jobs must meet the applicable wage standard. Under previous law, for the credit for worker training or the credit for creating new jobs, the jobs for which a credit was claimed were required to meet the applicable wage standard. For the credit for investing in machinery and equipment, the credit for research and development, and the credit for investing in central office and aircraft facility property, the jobs at the location with respect to which a credit was claimed were required to meet the applicable wage standard. For a tier one county, the jobs were required to pay an average weekly wage that was equal to the applicable average weekly wage for that county. For other tier counties, the average weekly wage of the jobs had to equal 110% of the applicable average weekly wage for that county.

Section 6 of this act makes several changes to the wage standard test. First, this act clarifies that the average wage of all jobs at the facility must exceed the applicable average weekly wage for the credit for investing in machinery and equipment, the credit for research and development, the credit for investing in central office and aircraft facility property, and the

credit for substantial investment in other real property⁶². Second, this act changes the wage standard test for the credit for worker training and the credit for creating new jobs. For those two credits, the average wage of the jobs for which the credit is claimed and the average wage of all jobs at the facility must exceed the applicable average weekly wage.

Safety and health and environmental eligibility amendments

Section 5 of this act makes changes to the safety and health program eligibility requirement under the Bill Lee Act. Previously, a taxpayer was ineligible for a credit under the Bill Lee Act if the taxpayer had any outstanding violations under the Occupational Safety and Health Act or had had any serious violations of that Act in the past three years. Section 5 of the act changes this standard in two ways. First, the new standard focuses only on citations that have become a final order. Second, instead of looking for "serious" violations the new standard looks for "willful serious" or "failure to abate serious" violations. The new standard would make more taxpayers eligible for credits under the Bill Lee Act. Section 5 is retroactive to taxable years beginning on or after January 1, 2000.

Section 6 of this act also changes the reporting procedures for the safety and health eligibility requirement and for the environmental impact requirements. Under previous law, Commerce had to report to the Department of Labor those taxpayers who claimed to meet the safety and health eligibility requirement and Labor could audit them randomly. Section 6 of the act provides that instead Labor will report to the Department of Revenue those employers who have final orders that would make them ineligible for credits. Similarly, under previous law, Commerce had to report to the Department of Environment and Natural Resources those taxpayers who claimed to meet the environmental impact eligibility requirements and DENR could perform random audits. Section 6 of the act provides that instead DENR will report to Revenue those persons who have pending or final determinations that would disqualify them from claiming credits.

Extended carryforward periods

The Bill Lee Act credits may not exceed 50% of the tax against which they are claimed. The limitation applies to the cumulative amount of credit claimed by the taxpayer, including carryforwards. As a general rule, any unused portion of a credit may be carried forward five years. Previously, the Bill Lee Act provided three exceptions that allowed longer carryforwards. Those three exceptions are:

1. Any unused portion of a credit with respect to a large investment may be carried forward for 20 years. A large investment is one where an eligible business purchases or leases, and places in service within a two-year period, \$150 million worth of one or more of the following: real property, machinery and equipment, or central office or aircraft facility property.
2. Any unused portion of a credit with respect to the technology commercialization credit may be carried forward for 20 years. The General Assembly created the technology investment credit in 1999 as an alternative to the 7% credit for investing in machinery and equipment. The credit applies only to investments in machinery and equipment used in production based on technology licensed from a research university. The investments must be located in a tier one, two, or three county and

⁶² This is a new credit created by this act and is discussed further below.

must equal at least \$10 million during the taxable year and must total at least \$100 million over a five-year period.

3. Any unused portion of a credit may be carried forward for 10 years if the Secretary of Commerce certifies that the taxpayer will purchase or lease, and place in service in connection with an eligible business within a two-year period, at least \$50 million worth of one or more of the following: real property, machinery and equipment, or central office or aircraft facility property. If the taxpayer fails to make the level of investment certified within the two-year period, the taxpayer forfeits the enhanced carryforward period.

This act (Section 7) creates two additional exceptions that allow longer carryforwards. Under this act, any unused portion of a credit with respect to research and development under G.S. 105-129.10 may be carried forward for 15 years. Additionally, any unused portion of a credit for substantial investment in other property⁶³ under G.S. 105-129.12A may be carried forward for 20 years. These changes are effective for taxable years beginning on or after January 1, 2002, and apply to credits that are first claimed on or after that date.

Statute of Limitations

Section 7 of the act establishes a statute of limitations so that Bill Lee Act credits cannot be taken more than six months after the deadline for filing the tax return (including extensions) on which they are claimed. This change is effective beginning with the 2001 tax year. In general, an overpayment may be refunded only if the discovery is made or the written request for a refund made within 3 years of the date set by statutes for filing the return or within 6 months of the date of the overpayment, whichever is later.

Bill Lee credits applications, fees, and reports

Under previous law, to claim a credit under the Bill Lee Act a taxpayer had to provide with the tax return the certification of the Secretary of Commerce that the taxpayer met all of the eligibility requirements with respect to each credit that the taxpayer claimed. This act (Sections 8 and others) eliminates the requirement that a taxpayer must get the certification of the Secretary of Commerce in order to claim a Bill Lee Act credit. Commerce will continue to establish enterprise tier and development zone designations and will make written determinations regarding the requirements for development zone projects, large investments, the investment amount for enhanced carry forwards, and the investment amount for the new credit for substantial investment in other property.

As amended by S.L. 2001-487, this change is effective for business activities occurring on or after January 1, 2002, and for business activities occurring before January 1, 2002, for which no application has been filed with the Department of Commerce by January 1, 2003. For business activities occurring before January 1, 2002, for which an application is filed with the Department of Commerce before January 1, 2003, special interim procedures are used. The taxpayer must file an application, along with any applicable fees, with the Department of Commerce. The Department of Commerce shall not make any determination regarding eligibility for the credits and shall not issue a certification, but shall instead mark the application as paid and return it to the taxpayer. The taxpayer must then submit the marked

⁶³ This is a new credit created by this bill and is discussed further below.

application to the Department of Revenue with the relevant tax return. The fees shall be divided between the two departments as under previous law. These interim procedures were put into place as the result of a compromise between the Department of Commerce and the Department of Revenue. Since the Department of Commerce's role in certification was being eliminated, that department wanted to end all association with certification as soon as possible. The Department of Revenue needed the interim period because that department had no feasible way to collect the fee during 2002.

Taxpayers will still pay the fee that is currently paid with the application, but under this act it must be paid to the Department of Revenue with the tax return filed for the year in which the eligible activity was engaged. The fee may be paid late, however, as long as it is paid before the credit is claimed.

Under Section 6 of this act, a taxpayer may seek an advisory ruling from the Secretary of Revenue regarding the taxpayer's eligibility for a credit. Such a ruling will help taxpayers determine in advance whether planned activity will qualify for a credit. This change became effective beginning with the 2002 taxable year.

Section 9 of this act changes the requirement that taxpayers report the number of development jobs that are filled by residents of development zones. This requirement now applies only to jobs located in development zones. This change became effective beginning with the 2002 taxable year.

Section 2 of the act provides that the Department of Commerce's equity and impact studies ("Luger Report") will be updated every two years. This change became effective November 29, 2001. Previously, the Department of Commerce was required to perform these studies only once and to report on them by April 1, 2001.

Section 8 of the act requires that more detailed information be published annually by the Department of Revenue, including an itemization of Bill Lee Act credits by individual taxpayer. Section 8 became effective beginning with the 2002 tax year.

Machinery and equipment credit changes

Section 10 clarifies how the threshold applies to taxpayers who invest in more than one tier. The threshold varies depending on the enterprise tier where the machinery and equipment are placed in service. Previous law stated that if machinery and equipment were placed in service in more than one area, the threshold applied separately to each area. The Department of Revenue had interpreted "area" to mean "enterprise tier area". Section 10 of this act clarifies that the threshold applies separately to each establishment of the taxpayer rather than to each enterprise tier area. An establishment is generally a site or location. Section 10 became effective for machinery and equipment placed in service on or after January 1, 2002.

Central office or aircraft facility property credit

Section 12 of this act removes a provision regarding the expiration of the credit for investing in central office or aircraft facility property. Under previous law, the credit for investing in central office or aircraft facility property expired if the total number of people employed at the taxpayer's central office or aircraft facilities Statewide fell by 40 or more. This provision

applied only to the credit for investing in central office or aircraft facility real property – the other credits under the Act were not affected by a drop of 40 or more employees. Section 12 removes this provision. However, as is clarified in Section 6 of the act, the credit for investing in central office or aircraft facility property expires if the number of employees at the office or facility falls to below 40. Section 12 is effective for taxable years beginning on or after January 1, 2001.

New credit for substantial investment in other property

Section 13 creates a new credit under the Bill Lee Act for substantial investment in other real property. This credit is modeled upon the existing credit for investment in central office or aircraft facility property. There are, however, some notable differences between the two credits. In order for the taxpayer to claim the credit for substantial investment in other property, the Secretary of Commerce must make a written determination that the taxpayer is expected to invest at least \$10 million in real property at a location within a three-year period and that the location will create at least 200 new jobs within two years of the time that the property is first used in an eligible business. In contrast, there is no minimum investment amount for the credit for investing in central office or aircraft facility property. For both credits, the taxpayer may begin to claim the credit once the property is first used in an eligible business. The amount of the credit for substantial investment in other property is equal to 30 percent of the eligible investment amount and must be taken in installments over a seven-year period. There is no ceiling on the amount of the credit. In contrast, the credit for investing in central office or aircraft facility property is equal to seven percent of the eligible investment amount and has a ceiling of \$500,000. The credit for substantial investment in other property expires if the number of people employed at the location falls below 200. As mentioned earlier, the carryforward period for the credit for substantial investment in other property is 20 years, whereas the carryforward period for the credit for investment in central administrative office or aircraft facility property is the standard five years. A taxpayer may not claim both the credit for substantial investment in other property and the credit for investing in central office or aircraft facility property with respect to the same property.

In several other sections of the act, conforming changes related to this new credit were made. This credit became effective for taxable years beginning on or after January 1, 2002, and applies to property first used in an eligible business on or after that date.

FedEx extension

In 1998, the General Assembly amended the Bill Lee Act and other tax laws to provide an incentive for the development of interstate air courier hubs. An air courier is an air carrier that delivers individually addressed letters, parcels, and packages. Examples of air couriers include UPS and Federal Express. One provision of that act granted a bidding law exemption for the Piedmont Triad Airport Authority. The exemption is effective for a five-year period beginning January 1, 1999, and applies to design and construction of an air freight distribution facility on airport property, and related supplies, equipment, and services. Section 16 of this act extends the period of that exemption for an additional four years, until January 1, 2008. This extension would benefit the Federal Express project in Greensboro. This change became effective November 29, 2001.

Sales tax on certain electricity

Section 17 of the act, as amended by S.L. 2001-487, reduces the sales tax on electricity sold to manufacturers. Currently, electricity that is sold to a manufacturer for use at a manufacturing facility and that is separately metered or measured is subject to the sales and use tax at a rate of 2.83% – most other sales of electricity are taxed at the rate of 3%. Section 17 enacts a new tax rate schedule that will apply to all manufacturers, based on volume of electricity used annually. Beginning January 1, 2002, each taxpayer will pay one rate on electricity throughout the year. The rate will be based initially on actual usage the previous year or, in the case of a new manufacturer, estimated usage for the current year. At the end of the year, if the taxpayer has used a volume of electricity that would qualify the taxpayer for a different rate, the taxpayer would be eligible for a refund of excess taxes paid or liable for a deficiency. Beginning on January 1, 2002, manufacturers who use more than 900,000 megawatt-hours of electricity annually will pay a rate of 0.17% while all other manufacturers will continue to pay a rate of 2.83%. Beginning, July 1, 2005, the following rate schedule goes into effect⁶⁴:

<u>Megawatt-hours used annually</u>	<u>Rate</u>
5,000 or less	2.83%
Over 5,000 and up to 250,000	2.25%
Over 250,000 and up to 900,000	2.0%
Over 900,000	.17%

This section also clarifies that electricity does not "enter into" or become a component part of tangible personal property that is manufactured and is not an accessory to equipment.

Section 15 of the act requires the Revenue Laws Study Committee to review the taxation of electricity and piped natural gas used by manufacturers.

Sales tax holiday amendments

Section 18 of the act incorporates certain definitions from the Streamlined Sales Tax Project into the sales tax holiday provision. The definitions of "clothing", "clothing accessories or equipment", "protective equipment", and "sport or recreational equipment" were not included in S.L. 2001-347, Senate Bill 144, because at the time that act became law there was no special treatment of these items for sales tax purposes. The enactment of the sales tax holiday in S.L. 2001-424, Senate Bill 1005, created an instance of differential treatment of these items. Handbags appear to be the only item negatively affected by this change – with this amendment they would no longer be exempt from sales tax during the sales tax holiday. Sport and recreational equipment would be included in the sales tax holiday; it is unclear if these items would be included under the sales tax holiday as enacted by S.L. 2001-424.

⁶⁴ Under S.L. 2001-476, the number of megawatt-hours used to receive the lower rate was 1,200,000 and the effective date for the lower rate was July 1, 2002. S.L. 2001-487 reduced the number of megawatt-hours used to 900,000 and changed the effective date to January 1, 2002.

Pass-through entity allocation extension

Taxpayers are allowed an income tax credit of 20% of the expenses of rehabilitating an income-producing historic structure if the taxpayer qualifies for the federal credit. A pass-through entity may qualify for the rehabilitation credit and pass the credit 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. Generally, under North Carolina law, the pass-through entity is required to allocate a tax credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, are allocated under the Code. In 1999, the General Assembly amended G.S. 105-129.35 to allow a pass-through entity to allocate this particular credit among its owners at its discretion. That change would have expired for taxable years beginning on or after January 1, 2002. This section extends that provision for an additional two years.

Technical, conforming, and clarifying changes

Section 6 of the act clarifies the forfeiture language of G.S. 105-129.4, as requested by the Department of Commerce. Section 6 and other sections remove references to Commerce "certifying" that taxpayers "will" make certain investments, and provides instead that Commerce will "determine in writing" that the taxpayer "is expected to" make the investment. In addition there are numerous other technical and conforming changes throughout the act related to the new credit for substantial investment in other property and to the elimination of the certification process.

TECHNICAL CORRECTION ACT

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-487	HB 338	Representative Culpepper

AN ACT TO MAKE TECHNICAL CORRECTIONS AND CONFORMING CHANGES TO THE GENERAL STATUTES AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION; AND TO MAKE VARIOUS OTHER CHANGES TO THE GENERAL STATUTES AND SESSION LAWS.

OVERVIEW: This act makes technical corrections, conforming and other changes to various statutes and session laws. This summary covers those sections of the act that contain changes related to finance matters.

FISCAL IMPACT: The part of the act that reduces the megawatt-hour volume threshold for determining tax rates for electricity used by manufacturers and amends the effective date for this rate change reduces General Fund revenues for fiscal year 2001-02 by \$322,000.

EFFECTIVE DATE: See the analysis.

ANALYSIS: Section 67 makes technical changes to S.L. 2001-430, Simplify Taxes on Telecommunications. It corrects statutory references and terminology and it amends G.S. 105-164.44F to provide for a tax distribution to cities served by a telephone membership corporation.⁶⁵ This section became effective January 1, 2002.

Section 68 provides that no highway use tax applies when a motor vehicle title is reissued to remove one or more co-owner's names as long as there is no consideration for the transfer. This change became effective December 16, 2001.

Section 69 deletes redundant language since the applicable oath requirement for tax returns is already contained in G.S. 105-252. It also exempts from sales tax telecommunications charges that would otherwise be inadvertently subjected to tax under S.L. 2001-430, Simplify Taxes on Telecommunications, due to a change in definitions. These charges are paid by State agencies and local governments and are not taxed. This section became effective January 1, 2002.

Section 70 deletes a redundant word that was left in the statute due to a redlining error. This section became effective December 16, 2001.

Section 118 repeals a section of S.L. 2001-427 that no longer has an effect since it amends a statute that has been subsequently repealed. It also corrects the introductory language of another section of the same session law to correctly reflect what is being set out for redlining. This section became effective December 16, 2001.

Section 119 amends a provision passed in the Current Operations and Appropriations Act of 2001 in order to clarify that the Utilities Commission has some flexibility in lowering rates, rather than being limited to lowering only basic local line rates by the exact amount of the reduced tax burden. This change related to the telecommunications changes enacted in S.L. 2001-430. This section became effective December 16, 2001.

Section 122 reduces the megawatt-hour volume threshold for determining tax rates for electricity received by industries or plants. It also amends the effective date for the electricity provisions of S.L. 2001-476, Bill Lee Act Changes.⁶⁶ This section becomes effective December 16, 2001, and applies to sales made on or after January 1, 2002.

⁶⁵ See the summary for S.L. 2001-430 for a more complete explanation of this tax law change.

⁶⁶ See the summary for S.L. 2001-476 for a more complete explanation of this tax law change.

Section 123 amends S.L. 2001-476 to eliminate the Department of Commerce's role in certifying applications for credits as soon as possible, but to still maintain a mechanism for the collection of fees paid in connection with the credits until the Department of Revenue can take over. This section became effective December 16, 2001.

**VEHICLE TRANSITION/HMOS/
PREPARED FOOD**

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-489	HB 748	Representative Nesbitt

AN ACT TO PROVIDE TRANSITIONAL PROVISIONS FOR THE REPEAL OF THE HIGHWAY USE TAX CAP ON NONCOMMERCIAL MOTOR VEHICLES, TO TEMPORARILY MODIFY THE TAXATION OF HMOS AND MEDICAL SERVICE CORPORATIONS, AND TO CLARIFY THE SALES TAX EXEMPTION FOR PREPARED FOOD.

OVERVIEW: This act contains the three provisions listed below:

- Section 1 provides that the repeal of the \$1,500 highway use tax cap effective October 1, 2001, does not apply to vehicle titles issued pursuant to a sale or a contract entered into or awarded before October 1, 2001.
- Section 2 delays by one year the premiums tax equalization for HMOs and Medical Service Corporations, and makes up the revenue by one-time estimated payments and a slightly higher rate in 2003.
- Section 3 clarifies that prepared food is taxed the same under the Streamlined Sales and Use Tax Agreement, enacted earlier this session as S.L. 2001-347, as it was taxed under previous law. Section 3 also deletes part of a definition that would have inadvertently exempted alcoholic beverages served in restaurants from local meals taxes.

FISCAL IMPACT: No fiscal impact is expected as a result of the enactment of Section 1. Any refunds to be made are based on over collections that were not anticipated in S.L. 2001-424, the Appropriations Act

No fiscal impact is expected in FY 2001-02 as a result of Section 2 (premiums tax). The specifics of the new plan were designed in such a way that the new revenue produced for 2002-03 would be equal to the amount captured for that year under S.L. 2001-424. Thus this section is revenue neutral for 2002-03 with regard to the provisions adopted in that act. For future years it is difficult to determine the exact impact of either the prior change or the new provisions due to the uncertainty in the health insurance marketplace. For 2003-04 there might be a revenue loss (compared to S.L. 2001-424) due to the acceleration of estimated tax payments into 2002-03 to ensure revenue neutrality for that year.

Enactment of Section 3 in and of itself has no fiscal impact as it returns the definition to that anticipated in the original fiscal note for S.L. 2001-347. However, failure to enact this change would have resulted in a substantial revenue loss to the State by eliminating the State sales tax on all take-out, drive-thru, and delivery foodstuffs. Based on the 1997 Economic

Census, Fiscal Research believes the minimum loss from not enacting this section of the act is as follows:

FY 2001-02	- \$30.26 million
FY 2002-03	- \$62.84 million
FY 2003-04	- \$63.34 million
FY 2004-05	- \$65.72 million
FY 2005-06	- \$70.26 million

This is only a minimum estimate as it does not include take-out from a full service restaurant or any other restaurant that is not primarily drive-thru, take-out, or delivery.

EFFECTIVE DATE: Section 1 and subsections a and b of section 2 became effective on December 19, 2001. Subsections f and g of Section 2 (premiums tax) are effective for taxable years beginning on or after January 1, 2004. The remainder of Section 2 is effective for taxable years beginning on or after January 1, 2003. Section 3 (prepared food) became effective January 1, 2002, and applies to sales made on or after that date.

ANALYSIS:

Motor Vehicle Transition

Section 1 of the act is a transitional provision regarding the repeal of the highway use tax cap on noncommercial vehicles. Section 34.24 of S.L. 2001-424 repealed the \$1,500 highway use tax cap that applied to certificates of title issued for motor vehicles other than certain commercial motor vehicles. This repeal became effective for certificates of title issued on or after October 1, 2001. The budget became law on September 26, 2001, only a few days before the repeal of the tax cap went into effect. Some motor vehicle dealers complained that they sold or contracted to sell vehicles, including expensive recreational vehicles, before October 1, 2001, but did not apply for the titles until after October 1. In these cases, they did not collect the additional tax from the purchaser but were liable to the State for the additional tax. Section 1 of this act provides that the repeal of the tax cap does not apply to titles issued as a result of a sale or a contract awarded or entered into before October 1, 2001.

Modify Taxation of HMOs and Medical Service Corporations

Section 2 of the act temporarily modifies the gross premiums tax on HMOs and Medical Service Companies. Section 34.22 of S.L. 2001-424 levied a gross premiums tax on HMOs and raised the rate of gross premiums tax on Medical Service Corporations. The rate for the 2002 tax year was to be 0.83% and the rate for 2003 and later tax years was to be 1%. Section 2 of the act changes that provision as follows:

- The tax changes are delayed from the 2002 tax year until the 2003 tax year.
- The tax rate for 2003 will be 1.1% and the tax rate for 2004 and later tax years will be 1%.
- For the 2003 tax year only, HMOs and Medical Service Corporations will pay the following estimated payments of the 2003 tax: 50% on April 15, 2003 and 50% on June 15, 2003, with true-up the following March 15. For subsequent tax years, the general law on installment payments of gross premiums tax will apply.

The HMO and medical service corporation industry requested this change because they had already sent their customers rate notices for the 2002 tax year that did not include the 0.83% rate for the 2002 tax year.

Clarify Sales Tax on Prepared Food and Meals Tax on Prepared Alcoholic Beverages

Under existing law, prepared foods that were prepared at a grocery store and sold in an unheated state were exempt from sales tax because they were eligible to be purchased for home consumption under the Federal Food Stamp Program. When the General Assembly enacted S.L. 2001-347, Streamlined Sales and Use Tax Agreement, it made the policy decision to tax candy, soft drinks, and prepared food in the same manner as under existing law. However, as the language in that act was drafted, some argued that it broadened the sales tax exemption for prepared food to include all take-out food items from restaurants and fast food chains and all catered food. These food items were taxable under existing law. An exemption for take-out food items would have resulted in a General Fund loss of approximately \$60 million a year. Subsection 3(b) of this act rewrites the language in the Streamlined Sales and Use Tax Agreement to make it clear that only those food items that were exempt under existing law will be exempt under the Streamlined Sales and Use Tax Agreement.

In addition, under existing law, local meals taxes applied to the entire meal, including alcoholic beverages. When the definition of food was rewritten in S.L. 2001-347 the definition excluded alcoholic beverages because, for sales tax purposes, alcoholic beverages were not entitled to the food tax exemption. Because local meals tax laws were linked to the sales tax definitions, prepared alcoholic beverages (beer, wine, mixed drinks) would have been inadvertently exempted from local meals taxes effective January 1, 2002. Section 3 maintains the existing law by providing that local meals tax continues to apply to alcoholic beverages. The following local governments have a meals tax: Cumberland County; Dare County; Mecklenburg County; Wake County; Town of Hillsborough

MODIFY VEHICLE TAX REFUND & TAX CAP

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-497	HB 72	Representative Allred

AN ACT TO EXTEND THE DEADLINE FOR APPLYING FOR A RELEASE OR REFUND OF PROPERTY TAXES AFTER THE OWNER HAS SURRENDERED THE VEHICLE LICENSE PLATE, AND TO CAP THE HIGHWAY USE TAX ON CERTAIN RECREATIONAL VEHICLES AT \$1,500 PER VEHICLE.

OVERVIEW: This act does two things:

- It extends from 120 days to one year the time a taxpayer has to request a refund for property taxes paid on a motor vehicle for which the taxpayer has surrendered the vehicle's registration plate.

- It places a maximum highway use tax of \$1,500 on recreational vehicles that do not qualify for the existing \$1,000 maximum tax.

FISCAL IMPACT: Due to a lack of data, the General Assembly’s Fiscal Research Division cannot determine how many taxpayers do not file for the refund and/or release once the plates are surrendered or what proportion of those taxpayers who did not apply will apply under the extended timeline. As such, no formal estimate is possible. However, both the Division of Motor Vehicles and Fiscal Research believe the number of taxpayers that will take advantage of the deadline extension will be insignificant.

Based on sales data from the years 2000 and 2001 from 3 high volume RV dealerships, the total revenue gained from removing the \$1,500 highway use tax cap on recreational vehicles is \$842,811 in a full year. Passage of this bill for the nine months in FY 2001-02 will result in the loss of \$632,000 to the Highway Trust Fund. The loss occurs because the anticipated gain from removing the cap in S.L. 2001-424 was transferred to the General Fund. While the cap was restored for recreational vehicles in this act, the General Fund transfer has not been reduced.

Applying the growth rates projected by the Office of State Budget and Management for the highway use tax, the future revenue loss is as follows:

<u>Fiscal Year</u>	<u>Revenue</u>
FY 2001-02	\$632,000
FY 2002-03	\$908,550
FY 2003-04	\$961,246
FY 2004-05	\$1,016,037
FY 2005-06	\$1,068,871

EFFECTIVE DATE: The effective date of the extension of the deadline for requesting a refund was December 19, 2001. The effective date for the reapplication of the \$1,500 cap on the highway use tax is retroactive to October 1, 2001

ANALYSIS:

Property Tax Change

An owner of a motor vehicle who a) either transfers the motor vehicle to another owner or moves out-of-state and registers the vehicle in another jurisdiction, and b) surrenders the registration plates from the vehicle to the Division of Motor Vehicles may apply for a release or refund of taxes on the vehicle for the full calendar months that remain in the vehicle's tax year. In 1995, the General Assembly extended the time period to apply for this refund or release to 120 days to give the taxpayer sufficient time to ask for a release or refund of taxes after the taxpayer received a property tax bill. This time period appeared to be sufficient except in instances where the tax bill was received late for some reason. Section 1 of this act extends the period of time a taxpayer has to request a refund for property taxes paid on a motor vehicle for which the taxpayer has surrendered the vehicle’s registration plate from 120 days to one year.

A taxpayer who has a valid defense to a tax also has the ability to ask for a refund of a property tax at any time within five years after the tax first became due or within six months from the date the tax was paid, whichever is the later date. This time period is the same for real property, personal property, and motor vehicles. There are three valid defenses to the enforcement of the collection of a tax assessed upon property:

- The tax is imposed through clerical error.
- The tax is levied for an illegal purpose.
- The tax is an illegal tax.

The board of county commissioners holds the county tax collector accountable for the amount of taxes collected. Unpaid taxes on motor vehicles are often collected when DMV refuses to renew the vehicle's registration until the taxes are paid. The unpaid taxes may also be collected through the enforcement measures of levy, attachment, and garnishment. The tax collector has 10 years from the date the property taxes become due to begin enforcement proceedings. This statute of limitations is the same for all types of property. If the tax is uncollectible because the taxpayer is insolvent, the board of county commissioners may, in its discretion, relieve the tax collector of the responsibility of collecting the tax if the tax is five or more years past due. This time period is shortened to one year for motor vehicles when the board finds that the taxes are uncollectible.

Highway Use Tax Change

Section 34.24 of the Current Operations and Appropriations Act, S.L. 2001-424, repealed the \$1,500 highway use tax cap that applied to certificates of title issued for motor vehicles other than certain commercial motor vehicles. Class A and Class B commercial motor vehicles are subject to a \$1,000 highway use tax cap. The Attorney General's office has written a letter indicating that recreational vehicles that weigh more than 26,000 pounds qualify as Class B commercial motor vehicles, and so are subject to the \$1,000 tax cap. Section 2 of this act restores a \$1,500 Highway Use Tax cap for lighter recreational vehicles, which are not subject to the \$1,000 cap because they do not qualify as commercial vehicles. Section 2 is effective retroactively to October 1, 2001, so that a \$1,500 cap applies to non-commercial recreational vehicles both before and after the removal of the \$1,500 tax cap for other vehicles. The maximum tax of \$1,500 on certain recreational vehicles means that a vehicle valued at over \$50,000 does not pay the highway use tax at a full 3% rate because the cap is reached once the vehicle's value reaches \$50,000.

AMEND USE VALUE STATUTES

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-499	HB 1427	Agriculture Committee

AN ACT TO AMEND THE PRESENT-USE VALUE STATUTES AND TO ESTABLISH THE PROPERTY TAX STUDY COMMISSION.

OVERVIEW: The act makes two changes to the present-use value statutes:

- It provides that the owner of land classified as agricultural land, horticultural land, or forestland can transfer the property, regardless of whether the new owner already has property in the classification, without losing the property's use value tax status.
- It allows the owner of land classified as agricultural land, horticultural land, or forestland to prepay any deferred taxes that are lien on the property.

The act also authorizes a Property Tax Study Commission.

FISCAL IMPACT: There is no General Fund impact due to this act. The estimated fiscal impact to local governments cannot be determined.

EFFECTIVE DATE: January 1, 2002.

BACKGROUND: Property tax law provides that unless property is exempted or classified for special tax treatment, it is to be taxed at its market value. Agricultural land, horticultural land, and forestland may be classified as a special class of property and taxed at their value in the land's present use as agricultural land, horticultural land, or forestland. The special classification for farm property was enacted in the 1970s to help preserve family farms. The difference between the taxes due on the present use value treatment and the taxes that would have been payable in the absence of this special treatment, together with any interest, penalties, or costs, are a lien on the property. The difference in taxes is carried forward in the records of the taxing unit as deferred taxes. The deferred taxes for the preceding three years become payable whenever the property loses its eligibility for the benefit of the special use value law.

ANALYSIS: Section 1 of the act expands the applicability of the use-value program to farmer-to-farmer transfers. Under current law, the property must be the owner's residence on have been owned by the person for four years before the property can be classified in the use-value program. When an owner transfers property to a person who does not qualify for the use-value program, then the previous owner is responsible for paying the deferred taxes. Prior to the act, there was an exception to the four-year ownership requirement, if the new owner owned other property classified in the use-value program. Section 1 removes the requirement that the new owner have other property classified in the use-value program. However, the new owner must acquire the land for the purposes of and continue to use the land for the purposes it was classified under the use-value program. The new owner is liable

for the deferred taxes. The years of deferred taxes, plus the current year's taxes including interest and penalties, on the classified property become due when the property no longer qualifies for the classification.

Section 2 of the act clarifies that a person may pay the deferred taxes for any given year for that year without the qualifying land becoming ineligible for use-value status. This prepayment of deferred taxes may be a helpful planning tool for a person who is planning to transfer the land in the near future to a person who does not meet the ownership requirements or to use the land in the future in a way that does not meet the use requirements.

Section 3 of the act establishes the Property Tax Study Commission. Both the Speaker of the House and the President Pro Tempore of the Senate may appoint eight members each: four legislative members and four public members. The Committee may submit a report to the 2002 Regular Session and must submit a report on or before the convening of the 2003 Session. The Committee may study all of the following issues:

General Property Tax Issues

Examine all classifications of property, including the taxability of nonprofit charitable hospitals, as well as other exemptions and exclusions of property from the property tax base.

Present-Use Value Issues

Study the present-use value system, including the following:

- Examine the implementation and application of the current use value statutes
- Evaluate other tax credits, including adjustments to and credits for ad valorem taxes, to encourage agricultural, forestry, and horticultural use of land.
- Evaluate the treatment of undeveloped land in ad valorem tax.
- Evaluate the possibility of tax incentives to encourage conservation and environmental protection of land. The study must include the feasibility of allowing forestland managed for conservation purposes and the preservation of wildlife habitats to be taxed at its present-use value.
- Review other issues related to the taxation of agricultural, horticultural, and forestland, including reducing the acreage requirement for land to qualify as forestland.

CERTAIN MANUFACTURED HOMES
REAL PROPERTY

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-506	HB 253	Representative Brubaker

AN ACT TO PROVIDE THAT MANUFACTURED HOMES NEED NOT HAVE MULTIPLE SECTIONS TO QUALIFY AS REAL PROPERTY FOR PROPERTY TAX PURPOSES, TO REQUIRE AN OWNER TO SURRENDER CERTIFICATE OF TITLE WHEN THE MANUFACTURED HOME BECOMES REAL PROPERTY, AND TO REQUIRE AN OWNER TO FILE EVIDENCE OF THE SURRENDER OF TITLE WITH THE REGISTER OF DEEDS.

OVERVIEW: The act makes the following changes to the laws regarding the classification of a manufactured home as real property:

- Amends the definition of "real property" in the property tax laws by removing the requirement that a manufactured home must have multiple sections to be considered real property.
- Codifies the current policy of the Division of Motor Vehicles (DMV) requiring an owner of a manufactured home to submit an affidavit and surrender the certificate of title to DMV when the manufactured home becomes real property under the property tax laws.
- Requires the owner of real property who has surrendered the certificate of title to a manufactured home on the real property and submitted an affidavit to DMV to then file the returned affidavit in the officer of the register of deeds where the property is located.
- Allows the owner of real property on which an untitled manufactured home has been or will be placed to file a declaration of intent to place a manufactured home on the real property and to convey or encumber the real property, including the manufactured home.

FISCAL IMPACT: There is no General Fund impact due to this act. The fiscal impact to local governments cannot be determined.

EFFECTIVE DATE: The change to the definition of "real property" in the property tax laws is effective for taxes imposed for taxable years beginning on or after July 1, 2002. The remainder of the act became effective January 1, 2002, and applies to manufactured home title cancellations and to declarations of intent, deeds, deeds of trust, and other instruments recorded after that date.

BACKGROUND: Since 1987, North Carolina law has provided that a residential manufactured home constitutes "real property" for property tax purposes if it meets the following requirements: is multi-sectioned (two or more sections); has the moving hitch,

wheels, and axles removed; and has been placed on a permanent foundation on land owned by the owner of the home. Manufactured homes, in many cases, are titled by DMV through the issuance of a certificate of title. When a home is treated as real property for property tax purposes, the owner will often apply to DMV to cancel the title, as the financing may be obtained through a real estate mortgage recorded in the local register of deeds office, rather than a personal property lien reflected on the title. DMV has developed an informal procedure for canceling these titles upon the owner's request, and with the consent of the lender. DMV, the manufactured housing industry, mortgage lenders, title insurance companies, and real estate closing attorneys have been interested in clarifying this procedure and enacting it into law. This act codifies and clarifies the procedure.

ANALYSIS: Under prior law, the tax assessor was to consider the manufactured home as real property for property tax purposes if it was a multi-section residential structure; had the moving hitch, wheels, and axles removed; and was placed upon a permanent enclosed foundation on land owned by the owner of the home. Section 1 removes the multi-section requirement from the definition of "real property" in G.S. 105-273. Section 1 also clarifies that a residential manufactured home will be considered tangible personal property if the moving hitch, wheels, and axles are still in tact, and the home has not been placed on a permanent foundation on land owned by the owner of the home. This change will allow for a more uniform procedure for determining whether a manufactured home is real or personal property for tax purposes.

Section 2 of the act codifies the current policy of the DMV to require an owner of a manufactured home to submit an affidavit and surrender the certificate of title to DMV when the manufactured home meets the definition of real property under G.S. 105-273. The affidavit must contain information of the manufacturer, vehicle identification number and serial number of the home, legal description of the property on which the home is placed, any security interests in the home, and the Division's notation that the title has been surrendered and cancelled. After canceling the title, DMV must return the original affidavit to the owner. The owner must then file the affidavit in the office of the register of deeds where the owner's real property is located. Section 2 also provides for a procedure to apply for a new certificate of title if the owner later seeks to remove the manufactured home from the real property. A violation of section 2 is a civil penalty of up to \$100 to be imposed in the discretion of the Commissioner of Motor Vehicles. This change was enacted to prevent manufactured home owners from attempting to have their homes assessed as personal property once the homes became affixed to the owner's real property and met the other requirements of "real property" in G.S. 105-273.

Sections 3 and 4 of the act, add new provisions to Chapter 47 (Probate and Registration) of the General Statutes regarding filing documents with the register of deeds when a manufactured home becomes attached to real property or will become attached to real property. Section 3 requires an owner of real property who has filed an affidavit and surrendered a certificate of title to a manufactured home on the real property to DMV, to then file the returned affidavit with the office of the register of deeds. Once this affidavit is recorded, the manufactured home is considered an improvement to real property, and all existing liens on the real property are considered to include the manufactured home.

Section 4 of the act adds a provision to Chapter 47 that allows the owner of real property on which an untitled manufactured home has or will be placed to file a declaration of intent to place a manufactured home on the real property and to convey or encumber the real property, including the manufactured home. A manufactured home may not have been titled in a situation where there is a new manufactured home and the buyer and seller intend for the home to be located on a permanent foundation and sold and financed as a real estate transaction. Section 4 allows the owner of the real property to record a declaration of intent that contains the same information that would be required in an affidavit submitted to DMV if that home had been previously titled. Upon filing of the declaration of intent, the manufactured home is treated as an improvement to the real property. Therefore, all liens or mortgages against the real property will include the manufactured home.

CORPORATE ASSET TRANSFERS

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-508	HB 168	Representative Culpepper

AN ACT TO PERMIT A CORPORATION TO TRANSFER ASSETS TO A WHOLLY OWNED UNINCORPORATED ENTITY, AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, TO AMEND THE INDEMNIFICATION PROVISIONS OF THE PATIENT'S BILL OF RIGHTS, TO SUPPORT TROOPS PARTICIPATING IN OPERATIONS ENDURING FREEDOM AND NOBLE EAGLE, AND TO PERMIT LEAVE FOR DISASTER SERVICE VOLUNTEERS.

OVERVIEW: This act makes the changes listed below. This summary addresses in detail only those provisions of the act that affect the tax laws.

- Permits the board of directors of a corporation to transfer corporate assets to a wholly owned limited liability company, limited partnership, registered limited liability partnership, or other unincorporated entity without the approval of the shareholders. (Section 1)
- Amends the indemnification provisions of the Patient’s Bill of Rights. (Section 2)
- Supports troops participating in Operations Enduring Freedom and Noble Eagle by authorizing the Governor to waive deadlines, fees, and penalties; extending applicable deadlines for paying property taxes and listing property for taxation; and allowing community college and UNC system refunds and waiver of legislative tuition grants to deployed students who are unable to complete the semester. (Sections 3 – 5 and 7 – 9)
- Permits State agencies to grant State employees who are certified Red Cross volunteers paid leave from work to assist with disaster relief. Under prior law, leave was permitted only for services related to a disaster occurring with the State. The act

permits paid leave to employees providing services related to a disaster occurring anywhere within the United States. (Section 6)

FISCAL IMPACT: Under certain circumstances, there could be tax advantages to transferring corporate assets to an unincorporated entity. However, many of these potential tax advantages were removed with the enactment of S.L. 2001-327. As a result, the North Carolina Department of Revenue does not believe passage of this legislation, in and of itself, will substantially affect State revenue. While there is a potential for a fiscal loss as an indirect consequence of the act, that impact is expected to be minimal. No estimates were available on the fiscal impact of the remaining sections of the act.

EFFECTIVE DATE: Section 2 (indemnification rights) is effective July 1, 2002; the remainder of the act became effective on December 19, 2001, the date the bill became law. Section 1 of the act applies to transfers occurring on or after that date.

ANALYSIS:

Corporate Asset Transfers

Section 1 of this act expands the types of entities to which the board of directors of a corporation can transfer corporate assets without shareholder approval to include wholly owned unincorporated entities. The term "unincorporated entity" is defined in the North Carolina Business Corporation Act to mean domestic or foreign limited liability companies, domestic or foreign limited partnerships, registered limited liability partnerships, and other partnerships. The articles of incorporation or the bylaws of the parent company could still prohibit such a transfer. This section was a recommendation of the General Statutes Study Commission.

Support Troops/ Civil Relief

Section 5 of this act extends property tax deadlines for military personnel called to active duty as a result of the terrorist attacks on September 11, 2001. Section 5(a) provides that these individuals are allowed 90 days after the end of their deployment to pay property taxes that became due or delinquent during the deployment. If the taxes are paid within this 90-day period, no interest is due. Section 5(b) of the act provides that deployed military personnel are allowed 90 days after the end of their deployment to list for taxation property that was otherwise required to be listed during their deployment. If the property is listed within this 90-day period, no penalties for failure to list apply.

NO TAX ON NEWSPAPERS SOLD IN VENDING MACHINES

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-509	SB 400	Senator Hoyle

AN ACT TO TREAT NEWSPAPER VENDING MACHINES AS STREET VENDORS FOR SALES TAX PURPOSES.

OVERVIEW: This act exempts all sales of newspapers sold through vending machines from sales and use tax.

FISCAL IMPACT: Data are not available to estimate the fiscal impact of this act. However, it is expected the impact of this act will be relatively small given the limited number of papers sold through stand alone machines and the fact that all vending machine sales that were primarily taxable were subject to only 50% of the tax rate.⁶⁷

EFFECTIVE DATE: January 1, 2002.

ANALYSIS: This act exempts all sales of newspapers through vending machines from sales and use tax. Confusion had arisen about the tax status of newspapers sold through vending machines at convenience stores, shopping areas, and malls. This act simplifies the taxation issue by exempting all sales of newspapers sold through vending machines.

Newspapers sold by a street vendor are specifically exempt from sales and use tax. Prior to January 1, 2002, the taxability of newspapers sold through vending machines depended upon whether the vending machine could be considered analogous to a "street vendor". Under the Department of Revenue's longstanding interpretation of the law, vending machines located in public areas, such as shopping centers and malls, airport terminals, train stations, bus stations, and other locations that were not inside or on the premises of a store or business, were considered a form of "street vendor". As such, the sale of newspapers through those machines was exempt from tax. However, newspapers sold through vending machines located inside or on the premises of a store or business were not considered analogous to a "street vendor" and therefore those sales were subject to tax.

The issue became more pronounced when the Department of Revenue began to consider the sale of newspapers through vending machines located inside or on the premises of a business in its sales tax audits of those businesses. As a result of the confusion on this issue, the Department agreed not to pursue any of these taxes before April 1, 2001, and not to attempt to collect back taxes prior to this date.

⁶⁷ G.S. 105-164.13(50).

TAX REVENUE FOR TURFGRASS RESEARCH

<i>Session Law #</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-514	HB 688	Representative Gibson

AN ACT TO TAX THE SALES OF FERTILIZERS AND SEED TO NONFARMERS AND TO APPROPRIATE REVENUES FOR TURFGRASS RESEARCH AND EDUCATION AND THE SAVINGS RESERVE ACCOUNT.

OVERVIEW: This act does three things:

- It imposes a 6.5% State and local sales tax on fertilizers and seed sold to consumers other than farmers.
- It appropriates \$700,000 from the General Fund for each year in the 2001-03 biennium budget for turfgrass research and education.
- It credits \$750,000 from the General Fund to the Savings Reserve Account in fiscal year 2001-02.

FISCAL IMPACT: The fiscal impact of the act is as follows:

	<i>FY 2001-02</i>	<i>FY 2002-03</i>	<i>FY 2003-04</i>	<i>FY 2004-05</i>	<i>FY 2005-06</i>
General Fund	\$2,305,937	\$6,271,702	\$5,745,039	\$5,867,577	\$5,990,116
NCSU	(600,000)	(600,000)			
Dept. of Ag.	(100,000)	(100,000)			
Savings Res.	(750,000)	-	-	-	-
Net General Fund	\$855,937	\$5,571,702	\$5,745,039	\$5,867,577	\$5,990,116

EFFECTIVE DATE: The act is effective February 1, 2002.

ANALYSIS: This act imposes the 6.5% State and local sales tax on seeds and fertilizers sold to non-farmers.⁶⁸ Prior to the enactment of this act, fertilizers used for agricultural purposes and seeds were not subject to State or local sales tax. The General Assembly enacted this exemption when farmers primarily used these items. Today, non-farmers purchase an increasing volume of these items.

The act appropriates \$700,000 from the General Fund for each of the two fiscal years in this biennium for turfgrass research and education. Of this amount, \$600,000 is appropriated to The University of North Carolina to be allocated to North Carolina State University (NCSU). The remaining \$100,000 is appropriated to the Department of Agriculture and

⁶⁸ The Governor's Loophole Study Commission and the Governor recommended this provision to the General Assembly. The Senate included it as one of its revenue raising items in its budget bill, the 3rd Edition of SB 1005.

Consumer Services for the purpose of educating the public on the results of the research conducted by the Center for Turfgrass Environmental Research and Education at NCSU.

NCSU estimates that it needs approximately \$1,000,000 annually to support current turfgrass research at the University. It has not received an appropriation of more than \$200,000 for this purpose. This act provides \$600,000 for this funding need. The remaining \$400,000 will come from the turfgrass industry and other private sources.

NCSU approved the establishment of the Center for Turfgrass Environmental Research and Education in March 2001. The Center will be the focus of turfgrass research activities at NCSU. It will be established as a partnership with the North Carolina turfgrass industry and serve a key educational role in communicating with the turfgrass community and the general public. The Center will be the first of its kind; one of its goals is to position the Turfgrass Program in North Carolina at the forefront of turfgrass research and education in the United States.

A faculty member at NCSU will serve as the Director of the Center. The Director will coordinate research and on-site extension activities. An "Industry Advisory Board" will meet annually to review research and outreach efforts and offer suggestions on focus, impact, and directions for the new program. The Board will set priorities and make decisions on project funding. The Board will be composed of leaders in the turfgrass industry. This act specifies that the Board must include representatives from NCSU and NC A&T University. The Board may receive requests for funding proposals from both NCSU and NC A&T University.

The act provides that the Board of Governors and the Commissioner of Agriculture must report to the Joint Legislative Commission on Governmental Operations and to the Fiscal Research Division by November 1, 2002, on the use of the funds allocated to the Center for Turfgrass Education and Research and the sharing of the research with the other constituent institutions.

Lastly, the act requires the State Controller to credit \$750,000 from the General Fund to the Savings Reserve Account by June 30, 2002. The Savings Reserve Account is a restricted reserve in the General Fund. The funds in the Savings Reserve Account cannot be used unless the use has been approved by an act of the General Assembly.

EXTEND SUNSET ON STATE PORTS TAX CREDIT

<i>Session Law</i>	<i>Bill #</i>	<i>Sponsor</i>
S.L. 2001-517	HB 1388	Representative Hurley

AN ACT TO EXTEND THE SUNSET ON THE STATE PORTS TAX CREDIT.

OVERVIEW: This act extends the sunset on the credit for North Carolina State Ports Authority wharfage, handling, and throughput charges to January 1, 2003.

FISCAL IMPACT: The act is expected to reduce General Fund revenues \$657,000 annually.

EFFECTIVE DATE: The bill is effective for taxable years beginning on or after March 2, 2000. The bill is effective retroactive to March 2, 2000, so that the availability of the credit remains uninterrupted.

ANALYSIS: This act extends the sunset on the State Ports tax credit an additional 34 months. Before the enactment of this act, the credit expired for tax years ending on or before February 28, 2001.

The State Ports Authority tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual (G.S. 105-151.22) or a corporation (G.S. 105-130.41). The amount of the tax credit is equal to the amount of wharfage, handling, and throughput charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50% of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is \$2 million.

In 1992, the General Assembly enacted the State Ports income tax credit to encourage exporters to use the two State-owned port terminals at Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. In 1994, the General Assembly expanded the credit to include all amounts assessed on exported cargo, regardless of who paid the shipping costs. In 1995, the General Assembly expanded the credit to include some imports by allowing a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. It did not allow a credit for bulk cargo imported at Wilmington. In addition, the credit for bulk exports was then limited to bulk exports at only the Morehead City terminal. In 1996, the General Assembly expanded the State ports income tax credit to include the importing and exporting at either terminal of one specific type of bulk cargo: forest products. All imports and exports of bulk cargo at the Morehead City terminal were already covered, so the effect of this change was to allow a credit for

forest product imports and exports at the Wilmington terminal. In 1997, the General Assembly extended the sunset of the State ports income tax credit from February 28, 1998 to the taxable year ending on or before February 28, 2001, and increased the maximum cumulative credit from \$1 million to \$2 million per taxpayer. This increase became effective for taxable years beginning on or after January 1, 1998.

Although not defined by the relevant statutes, the various types of cargo differ as follows:

- Bulk cargo is a type of commodity that is loose and usually stockpiled. Examples of this type of commodity include coal, grain, salt, and wood chips.
- Break-bulk cargo consists of commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc. Break-bulk cargo also includes machinery,
- Container cargo consists of commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling.

-END-