2003 Finance Law Changes

ONE-TIME RENTAL CAR TAX ELECTION EXCEPTION.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-5	**SB 235**	**Senator Hoyle**

AN ACT TO ALLOW A RETAILER THAT LEASES MOTOR VEHICLES AND THAT HAS PAID THE HIGHWAY USE TAX ON THE MOTOR VEHICLES TO PAY AN ADDITIONAL GROSS RECEIPTS TAX ON THE MOTOR VEHICLES.

OVERVIEW: This act allows a retailer who leases motor vehicles to elect to begin paying the highway use tax on the gross receipts derived from leasing the vehicles even though the retailer has previously paid the 3% highway use tax on these vehicles. The retailer's election to begin paying the gross receipts tax must have been made by July 1, 2003 and if made, is irrevocable. The election does not relieve the retailer of liability from a tax previously imposed.

FISCAL IMPACT: This act has no fiscal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on March 28, 2003. An election to pay the gross receipts tax must have been made by the retailer by July 1, 2003.

ANALYSIS: In 1989, the General Assembly enacted the highway use tax to provide a major source of revenue for the Highway Trust Fund. The tax rate is 3% of the retail value of a motor vehicle for which a certificate of title is issued. The Division of Motor Vehicles collects the tax. A retailer that leases or rents motor vehicles may elect not to pay the highway use tax. Instead, the retailer may elect to pay an 8% tax on the gross receipts of the short-term lease or rental and a three percent (3%) tax on the gross receipts of long-term rentals. Although the gross receipts tax is imposed on the retailer, it is added to the lease or rental price of the vehicle and is ultimately paid by the person who leases or rents the vehicle. The gross receipts tax is collected by the Department of Revenue. The tax levied at 3% is credited to the Highway Trust Fund and the tax levied at 8% is credited to the General Fund.

This act allows a retailer who leases motor vehicles and who elected to pay the highway use tax on the retail value of the vehicles at the time the retailer obtained a certificate of title for those vehicles to collect the alternate gross receipts tax. In order to collect the gross receipts tax on these vehicles, a retailer must have submitted a written request to the Division of Motor Vehicles and the Department of Revenue by July 1, 2003. The retailer was required to specifically identify the vehicles to which the election applied, the date upon which the retailer would begin collecting the additional taxes, and any additional information needed to collect the tax. If a retailer elected to pay the gross receipts tax under this act, that election is irrevocable and does not relieve the taxpayer of liability for any tax previously imposed.

Typical practice throughout the rental car industry is for the highway use tax to be paid on the receipts of the rentals. Typically states that impose a tax on the leasing of vehicles impose a gross receipts tax. However, in North Carolina, at least one rental car retailer elected to pay the highway use tax at the time the retailer obtained the certificates of title for its fleet. To be consistent with other companies in the industry and to be consistent among the various states in which the retailer leases its motor vehicles, the retailer requested authorization to collect the gross receipts tax on its rentals.

IRC UPDATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-25	**HB 320**	**Rep. McComas**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS.

OVERVIEW: This act rewrites the definition of the Internal Revenue Code used in State tax statutes to change the reference date from May 1, 2002 to January 1, 2003. Part XXXVII-A of S.L. 2003-284 updated the reference date to June 1, 2003. (See summary for S.L. 2003-284 for more details.) Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law.

FISCAL IMPACT: This act results in a revenue gain of less than $30,000 per year. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on April 24, 2003.

ANALYSIS: Congress enacted the Clergy Housing Allowance Clarification Act of 2002 (P.L. 107-181) which clarifies the amount that may be excluded from gross income by a minister for a rental allowance paid to the minister as part of the minister's compensation. Under previous federal law, the rental allowance was excluded to the extent the allowance was used to rent or provide a home for the minister. Specifically, new la provides that the rental allowance is excluded to the extent that it is used to rent or provide a home for the minister but only to the extent that it does not exceed the fair market rental value of the home.

This legislation originated as an effort to head off a constitutional challenge to the clergy housing exclusion in a case before the Ninth Circuit Court of Appeals, *Warren v. Commissioner of Internal Revenue*, 282 F.3d 1119 (9th Cir. 2002). In this case, Reverend Rick Warren had purchased a home and for three years excluded a portion of his compensation from his church on the basis of the rental allowance exclusion. The IRS determined that, pursuant to a 1971 Revenue Ruling, the amount excluded should have been limited to the fair market rental value of his home and assessed a deficiency. Rev. Warren contested the deficiency. In May 2000, the United States Tax Court ruled that the IRS erred in finding Rev. Warren's housing allowance exclusion was limited to the fair market rental value of his home. The government appealed the Tax Court decision to the Ninth Circuit Court of Appeals. Although neither party raised a constitutional issue on appeal, the Ninth Circuit, on its own, queried whether the rental allowance exclusion for ministers of the Code violated the Establishment Clause of the United States Constitution and requested the parties to submit briefs on that issue. This prompted the introduction of the Clergy Housing Allowance Clarification Act of 2002 as an effort by Congress to preserve the 81-year-old law exempting from federal income tax the provision of residential housing for clergy. The legislation moved swiftly thorough Congress, and two days after the President signed the measure, both parties in the case requested a dismissal of the appeal.

MODIFY COUNTY TAX CERTIFICATION AUTHORITY.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-72	**HB 393**	**Representative Stam**

AN ACT TO MODIFY THE AUTHORITY OF THE BOARD OF COUNTY COMMISSIONERS IN CERTAIN COUNTIES TO REQUIRE THE REGISTER OF DEEDS IN THE COUNTY NOT TO ACCEPT ANY DEED TRANSFERRING REAL PROPERTY FOR REGISTRATION UNLESS THE COUNTY TAX COLLECTOR CERTIFIES THAT NO DELINQUENT TAXES ARE DUE ON THAT PROPERTY.

OVERVIEW: This act provides that a register of deeds serving in a county where tax collector certification of a deed is normally required prior to registration must accept an uncertified deed if the closing attorney states the intent to pay any delinquent taxes from the closing proceeds. It also adds Hyde County to the list of counties that have the authority to require tax certification of a deed prior to registration.

FISCAL IMPACT: This act does not affect State revenues.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on May 20, 2003.

ANALYSIS: G.S. 161-31 provides that in certain counties, the board of county commissioners may adopt a resolution 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. Before the 2003 Session, this provision applied to the following 45 counties: Alleghany, Anson, Beaufort, Bertie, Cabarrus, Camden, Carteret, Cherokee, Chowan, Clay, Cleveland, Currituck, Davidson, Durham, Forsyth, Gaston, Graham, Granville, Harnett, Haywood, Henderson, Hertford, Iredell, Jackson, Lee, Macon, Madison, Martin, Montgomery, Northampton, Pasquotank, Perquimans, Person, Pitt, Polk, Rockingham, Rowan, Rutherford, Stanly, Swain, Transylvania, Vance, Warren, Washington, and Yadkin Counties. This act adds Hyde County to the list. S.L. 2003-189 added Gates County and S.L. 2003-354 added Duplin County to the list, to bring the total to 48.

In addition to G.S. 161-31, the General Assembly has enacted similar laws that prohibit a register of deeds from registering a deed unless the tax collector has certified that no delinquent taxes are due. These provisions apply to the following local governments: Avery County (1963); Mitchell County (1987); Ashe County (1993); the Towns of Newland and Spruce Pine and Alleghany County (1997);[1] the Town of Banner Elk (1998); and the Town of Bakersville (1999).

In a county or local government where G.S. 161-31 and other similar State laws do not apply, the register of deeds registers deeds regardless of whether delinquent taxes are due on the property.

The purpose of G.S. 161-31 is to provide certain counties an additional tool to collect delinquent property taxes. This act amended G.S. 161-31 to provide that if the board of county commissioners has adopted a resolution to require the register of deeds to refuse to register a deed without the certification of the county tax collector, the register of deeds must still accept an uncertified deed that is submitted for registration under the supervision of a closing attorney and containing the statement, "This instrument prepared by: _________________, a licensed North Carolina attorney. Delinquent taxes, if any, to be paid by the closing attorney to the county tax collector upon disbursement of closing proceeds." The change is intended to provide the same level of protection for counties while reducing the paperwork burden associated with transfers of real property.

PUBLISH REVENUE-NEUTRAL PROPERTY TAX RATE.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-264	**SB 511**	**Senator Rucho**

AN ACT TO REQUIRE LOCAL GOVERNMENTS TO PUBLISH THE REVENUE-NEUTRAL TAX RATE IN YEARS WHEN THERE IS A GENERAL REVALUATION OF REAL PROPERTY.

[1] Although Allegheny County had a local provision, it was added to G.S. 161-31 in 2001 because that provision allows the county to decide what form the certification will take.

OVERVIEW: This act requires counties to state the revenue-neutral property tax rate in their budgets in a year in which a general reappraisal of real property takes place.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 26, 2003.

ANALYSIS: The amount of property tax due is dependent upon two factors: the property tax rate and the value of the property to which the rate is applied. Property is to be appraised for tax purposes at its true value or market value.[2] To ensure that property is appraised at its true value, the law requires that a county conduct a general reappraisal of real property at least once every eight years.[3] Typically, the value of the tax base increases in revaluation years, especially in urban areas. This increase in value may result in a decreased tax rate, if the county seeks to maintain revenue neutrality with regard to the stream of revenue derived from property taxes.

This act requires a county, in the year in which it conducts a general reappraisal of property, to include in its budget a statement of the revenue-neutral property tax rate for the budget. The revenue-neutral tax rate is the rate that is estimated to produce revenue for the next fiscal year equal to the revenue that would have been produced for the next fiscal year by the current tax rate if no reappraisal had occurred. To calculate the revenue-neutral tax rate, the budget officer must first determine a rate that would produce revenues equal to those produced for the current fiscal year and then increase the rate by a growth factor equal to the average annual percentage increase in the tax base due to improvements since the last general reappraisal. This growth factor should represent the expected percentage increase in the value of the tax base due to improvements during the next fiscal year. The budget officer must further adjust the rate to account for any annexation, deannexation, merger, or similar event.

2003 BUDGET ACT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-284	**HB 397**	**Rep. Crawford, Sherrill (Primary Sponsors)**

AN ACT TO APPROPRIATE FUNDS FOR CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS FOR STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES, AND FOR OTHER PURPOSES, AND TO IMPLEMENT A STATE BUDGET THAT ENABLES THE STATE TO PROVIDE A SUSTAINABLE

[2] Agricultural, horticultural, and forestland property, upon proper application, are appraised at present-use value.
[3] G.S. 105-286.

RECOVERY THROUGH STRONG EDUCATIONAL AND ECONOMIC TOOLS.

<u>OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:</u>

Part #	*Description and Effective Dates*	*Fiscal Impact*
37	**Adjust Local Government Hold-Harmless** Effective June 30, 2003, changed the date that sales tax hold-harmless payments are made to local governments each year, from September 15 to August 15. It also provided that the payments will be made in 2003 and 2004, with intent language for the payments to continue through 2012. This part also provided that the estimates used to calculate the hold-harmless payments must be updated to reflect legislative changes.	No significant fiscal impact on the General Fund in the 2003-05 fiscal biennium.
37-A	**Update Internal Revenue Code Reference and Adjust Bonus Depreciation and Estate Tax** Effective June 30, 2003, changed the State tax law reference to the Internal Revenue Code from January 1, 2003 to June 1, 2003. In May 2003, Congress enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003. That legislation increased from 30% to 50% the bonus depreciation allowance originally enacted in March 2002 in response to the September 11 terrorist attacks and moved the sunset for bonus depreciation from September 10, 2004 to December 31, 2004. In addition, the package increased the amount of investment in capital equipment that a business can expense during the acquisition year (instead of depreciating over many years) from $25,000 to $100,000. Continued technical conformity to bonus depreciation so that taxpayers do not have to keep a separate depreciation schedule for State tax purposes for each piece of equipment in addition to the federal	The update in the Code reference fully conforms North Carolina law to the federal expensing limit increase at a cost to the General Fund of $29.2 million in FY 2003-04 and $18.0 million in FY 2004-05. This will reduce state revenues in FY 2003-04 by $40.8 million (due to the increase in bonus depreciation from 30% to 50%) but increase revenues by $18.0 million in FY 2004-05. This provision has no impact for the 2003-04 fiscal year because estates have 9 months after a death to file a return. For FY 2004-05, the proposal saves $70.8 million of General Fund revenue that would have disappeared if the 2002 partial

Part #	Description and Effective Dates	Fiscal Impact
	schedule. Extended until July 1, 2005, the partial conformity of the State estate tax to changes in the federal estate tax.	conformity had been allowed to sunset on January 1, 2004.
38	**Temporarily Maintain State Sales Tax Rate** Effective June 30, 2003, extended sunset on the half-cent state sales tax enacted in 2001 from July 1, 2003 to July 1, 2005.	Joint estimates provided by Fiscal Research and the Office of State Management and Budget suggest the following revenue stream from this tax extension. FY 2003-04 $341.7 million FY 2004-05 $388.2 million FY 2005-06 $26.5 million
39	**Temporarily Maintain Upper Income Tax Rate** Effective June 30, 2003, extended the sunset of the 8.25% individual income tax bracket from January 1, 2004 to January 1, 2006.	The additional revenue from this extension is calculated using the North Carolina Individual Income Tax Model. The model estimates that $83.3 million in individual income tax payments will be generated in tax year 2004 and $104.2 million in revenue in tax year 2005. This revenue is divided into fiscal years as follows: FY 2003-2004: $37.5 million FY 2004-2005: $92.7 million FY 2005-2006: $57.3 million
39-B	**Conform Child Tax Credit to Federal Credit** Effective for the 2003 tax year, conformed the State definition of a dependent child to the federal definition for purposes of the individual income tax credit for children.	The change will increase General Fund revenue by $16.8 million in FY 2003-04 and by $17 million in FY 2004-05.
43	**Equalize Insurance Tax Rates on Article 65 Corporations** Raised the insurance premiums tax rate on Article 65 corporations from 1.0% to 1.9%, effective for the 2004 tax year. In addition, for the 2004 and 2005 tax years,	This change will increase General Fund revenue by $18.6 million for the 2003-04 fiscal year and $13.9 million for FY 2004-05.

Part #	Description and Effective Dates	Fiscal Impact
	this act required the affected companies to make estimated tax payments in April and June of each year equal to 50% of the annual liability for that tax year.	
43-A	**Clarify Property Tax Exclusion for Property Used to Reduce Cotton Dust** Clarified a property tax exclusion	No impact on General Fund. No estimate on the fiscal impact on local governments is possible, but the impact is expected to be small.
44	**Continue Use Tax Line Item on Income Tax Form** Effective June 30, 2003, this act extended for two years the law that provides that consumer use tax is payable on the individual income tax return.	This extension will increase General Fund revenue by $3.1 million in both FY 2003-04 and FY 2004-05.
45	**Conform to Streamlined Sales and Use Tax Agreement** This act made numerous changes to the sales and use tax statutes to bring North Carolina into conformity with the Streamlined Sales Tax Agreement. Various effective dates.	The tax on soft drinks will increase sales tax revenues by $41.4 million in FY 2003-04 and by $45.1 million in FY 2004-05. Conversely, the 50% vending machine exemption will reduce sales tax revenue by $4.05 million in FY 2003-04 and $8.6 million in FY 2004-05. The tax on prepared food will increase revenue by $3.05 million in FY 2003-04 and by $3.3 million in FY 2004-05. The candy exemption will reduce revenue by $400,000 in FY 2003-04 and by $800,000 in FY 2004-05.
45-A	**Eliminate Tobacco and Alcohol Discounts** Effective August 1, 2003, eliminated tax reductions that were allowed to distributors and wholesalers who pay the excise taxes on cigarettes and other tobacco products. Effective August 1, 2003, eliminated tax reductions that were allowed to distributors and wholesalers who pay the	The change will increase General Fund revenue by $1.74 million in FY 2003-04 and by $1.9 million in FY 2004-05. The change will increase General Fund revenue by $3.67 million in FY 2003-04 and by $4.0 million in FY

Part #	Description and Effective Dates	Fiscal Impact
	excise taxes on wine, beer, and spirituous liquor.	2004-05.
46	**Repairs and Renovations** Effective July 1, 2003, enacts the procedural and regulatory provisions governing the State's issuance of security interest indebtedness. It also provides the specific legislative authorization for up to $300 million of special indebtedness to be used for the repair and renovation of State facilities and related infrastructure.	The expected debt service is $35 million for 2004-05, $32.5 million for 2005-06, and $31.6 million for 2006-07.
46-A	**State Capital Facilities Finance** Effective July 1, 2003, provides specific legislative authorization for three projects: The purchase of two private prisons currently leased by the State. Up to $6,780,000 for the design, construction drawings, and solicitation of bids for three youth development centers. The construction of a structural pest control training facility to be located at NCSU.	The amount of the issuance is to be negotiated. No other fiscal information available. No fiscal information available, in planning stage. No fiscal information available.
47	**Lease-Purchase Three New Prisons** Effective July 1, 2003, provides specific legislative authorization for the lease-purchase of three new prisons.	The cost of constructing the prisons is expected to be between $344 and $364 million. The annual operating cost is expected to be $18 million.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)

ANALYSIS:

Part 37: Adjust Local Government Hold-Harmless

Part 37 of this act changes the date that sales tax hold-harmless payments are made to local governments each year, from September 15 to August 15. It also provides that the payments will be made in 2003 and 2004 only, but includes intent language for the payments to continue through 2012. The Governor's budget would have eliminated the hold harmless payments beginning in 2003.

In 2001, the General Assembly gave local governments the authority to increase their local sales tax by one-half percent, effective upon the repeal of the State's additional half-percent sales tax on July 1, 2003. Also effective July 1, 2003, the State's reimbursements to local governments were repealed, and the State was directed to provide hold-harmless payments to those local governments whose potential gain from the half-cent local sales tax increase would be less than their loss from the repealed State reimbursements. State reimbursements were for losses due to 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.

In 2002, the General Assembly accelerated the repeal of the State reimbursements from July 1, 2003, to July 1, 2002, and accelerated the effective date that local governments could begin levying the additional half-cent local tax from July 1, 2003, to December 1, 2002.

This part also provides that the estimates used to calculate the hold-harmless payments must be updated to reflect legislative changes.

This part became effective when the act was signed into law by the Governor on June 30, 2003.

Part 37-A: Update Internal Revenue Code Reference And Adjust Bonus Depreciation And Estate Tax

This part makes three changes relating to conformity of State tax laws to federal tax laws. These provisions were not in the House or Senate budgets.

Section 37A.1 of this act updates to June 1, 2003, the date used in defining and determining certain State tax provisions. In May 2003, Congress enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003. That act contained two tax changes that affect federal taxable income, which is the starting point for determining State taxable income, and became effective for the 2003 tax year. The two changes were an increase in the bonus depreciation allowance first enacted after the September 11, 2001, terrorist attacks and an increase in the amount that can be expensed under section 179 of the Internal Revenue Code[4] Section 37A.1 of the act conforms to both of these provisions. Sections 37A.2 and 37A.3 of the act would provide for a bonus depreciation add-back for the 2004 taxable year to offset the second-year losses from the depreciation and expensing provisions.

Sections 37A.4 and 37A.5 delay until July 1, 2005, the phase-out and elimination of the State estate tax that would otherwise occur due to the phase-out and elimination of the federal credit for State death taxes. North Carolina repealed its inheritance tax in 1998, effective for deaths occurring on or after January 1, 1999. It replaced the inheritance tax with an estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of state estate tax is known as a "pick-up" tax because it picks up for the state the amount of federal estate tax that would otherwise be paid to the federal government. In 2001, Congress increased the exclusion amount for the federal estate tax and phased out the state death tax credit over four years by reducing it 25% in 2002, 50% in 2003, and 75% in 2004, and by repealing it entirely in 2005. In 2002, the General Assembly enacted legislation not to conform to the phase-out of the state death tax credit. In other words, the amount of the State estate tax is tied to the federal credit as it existed in 2001 rather than as it currently

[4] Section 179 of the Code allows a taxpayer to treat the cost of certain property as an expense which is not chargeable to a capital account. This allows the taxpayer to take a deduction for the property in the year in which it is placed into service rather than depreciating the property over a number of years.

exists. The 2002 legislation was set to sunset for estates of decedents dying on or after January 1, 2004. This part extends the sunset to July 1, 2005, meaning that the estate tax will continue to be based on the federal credit as it existed in 2001. This part became effective when the act signed into law by the Governor on June 30, 2003.

Part 38: Temporarily Maintain State Sales Tax Rate

Part 38 of this act delays the sunset of the one-half-percent increase in the State sales tax from July 1, 2003, to July 1, 2005. This part became effective when the act was signed into law by the Governor on June 30, 2003. In the 2001 Appropriations Act, S.L. 2001-424, the General Assembly increased the State sales tax by one-half percent, from 4% to 4.5%, effective October 16, 2001. This State sales tax increase was to sunset July 1, 2003. Before 2001, the State sales tax rate had last been increased in 1991 from 3% to 4%.

Part 39: Temporarily Maintain Upper Income Tax Rate

Part 39 of this act delays the sunset of the upper-income individual income tax bracket from January 1, 2004, to January 1, 2006. In 2001, the General Assembly added a new tax bracket that imposed an additional one-half percent income tax (a total rate of 8.25%) 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:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
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

The 2001 law created a fourth tax bracket for North Carolina taxable income as follows:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
8.25%	Over $200,000	Over $160,000	Over $120,000	Over $100,000

This change was estimated to affect approximately 2% of North Carolina taxpayers. This provision extending the tax rate for two more years was recommended by the Governor.

This part became effective when the act was signed into law by the Governor on June 30, 2003.

Part 39-B: Conform Child Tax Credit To Federal Credit

Part 39-B of this act conforms the State credit for children to the federal definition of whether a dependent child is eligible for the federal credit for dependent children. The effect of this change is to limit the credit to children below 17 years of age. The federal credit is limited to dependent children under age 17 but the North Carolina credit previously applied to 17-year-olds as well as to children over 17 up to age 23 if they are in college. This provision was part of a provision that was in the Senate budget that would have also delayed the scheduled increase in the credit. This change is effective beginning with the 2003 tax year.

Part 43: Equalize Insurance Tax Rates On Article 65 Corporations

Before 2004, nonprofit medical service corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, and HMOs paid a gross premiums tax of 1%. Other insurance providers pay a gross premiums tax of 1.9% on most insurance contracts. Companies that pay a gross premiums tax are automatically exempt from corporate income and franchise taxes. This part increases the gross premiums tax rate on medical service corporations from 1% to 1.9% effective January 1, 2004. The tax rate for HMOs (including HMOs directly operated by medical service corporations) remains at 1%.

This part also provides that for the 2004 and 2005 tax years only, medical service corporations will make the following estimated payments of the tax: 50% on April 15 and 50% on June 15, with true-up the following March 15. For subsequent tax years, the general law on installment payments of gross premiums tax will apply. This change accelerates the timing of the tax payment to move the revenue gain to an earlier fiscal year.

This part provides a conditional sunset of the increased tax rate. It requires the Commissioner of Insurance to make a certification to the Department of Revenue and the Revisor of Statutes when there are no longer any medical service corporations that offer anything other than dental service plans. Beginning with the first taxable year after that certification is made, this part will expire and the gross premiums tax rate applied to medical service corporations will revert to 1%. The effect of this provision would be to reduce the rate on medical service corporations if Blue Cross/Blue Shield completes its conversion to for-profit status. In July 2003, Blue Cross/Blue Shield announced its intention not to pursue conversion at this time.

The insurance gross premiums taxes are taxes based on the amount of insurance premiums that are paid or, for certain self-insurers, would have been paid during the year. Before the effective date of this part, they consist of the following:

- A 1.9% tax on most insurance contracts.
- A 1% tax on HMOs and on nonprofit medical service companies, such as Blue Cross/Blue Shield and Delta Dental, that provide hospital, medical, and dental service plans.
- A 2.5% tax on workers' compensation premiums and workers' compensation self-insurers.
- An additional 1.33% tax on premiums for fire and lightening coverage of property other than motor vehicles and boats.
- An additional 0.5% tax on premiums for fire and lightening coverage of property within a fire district.

Part 43-A: Clarify Property Tax Exclusion For Property Used To Reduce Cotton Dust

Part 43A amends the existing property tax exclusion for property exclusively used to reduce or prevent cotton dust in textile plants in accordance with OSHA standards. The new law provides that if parts of a ventilating or air conditioning system are integrated with the cotton dust equipment, the entire system benefits from the tax exclusion, except for the chillers and cooling towers. Because it apparently reflects the previous practice in some counties, the provision became effective when the act was signed into law by the Governor on June 30, 2003.

Part 44: Continue Use Tax Line Item On Income Tax Form

Part 44 extends for two years the law that provides that consumer use tax is payable on the individual income tax return. The law would otherwise sunset for the 2003 taxable year.

North Carolina has State and local sales and use taxes. The sales tax is paid on purchases made in this State. It is collected by the retailer and remitted to the State. The use tax complements the sales tax by taxing transactions that are not subject to the sales tax because of movement in interstate commerce. The use tax is imposed on the purchaser. Unlike the sales tax, the responsibility for remitting the use tax to the Department of Revenue is also on the purchaser. The 1997 General Assembly established an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-state purchases. This change relieved consumers of the duty to file either monthly or quarterly returns.

In 1999, the General Assembly further simplified use tax collection by providing that the use tax will be paid on taxpayers' income tax returns. An individual who owes use tax on nonbusiness purchases and who must remit a State income tax return must pay the use tax with the income tax return. The income tax return has space on it to indicate the amount of use tax owed. Placing the use tax on the individual income tax return, as opposed to a separate use tax return sent to the taxpayer with the income tax return, is intended to increase taxpayers' awareness of their responsibility to pay the tax. In 2000, the General Assembly sunset this provision in anticipation that use tax collection would be handled by retailers by 2003 as a result of the Streamlined Sales Tax Agreement. The 2003 sunset date may have been overly optimistic; this part extends it for two more years. This part became effective when the act was signed into law by the Governor on June 30, 2003.

Part 45: Conform To Streamlined Sales And Use Tax Agreement

In November 2002, the Streamlined Sales Tax implementing states[5] approved a final version of an historic multistate agreement designed to simplify and modernize sales and use tax collection and administration. One objective of the Streamlined Sales and Use Tax Project is to encourage remote vendors to voluntarily collect use tax owed to the states, thereby increasing their collections. A study issued in September 2001 by Bruce and Fox of the University of Tennessee, Knoxville estimated the state and local government revenue loss from sales made through the Internet at $7 billion in 2001 and increasing to $24.2 billion by 2006. The study estimates that North Carolina is currently losing $200 to $300 million a year in uncollected use tax revenues.

A second objective of the Project is to convince Congress or the U.S. Supreme Court to grant collection authority over remote sales to the states that enact the streamlined system embodied in the multistate agreement, on the premise that the system eliminates the burdens

[5] Currently, 40 states plus the District of Columbia are involved in the Streamlined Sales Tax Project. In November 2002, 35 states plus the District of Columbia were involved in the Project.

on interstate commerce that have been the justification for denying states that authority. If federal legislation is enacted granting states this authority, it is likely to be linked with proposals to extend the Internet Tax Freedom Act moratorium, which expires on November 1, 2003.

To participate in the Streamlines Sales and Use Tax Agreement (Agreement), a state must amend or modify its sales and use tax law to conform to the simplifications and uniformity in the Agreement. The Agreement becomes effective when at least 10 states representing at least 20% of the total population of all states imposing a state sales tax have petitioned for membership and have been found to be in compliance with the requirements of the Agreement. A certificate of compliance will document each state's compliance with the provisions of the Agreement. As of July 7, 2003, 19 states, with more than 20% of the total population of all states, were in compliance with the Agreement.

Part 45 makes changes to the sales and use tax statutes to bring North Carolina into conformity with the Agreement.

Uniform local sales tax base. – Under the Agreement, all local jurisdictions in a state must have a common tax base. The base for the most recent ½% local sales tax and the ½% Mecklenburg local transit tax does not include food while the other local sales and use taxes do. To conform to the Agreement, the base must be consistent. The State is allowed to tax food at a different rate than its general rate of tax. Section 45.6A of this part finesses the non-uniform local base effective October 1, 2003, by stating that the taxes will be administered as if the local tax on food were zero and the State had a 2% tax on food. This change complies with the Agreement without changing the amount of tax. The State will collect and distribute the 2% local tax on food. Under this act, the distribution with respect to food tax proceeds would have be in proportion to other local sales tax proceeds rather than based on the actual county of collection. This would have resulted in a shifting of revenue among counties, in favor of counties that are retail centers. However, this part was amended by Section 27 of S.L. 2003-416. Half of these proceeds will now be distributed based on population with the remaining half being distributed based on the proportion of sales taxes on food collected under Article 39 of Chapter 105 of the General Statutes within the county in the 1997-98 fiscal year in relation to the total collections under that Article.

Candy, soft drinks, and prepared food. – Under the Agreement, if there is a uniform definition for a type of product, a state may not exempt only part of the items included in the definition. Candy, soft drinks, and prepared foods have uniform definitions in the Agreement. Under previous law, North Carolina exempted those items as food only to the extent they were purchased for home consumption. To conform to the Agreement, the products must be treated consistently whether or not they are intended for home consumption. This part removed soft drinks and prepared foods from the exemption for food effective July 15, 2003. It offsets the impact of this change by extending to vending machine soft drinks the 50% sales tax reduction currently allowed to other products sold in vending machines, effective January 1, 2004. This part exempts all candy as if it were food, effective January 1, 2004.

Definitions. – The Agreement mandates that a state that uses any of the terms defined in the Agreement in its sales and use tax laws must define the terms in substantially the same language as the Agreement uses. To conform to the Agreement, this part modifies and defines the following terms: computer, computer software, custom computer software, prewritten computer software, delivered electronically, load and leave, direct mail, drug, durable medical equipment, durable medical supplies, electronic, lease or rental, mobility enhancing equipment, over-the-counter drug, prepared food, prescription, prosthetic device, and tangible personal property. This provision became effective July 15, 2003.

Modifications to prewritten software. – As discussed above, the Agreement mandates that a state must either tax or exempt all products within a given uniform definition. Previously, North Carolina taxed prewritten computer software that had not been modified and it exempted both custom computer software and prewritten computer software that had been modified. To conform to the Agreement, the State will tax the prewritten portion of modified computer software and it will exempt the modifications to it if the charges for the modifications are separately stated. Through the use of defined terms, computer software that is delivered electronically or by "load and leave" will remain exempt from tax. This provision became effective July 15, 2003.

Mobility enhancing equipment. – To provide consistent treatment of products within a uniform definition, this part provides that mobility enhancing equipment must be sold on a prescription to be exempt from tax. Under previous law, a few items that come within this defined term, such as crutches, did not need to be sold on a prescription to be exempt. However, to preserve the previous tax treatment as much as possible, this part requires mobility enhancing equipment to be sold on a prescription in order to be exempt since previous law required most items in this category to be sold on prescription in order to be exempt. This provision became effective July 15, 2003.

Uniform sourcing rules. – North Carolina adopted many of the uniform sourcing principles in 2001. This part codifies additional sourcing principles for periodic rental payments. The codified principles reflect previous practice. This provision became effective July 15, 2003.

Uniform returns and remittances and notices. – North Carolina adopted many of the uniform provisions governing returns, remittances, and notices in 2001. This part adds a few more provisions:

- The collection period for a seller that collects less than $1,000 in State sales tax during a calendar year cannot be more often than annually. This provision became effective October 1, 2003.
- Monthly returns are due by the 20th day of the month, instead of the 15th day of the month. This provision became effective October 1, 2003.
- Catalog sellers must be given at least 120 days' notice of tax changes and tax rate changes. This provision became effective July 15, 2003.

Sales tax holiday. – The Agreement sets forth certain conditions that sales tax holidays must meet after December 31, 2003. One of the conditions is that the items to be exempt must be specifically defined in the Agreement. North Carolina's sales tax holiday exempts printers, printer supplies, educational computer software, and school supplies. None of these terms are defined in the Agreement. The implementing states are currently working on a definition of "school supplies". This act makes the following changes to the Sales Tax Holiday effective October 1, 2003: It removes printers, printer supplies, and educational computer software from the exemption. It also extends the exemption to layaway sales.

In addition to the sales and use tax modifications made by this part, North Carolina will need to address the following issue in the near future to remain in conformity with the Agreement:

Multiple rates, caps, and thresholds. – The Agreement mandates the elimination of caps and thresholds under most circumstances after December 31, 2005. It also mandates a single tax rate per taxing jurisdiction after December 31, 2005. North Carolina currently has a 1% tax rate on certain items and a 1% rate with a $80 cap on some other items. It has a 3% rate with a $1,500 cap on mobile classrooms and offices. It also has a different rate on telecommunications, satellite TV, and spirituous liquor and it has a $1,500 threshold for the sales tax applicable to funeral expenses.

Part 45-A: Eliminate Tobacco And Alcohol Discounts

Part 45A of this act eliminates tax reductions that were previously allowed to distributors and wholesalers who pay the excise taxes on cigarettes, other tobacco products, wine, beer, and spirituous liquor. These discounts were equal to 4% of the tax due. The cigarette and tobacco discounts were intended to cover expenses incurred in preparing tax reports and the expense of furnishing a bond. The discounts for alcoholic beverages are intended to cover these expenses and also losses due to spoilage or breakage. This part became effective August 1, 2003.

An amendment to House Bill 1303 would have partially restored these discounts. On July 19, 2003, the Senate passed an amendment that would have reinstated these discounts at a rate of 2% rather than 4%. That bill then passed the Senate and was sent to the House for concurrence. The House adjourned without voting on concurrence.

Part 46: Repairs And Renovations

Part 46 enacts the procedural and regulatory provisions governing the State's issuance of security interest indebtedness by creating the "State Capital Facilities Financing Act".[6] Security interest indebtedness, commonly referred to as "certificates of participation", is debt that is secured by an interest in the property being financed, repaired, or renovated. Since the property serves as the security for the indebtedness, there is no pledge of the State's faith and credit or taxing power. Thus, voter approval is not necessary for the borrowing. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the capital facilities that serve as security could be disposed of to generate funds to satisfy the debt. The State could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the State's credit rating.

The Act uses the term "special indebtedness" to cover the three forms that this type of debt can take: installment purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), and limited obligation bonds. The particular form to be used for a given project will depend on its size, the nature of the property and the improvement, and other circumstances. Based on these circumstances, one form or another of security interest debt may be the least expensive and most practical for the State to utilize. (*For a more extensive summary of the "State Capital Facilities Financing Act", see the summary for S.L. 2003-314.*)

[6] This act rewrites the "State Capital Facilities Financing Act" contained in S.L. 2003-314. In that legislation, the procedural and regulatory provisions applied only to the financing of a new psychiatric hospital.

Part 46 also provides the specific legislative authorization for up to $300 million of special indebtedness to be used for the repair and renovation of State facilities and related infrastructure that are supported from the General Fund. The proceeds of the obligations would be used to repair and renovate State buildings in the same manner as funds in the Reserve for Repair and Renovations are used. Funds in that Reserve may be used for structural and roof repairs, repairs to heating, air conditioning and related equipment, repairs needed for health and safety or to comply with standards imposed by law, and repairs for energy efficiency and to improve the usage of space. Funds may not be used for new buildings or to increase the footprint of a building unless required to comply with standards imposed by law. Except in the case of an emergency, the Director of the Budget is required to consult with the Joint Legislative Commission on Governmental Operations before incurring debt for specific repair and renovation projects.

Part 31.5 of this act modifies how the funds in the Repairs and Renovations Reserve Account can be used for the 2003-04 fiscal year; it did not amend G.S. 143-15.3A, the statute that governs the Reserve Account. Under Part 31.5, 46% of the funds in the Reserve for the 2003-04 fiscal year is allocated to the Board of Governors of The University of North Carolina for repairs and renovations and the remaining 54% is allocated to the Office of State Budget and Management. Notwithstanding G.S. 143-15.3A, Part 31.5 provides that the Board of Governors may use the funds allocated to it for repairs and renovation of facilities not supported by the General Fund if the Board determines that sufficient funds are not available from other sources and that conditions warrant General Fund assistance. Part 31.5 also provides that the Office of State Budget and Management can use the funds allocated to it during the 2003-04 fiscal year to complete the construction of State-owned facilities that are partially completed.

The bond proceeds authorized to be issued by this Part will not go directly into the Repairs and Renovations Reserve Account; they will go into a trust account and, according to this Part, be used "for the purposes and in accordance with the procedures provided in G.S. 143-15.3A". Because the modifications made by Part 31.5 of this act to the purposes for which the funds in the Reserve Account could be used were not made to the statute itself, it is unclear whether the bond proceeds authorized by this Part may be used in accordance with the modifications made by Part 31.5 of this act. Section 98 of the technical corrections bill, House Bill 281, 6th edition, sought to clarify this issue by providing that the debt issued during the 2003-04 fiscal year for repairs and renovations be spent in accordance with the modifications to G.S. 143-15.3A made by Part 31.5 of this act. However, the General Assembly did not enact House Bill 281.

Part 46-A: State Capital Facilities Finance

Part 46A authorizes the State to incur security interest indebtedness for three projects. The first is to purchase two private prisons currently being leased and operated by the State.[7] The Office of the State Treasurer estimates that the annual debt payments will be lower than the annual lease payments. The Treasurer's Office has been advised by bond counsel that under the terms of the lease it may be possible to purchase these prisons during the 2003-2004 fiscal year, possibly during the first six months of the fiscal year. For that reason, the bond counsel advised that the authorization be included within the budget for the upcoming fiscal

[7] Pamlico County Correctional Facility and the Mountain View Correctional Facility located in Avery County. The prisons are owned by a private vendor and were originally operated by the vendor.

year. The provision states that the amount that the Department of Correction would otherwise pay for property taxes on the facilities during the 2004-2005 biennium will be paid to the counties in lieu thereof if the purchase is made at a time that will result in no taxes being due for either year of the biennium.

Second, Part 46A authorizes the State to incur up to $6,780,000 in security interest indebtedness for design, construction drawings, and solicitation of bids for construction of three youth development centers to be operated by the Department of Juvenile Justice and Delinquency Prevention and for infrastructure and site work at one of the three centers. The Office of State Construction will manage the design process. Section 15.7 of this act allows the Department for Juvenile Justice and Delinquency Prevention to continue planning for the new centers but requires a quarterly status report on the planning and design to the JPS Appropriations Chairs and the Joint Legislative Corrections, Crime Control, and Juvenile Justice Oversight Committee. The design phase should be completed by April 15, 2004, and a final report should be issued that includes the anticipated total cost of each proposed center and the recommended locations.

Third, Part 46A authorizes the State to incur security interest indebtedness for the construction of a structural pest control training facility to be located at North Carolina State University.

Part 47: Lease-Purchase Three New Prisons

Part 47 would authorize the State to enter into lease-purchase contracts to build three new prisons. In 2001, the General Assembly authorized lease-purchase financing of three new 1000-cell close security prisons. Section 47.1 would authorize three more substantially identical prisons. Section 47.2 provides that if construction begins before January 1, 2004, and the plans have been approved by the Department of Insurance, the 1996-1999 version of the Building Code applies to the first two of the three prisons.

The State may first try to negotiate a contract for these new prisons with the same company that is building the 2001 prisons. If the Secretary of Administration and the Council of State find that the negotiations have failed to produce a reasonable price, the State would solicit proposals for the projects using a similar procedure as for the 2001 prisons. Unlike with the 2001 prisons, the initial construction loan will not be obtained by the vendor on a private, taxable basis. The entire cost, including construction, will be financed by the State with tax-exempt obligations. The prisons are exempt from property taxes both during and after construction.

Part 47 provides that a nonprofit corporation controlled by the State will work with the Department of Correction to contract directly with the construction contractor for construction of the prisons and will lease the prisons to the State under a lease-purchase agreement. The nonprofit corporation would finance the costs by selling tax-exempt obligations known as certificates of participation (COPs). The COPs would represent interests in the nonprofit corporation's rights to receive the lease payments under the lease-purchase agreement with the State. The COPs would be secured by a lien on the property, not by a pledge of the State's full faith and credit. The COPs would be paid from the State's lease-purchase payments over the course of 20 years.

Because the construction contract is technically between a private, nonprofit corporation and the construction contractor, the Attorney General's Office has determined that requirements for public bidding of construction would not apply. The new prisons are to be substantially identical to the 2001 prisons, so the State and the nonprofit corporation will first try to negotiate a contract with the existing construction contractor to build the new prisons. If, in the opinion of the Secretary of Administration and the Council of State, the terms of the proposed negotiated contract are not favorable to the State, the Department of Correction will solicit for the construction of the new prisons. In this situation, the Department of Correction would be required to consult with the Joint Legislative Commission on Governmental Operations before making a final award decision. The final award decision would also be subject to the approval of the Council of State.

The prisons would be 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 would inspect and review the facilities during construction to ensure that they are suitable for use and acquisition by the State. The minority participation requirements of G.S. 143-128.2 apply to these projects.

The lease-purchase agreement would be 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 would make lease-purchase payments to the nonprofit corporation, which would use the funds to retire the COPs. The COPs would 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 would determine the price to be paid for the COPs and the rate of interest to be paid on them. The State would retain the option of refinancing the debt if interest rates fall. The State would also retain 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. The nonprofit corporation that issues the COPs would be subject to the Public Records Act and the Open Meetings Law.

WAIVE DEADLINES FOR TROOPS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-300	**SB 936**	**Senator Kerr**

AN ACT TO WAIVE VARIOUS DEADLINES, FEES, AND PENALTIES FOR DEPLOYED MILITARY PERSONNEL.

OVERVIEW: This act provides assistance to military personnel called to active duty in support of Operation Iraqi Freedom on or after January 1, 2003 as follows:

- Authorizes the Governor to allow military personnel 90 days from the end of their deployment to renew their driver's license, renew their motor vehicle liability insurance, or renew an occupational license.

- Allows military personnel 90 days from the end of their deployment to pay current year's property taxes or list property for next year's property taxes.

- Authorizes the Governor to waive civil penalties and restoration fees for military personnel whose motor vehicle liability insurance lapsed during the period of deployment or within 90 days after the member returned to North Carolina if the member certifies that the motor vehicle was not driven during the period in which the vehicle was uninsured and that the vehicle is now insured.

- Directs community colleges to grant full refunds of tuition to military reserve and National Guard personnel called to active duty and to active personnel, who because of their reassignments, are unable to complete courses. The community colleges must buy back textbooks to the extent possible.

- Authorizes the constituent institutions of The University of North Carolina to issue refunds of tuition and required fees and to determine whether to give full or pro rata refunds of housing, parking, and other optional fees to students to whom they give tuition and required fee refunds. The refunds may be issued to students who are involuntarily called to active duty, who volunteer for military service, or who withdraw because of circumstances related to a national emergency.

- Waives repayment of the North Carolina Legislative Tuition Grant for any semester that the student loses full-time student status due to a call to active military duty.

FISCAL IMPACT: The act does not affect the State General Fund, but it may delay revenue collection in the 2003-2004 fiscal year for driver's licenses (Highway Fund), occupational licenses (Licensing Board Special Accounts), and property tax collections (local governments). It is not possible to estimate this temporary fiscal impact, because the General Assembly's Fiscal Research Division does not have access to records of military personnel assigned to Operation Iraqi Freedom. Even if such records were accessible, the Division could not easily match driver records, local tax records, and occupational license records to military personnel. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 4, 2003.

ANALYSIS: This act provides relief to deployed military personnel by extending certain deadlines, waiving penalties and fees, and allowing tuition refunds. The term "deployed military personnel" is defined as a member of any of the following that are on active duty in support of Operation Iraqi Freedom on or after January 1, 2003:

- Armed forces or armed forces reserves of the United States.

- The North Carolina Army National Guard or the North Carolina Air National Guard, but only if called to active duty in support of the Operation on or after January 1, 2003.

Verification by the military member's command specifying deployment is conclusive evidence of the soldier's deployment.

Extend Deadlines and Waive Penalties and Fees

The act allows the Governor to extend deadlines and waive penalties and fees for deployed military personnel. These extensions and waivers include the following:

- Extend for up to 90 days from the end of deployment the validity of a driver's license or temporary driver's license.[8]
- Extend for up to 90 days the validity of an occupational license and allow for the prorating of any renewal fee associated with an occupational license.[9]
- Waive any civil penalty and restoration fees associated with motor vehicle liability lapses if the soldier certifies that the motor vehicle was not driven during the period in which the vehicle was insured and that the vehicle is now insured. The Division of Motor Vehicles already has policies and procedures in place to handle military personnel on a case-by-case basis. Fines, penalties, and revocations are waived if a person is deployed or unable to handle his or her business due to military actions.

Extend Property Tax Listing and Payment

The act extends property tax deadlines for deployed military personnel by allowing them 90 days after the end of their deployment to pay property taxes that become due or delinquent during the deployment. If the taxes are paid within this 90-day period, no interest is due. The act also 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.[10]

Refund Community College and UNC System Tuition and Fees

The act requires community colleges to grant a full refund of tuition and fees to deployed military reserve and national guard personnel who request a refund because their deployment makes it impossible to complete course requirements. The community colleges must also buy back textbooks to the extent possible and use distance-learning technologies to help these students complete their course requirements. This section of the act applies to the 2002-2003 and 2003-2004 academic years only.

The act authorizes the constituent institutions of The University of North Carolina to grant a full refund of tuition and required fees to students who request a refund because of

---

[8] S.L. 2003-152 establishes a military designation for a driver's license issued to a person on active duty and to the person's spouse and dependent children. The military designation allows the holder of the license to renew by mail no more than two times during the holder's lifetime. A license renewed by mail is considered a permanent license and does not expire when the holder returns to the State. The military designation also allows the person on active duty to renew the license up to one year prior to its expiration. A license holder who is serving in a combat zone or a qualified hazardous duty zone may renew by mail without having to take an eye exam.

[9] Section 3 of the act refers to the definition of "occupational license" as defined in G.S. 93B-1. Although that definition does not specifically preclude occupational licenses issued by State agencies, such as a license to sell insurance, the term "occupational licensing board" in G.S. 93B-1 specifically excludes State agencies. House Bill 281 would have amended this portion of the act to clarify that the authority of the Governor to extend the validity of occupational licenses for deployed military personnel includes occupational licenses issued by a State agency. House Bill 281 was sent to a conference committee but was never ratified.

[10] Under G.S. 105-360, property taxes are due September 1 of the fiscal year, and interest begins to accrue on the taxes on or after January 6 following the due date. Under G.S. 105-307, the regular listing period for property taxes ends on January 31.

involuntary or voluntary service in the military or because of circumstances related to national emergencies. The constituent institutions should determine whether to give full or pro rata refunds of housing, parking, and other optional fees to students to whom they give tuition and required fee refunds. The act recommends that every campus review its policy on tuition refunds and make modifications to cover the circumstances described in the act.

Legislation similar to this part of the act was enacted for military personnel deployed or called to active duty during Operation Desert Storm, S.L. 1991-160, and during Operation Enduring Freedom and Noble Eagle, S.L. 2001-508. As a result of the 2001 legislation, the State Board of Community Colleges and the UNC System now have policies on refunds of tuition and fees. The State Board of Community Colleges authorized the initiation of the rule-making process to make permanent military tuition refunds when students are unable to complete their course requirements because they were called to active duty in September 2001.[11] Effective October 12, 2001, the UNC Policy Manual has guidelines for refunds of tuition and fees for students requesting refunds due to military service or national emergencies.[12]

Waive Legislative Tuition Grants

The act waives repayment of the North Carolina Tuition Grant by students who lose their full-time student status due to active military duty or circumstances related to national emergencies. This section of the act applies to the 2002-2003 and 2003-2004 academic years only.

PSYCHIATRIC HOSPITAL FINANCING.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-314, as amended by S.L. 2003-284	**HB 684**	**Rep. Crawford, G. Allen, Fox, Luebke (Primary Sponsors)**

AN ACT TO PROVIDE FOR FINANCING THE CONSTRUCTION OF A NEW PSYCHIATRIC HOSPITAL TO BE LOCATED IN BUTNER.

OVERVIEW: This act, as rewritten by S.L. 2003-284, authorizes the issuance of up to $110 million in security interest debt to finance the acquisition, construction, and equipping of an approximately 450,000 square foot, 432-bed new psychiatric hospital to be located in Butner. The act also enacts the procedural and regulatory provisions governing the State's issuance

[11] 23 NCAC 02D.0202(f) and 23 NCAC 02D.0203(e). The wording of this rule is almost verbatim the language in Sections 5(a) and (b) of the act.
[12] The wording of the policy is almost verbatim the language in Section 6(a) of the act.

of security interest indebtedness by creating the "State Capital Facilities Financing Act".[13] Security interest indebtedness is debt that is secured by an interest in the property being financed, repaired, or renovated. The act uses the term "special indebtedness" to cover the three forms that this type of debt can take: installment purchase, lease-purchase, and bonds. In each case, the debt is non-voted.

FISCAL IMPACT: Debt service for the construction of the new psychiatric hospital is anticipated to cost the State from $12.1 million to $5.83 million a year. It is anticipated that the cost savings from the closure of both Dorothea Dix Hospital and John Umstead Hospital will be sufficient to offset the cost of these debt service payments. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on July 10, 2003. S.L. 2003-284 became effective June 30, 2003. Therefore, the limited scope of the State Capital Facilities Financing Act as enacted by this act was superseded from the beginning by the broader rewrite of the Act in S.L. 2003-284.

ANALYSIS: The North Carolina Constitution[14] and the North Carolina General Statutes restrict the General Assembly's authority to issue debt. Except in limited circumstances, [15] the General Assembly does not have the power to authorize the issuance of bonds secured by a pledge of the faith and credit of the State without a referendum approved by a majority of the voters voting in an election. These bonds are referred to as general obligation bonds because the general taxing power of the State secures the bonds. Article 5 of Chapter 159 of the General Statutes authorizes the State to use revenue bonds to finance a project without voter approval, but authorization by specific legislation is required under G.S. 159-88(c). Revenue bonds involve the pledge of non-tax revenues related to the project, such as parking fees for parking decks and water and sewer charges for water and sewer projects. In recent years, the State has used security interest indebtedness as a financing tool on a project-by-project basis.[16] This act provides the procedural and regulatory provisions needed to carry out security interest indebtedness. As with revenue bonds, authorization to use security interest indebtedness must be given by the General Assembly through specific legislation under G.S. 142-83, as enacted by this act.

---

[13] The bill as enacted provided procedural and regulatory provisions only for security interest indebtedness for the psychiatric hospital. The Current Operations and Capital Improvements Appropriations Act of 2003, S.L. 2003-284, rewrote this act to extend the procedural and regulatory framework to any State security interest indebtedness. Under S.L. 2003-284, the State may employ security interest indebtedness for the following projects: $300,000,000 for repairs and renovations of State facilities and related infrastructure that are supported from the General Fund; the acquisition of two private prisons in Pamlico and Avery Counties; $6,780,000 for the design and planning of three youth development centers; $310,000 for a structural pest control training facility at North Carolina State University; and the lease purchase of three new prisons.

[14] Article V, Sec. 3 of the North Carolina Constitution.

[15] The North Carolina Constitution allows the General Assembly to issue non-voted general obligation bonds in an amount not to exceed 2/3 of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. Other Constitutional exceptions for non-voted general obligation debt include the following: to fund or refund an existing debt; to supply an unforeseen deficiency in the revenue; to borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50% of the taxes due; to suppress riots or insurrections, or to repel invasions; and to meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor.

[16] S.L. 2000-143 authorized installment contract financing for a $13.5 million office building and wildlife education center for the Wildlife Commission and a $4 million Eastern Wildlife Education Center. S.L. 2001-84 authorized the State to enter into lease-purchase contracts to finance three prisons. S. L. 2002-161 authorized installment-financing contracts for guaranteed energy savings contracts for State buildings.

Security interest indebtedness is commonly referred to as "certificates of participation". The act employs the term "special indebtedness" to cover the three forms that this type of debt can take: installment purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), and limited obligation bonds. In each case, the debt is non-voted. The particular form to be used for a given project[17] will depend on its size, the nature of the property and the improvement, and other circumstances. Based on these circumstances, one form or another of security interest debt may be the least expensive and most practical for the State to utilize.

Under security interest indebtedness, the debt is secured by a lien on or security interest in all or any part of the capital facilities to be financed, including all or part of any land on which improvements are to be constructed. If the project is a renovation, the entire existing facility as well as the improvement could serve as security. The value of the property securing the debt may exceed the amount of the debt and the financing of several capital projects may be jointly secured by liens on some or all of the capital facilities being financed.

Because the property serves as the security for the indebtedness, there would be no pledge of the State's faith and credit or taxing power. Thus, voter approval is not necessary for the borrowing. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the capital facilities that serve as security could be disposed of to generate funds to satisfy the debt. The State could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the State's credit rating.

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

Once it is determined that special indebtedness can be issued or incurred, the funds can be borrowed from a single entity in an installment purchase or lease purchase contract, generated by the issuance of limited obligation bonds, or borrowed under an installment financing contract by the sale of certificates of participation. A certificate of participation represents the holder's undivided interest in the right to receive the installment payments to be made by the State. If certificates of participation are issued, a nonprofit corporation will act as a straw person to facilitate the financing.

This act not only provides the statutory framework for special indebtedness as a financing tool of the State, but also provides the specific legislative authorization for up to $110

---

[17] The Act specifically defines the capital expenditures that may be financed as any combination of buildings, utilities, structures, and other facilities and property developments, including streets, landscaping, equipment and furnishing in connection with a building project; additions, renovations, and improvements to existing facilities; land acquisition; infrastructure; and furniture, equipment, vehicles, machinery, and similar items.

million of this type of indebtedness to be used for a new psychiatric hospital to be located in Butner. The new facility will consist of approximately 450,000 square feet and contain 432 beds. The indebtedness for this project cannot be incurred prior to July 1, 2004.

The new psychiatric hospital to be built in Butner will replace the current John Umstead Hospital in Butner and Dorothea Dix Hospital in Raleigh. These two psychiatric hospitals are outdated facilities that need extensive repairs and renovations. Even with significant repairs and renovations, the Secretary of Health and Human Services says that they would still be unable to support the latest mental health treatments. The Secretary believes that replacing the two hospitals with one regional facility will save an estimated $40.9 million a year by reducing costs. The act directs that any nonrecurring savings in State appropriations realized from the closure of the two current facilities that are in excess of the cost of operating and maintaining the new hospital will be credited to the Trust Fund for Mental Health, Developmental Disabilities, and Substance Abuse Services and Bridge Funding Needs. The act also directs that any recurring savings realized from the closure of the existing two hospitals shall be used for the payment of debt service on financing contract indebtedness for the construction of the new hospital. The act provides that the State Treasurer may require one or more reports evidencing the savings expected to be realized from the closure of existing psychiatric hospitals that are to be replaced by the project and the feasibility of the financing of the project.

The act also makes the following changes:

- Requires DHHS to maintain research programs currently being conducted at Dorothea Dix hospital and John Umstead hospital by the UNC Medical School and the UNC-Chapel Hill Psychology Department.
- Authorizes the county chosen as the site for the hospital to acquire the land by eminent domain and to convey the land to the State.
- Creates a study commission to consider the potential disposition of the State-owned real property encompassing the Dorothea Dix Hospital campus. The Dorothea Dix Hospital Property Study Commission must make recommendations on the options for sale of the property to the Joint Legislative Commission on Governmental Operations before any part of the property may be sold to a nongovernmental entity.

WATER & SEWER AUTHORITY SETOFF.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-333	**SB 529**	**Senator Hartsell**

AN ACT TO AUTHORIZE WATER AND SEWER AUTHORITIES TO USE THE SETOFF DEBT COLLECTION ACT.

<u>OVERVIEW:</u> This act adds water and sewer authorities to the list of local governments allowed to submit debts to the Department of Revenue for collection under the Setoff Debt Collection Act.

<u>FISCAL IMPACT:</u> This act has no impact on the State General Fund, and any fiscal impact on water and sewer authorities cannot be determined.

<u>EFFECTIVE DATE:</u> This act is effective January 1, 2004, and applies to income tax refunds determined on or after that date.

<u>ANALYSIS:</u> The act adds water and sewer authorities to the Setoff Debt Collection Act, under which the Department of Revenue diverts part or all of an individual's income tax refund to pay a debt the individual owes to a State or local agency.[18] Thus, the debt the individual owes the agency is set off against the individual's income tax refund. Before January 1, 2000, the setoff program was open only to State agencies.[19] Now, counties and municipalities participate through a clearinghouse that submits debts on their behalf to the Department of Revenue. The clearinghouse was established pursuant to an interlocal agreement adopted under Article 20 of Chapter 160A of the General Statutes. Because there are so many local agencies, funneling their claims through a clearinghouse avoids placing an undue administrative burden on the Department of Revenue.

The act allows water and sewer authorities to participate in the setoff program through the clearinghouse in the same manner as counties and cities. Like counties and cities, a water and sewer authority will be authorized to submit its debts for collection by setoff only after providing the debtor with notice, an opportunity to be heard before the water and sewer authority, and an appeal process under the Administrative Procedure Act.

The creation of a water and sewer authority is one mechanism a county and city can use to address water and sewer needs. One or more counties, cities, sanitary districts, and other political subdivisions may create a water and sewer authority by adopting resolutions stating their intent to do so.[20] Each resolution must be adopted after notice is published and a public hearing is held on the issue. A political subdivision can withdraw from the authority at any time before obligations of the authority have been incurred. A water and sewer authority may issue revenue bonds; enter into installment finance contracts; impose rates, fees, and charges; and levy special assessments. Water and sewer authorities may also apply for grants from the Clean Water Revolving Loan and Grant Fund.

Currently there are fewer than a dozen water and sewer authorities in the State. A water and sewer authority may discontinue services to a customer whose account is delinquent for 30 days or more. However, this remedy is not sufficient when the customer moves out of the authority's service district or when the amount due is large enough that discontinuing the service would not result in the payment of the amount due.

---

[18] The Setoff Debt Collection Act applies only to a debt that is at least $50 and to a refund that is at least $50. Debts collected through the Setoff Debt Collection Act are subject to both a State collection assistance fee and a local collection assistance fee. The amount of the local fee is $15. The amount of the State collection assistance fee is based on the Department's actual cost of collection debts under the Act during the preceding year. The current amount of that fee is $4.32.

[19] S.L. 1997-490.

[20] In certain circumstances, a nonprofit water company may also be a part of a water and sewer authority. See G.S. 162A-3.

REVENUE ADMINISTRATIVE CHANGES.

Session Law	Bill #	Sponsor
S.L. 2003-349	SB 236	Senator Kerr

AN ACT TO MODIFY THE DIVIDEND RECEIVED DEDUCTION FOR REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS TO ENSURE THAT ALL DIVIDENDS ARE TREATED UNIFORMLY, TO EXTEND FOR TWO YEARS THE DEPARTMENT OF REVENUE'S AUTHORITY TO OUTSOURCE THE COLLECTION OF IN-STATE TAX DEBTS, TO AMEND THE MOTOR FUEL TAX LAWS, AND TO MAKE VARIOUS ADMINISTRATIVE CHANGES IN THE TAX LAWS.

OVERVIEW: This act makes the following changes:

- It modifies the dividends received deduction for regulated investment companies and real estate investment trusts to ensure that all dividends are treated uniformly, effective for taxable years beginning on or after January 1, 2003, as recommended by the Revenue Laws Study Committee.
- It amends the reporting requirements regarding sales of seized property by the Secretary of Revenue to avoid duplicative filing of reports, as recommended by the Revenue Laws Study Committee.
- It extends until October 1, 2005, the Department of Revenue's authority to continue using private collection agencies for the collection of in-state tax debts, as recommended by the Revenue Laws Study Committee.
- It revises the secrecy provision regarding the disclosure of tax information to reflect the transfer of certain functions and personnel from the Division of Motor Vehicles to the Division of the State Highway Patrol of the Department of Crime Control and Public Safety, as recommended by the Revenue Laws Study Committee.
- It ensures that the monthly distribution of local sales and use tax proceeds is based on taxpayer data from filed returns, effective July 1, 2003, as recommended by the Revenue Laws Study Committee.
- It simplifies the process for making the local sales tax hold-harmless calculation by requiring the Department of Revenue, rather than the Office of State Budget and Management, to make the required projection of estimated tax proceeds, as recommended by the Revenue Laws Study Committee.
- It clarifies that the $20 filing fee for corporate annual reports is nonrefundable, as recommended by the Revenue Laws Study Committee.

- It clarifies the Research and Development tax credit, as requested by the Department of Commerce and the Department of Revenue.
- It directs the Revenue Laws Study Committee to form a group of tax professionals to work with the Department of Revenue to gather appropriate data to support an estimate of the fiscal impact of allowing corporations to file consolidated tax returns.
- It makes various changes to the motor fuel laws, as requested by the Motor Fuels Tax Division of the Department of Revenue. These changes include technical changes, conforming changes, and substantive changes.
- It codifies the administrative practice of allowing municipalities that sell electricity to exempt from their gross receipts for sales tax purposes those customer accounts that have been determined to be worthless. The sales tax law clearly allows this exemption for other taxpayers.

FISCAL IMPACT: This act has no impact on the General Fund. Part 10 of this act is expected to affect the Highway Fund and other funds, as described in the analysis of Part 10, below. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See Analysis.

ANALYSIS:

Part 1: Modify Dividends Received Deduction for RICs and REITs

Part 1 of this act repeals the dividend deduction provisions that previously applied to regulated investment companies (RICs) and real estate investment trusts (REITs), effective beginning with the 2003 tax year. The effect of the repeal is to conform to the federal dividend deduction for RICs and to the federal disallowance of any dividend deduction for REITs.

The federal dividends received deduction[21] is meant to reduce the negative effects of the double tax on C corporation profits distributed as dividends to corporate shareholders. Subject to certain exceptions and limitations, corporations may deduct 70% of the dividends received from another domestic corporation if the receiving corporation owns less than 20% of the distributing corporation. The deduction rises to 80% of dividends if the corporation owns 20% or more of the corporation paying the dividends, and to 100% if the corporations are "affiliated" under the Internal Revenue Code.

Certain investment companies, including mutual funds, may elect to be taxed as RICs. There are several conditions that must be satisfied to qualify for the election, including (i) 90% of gross income must be derived from dividends, interest, and gains on the sale of stock or securities and (ii) the corporation's investments must be diversified as prescribed by Section 851 of the Internal Revenue Code. A qualified RIC is taxed only on its undistributed income and is treated as a partial conduit for the income it earns. The fundamental premise of conduit treatment is that the RIC's income should be taxed only once, at the shareholder level, rather than to the RIC. Dividends received from RICs are eligible for the federal deduction, subject to additional limitations.[22]

---

[21] 26 U.S.C. § 243.

[22] Capital gain dividends received from a regulated investment company do not qualify for the deduction.

A REIT is a corporation or trust that uses the pooled capital of many investors to purchase and manage real estate. REITs are traded on major exchanges just like stocks and are granted special tax considerations. A REIT pays yields in the form of dividends. It is required to pay out at least 90% of its income to shareholders and deducts the amount paid out, so there is no taxation at the REIT level. The shareholders pay tax on the dividends they receive.

Under prior law, G.S. 105-130.7 provided that a corporation may deduct the proportionate part of dividends received by it from a RIC or a REIT as corresponds to income received by the company or trust that would not be taxed by North Carolina if received directly by the corporation. In other words, dividends received by a corporation from a RIC or REIT were deductible to the extent that income received by that corporation from a RIC or a REIT would not be taxable by North Carolina.

Section 1.1 of the act repeals G.S. 105-130.7.[23] In 2001, the General Assembly piggybacked the federal law with regard to the corporate dividends received deduction, by repealing G.S. 105-130.7(b) and G.S. 105-130.5(a)(7), which had provided corporations with an income tax deduction for dividends received by their subsidiaries. Adopting the federal approach simplified tax administration and compliance because the taxpayer is required to make fewer adjustments to taxable income in order to calculate State net income. The repeal under Section 1.1 of this act is consistent with this philosophy.

Dividends received from a RIC qualify for the federal dividends received deduction. Therefore, despite the repeal of G.S. 105-130.7 by this act, dividends received from RICs will continue to be deductible. The repeal of G.S. 105-130.7 also ensures that dividends received from a RIC are subject to the same rules concerning attribution of expenses as dividends received from other corporations.

Dividends from REITs do not qualify for the federal dividends received deduction. Therefore, under past law, dividends from REITs were taxed more favorably for State tax purposes than under federal law. The repeal of G.S. 105-130.7 ensures that the State treatment of dividends from REITs is the same as under federal law.

Part 2: Avoid Duplicative Reporting Requirements Regarding Sales of Seized Property

If any tax levied by the State and payable to the Department of Revenue has not been paid within 30 days after the taxpayer was given a notice of final assessment of the tax, the Department is authorized to collect the tax through the levy upon and sale of the taxpayer's real or personal property. The Department may direct the sheriff to levy upon and sell property or it may levy upon the property itself through one of its employees.

Most personal property seized by the Department of Revenue is for the payment of unauthorized substance taxes. When the Department employees levy upon the property without the use of the sheriff, the actual sale of the property is conducted by the Department of Administration's State Surplus Property section in accordance with the same notice and bidding procedures that apply to surplus property. The State Surplus Property section posts information related to bids and sales of seized property both online and in written format, which is available to the public.

[23] The repeal of G.S. 105-130.5(b)(3) and the changes in Sections 1.2 and 1.3 of the act are conforming changes.

The laws in Article 29B of Chapter 1 of the General Statutes, which apply to the sheriff when conducting the levy and sale of property, also apply to the Department of Revenue when it conducts the levy and sale of property. Among those provisions is G.S. 1-339.63, which states that the sheriff must file a report of sale with the clerk of superior court. Because the Department is subject to the same laws governing execution sales, it had construed this provision to mean that the Department must file a report of all sales of seized property with the clerk of superior court.

Because the Department of Administration makes a report of all property sold through the surplus property sales, the Department of Revenue did not see a need to file a report of sale with the clerk of court as well. Therefore, Section 2 of the act amends G.S. 105-242 to provide that the Department of Revenue is not required to file a report of sale of seized property with the clerk of superior court as long as the sale is otherwise publicly reported. This change became effective when the act was signed into law by the Governor on July 27, 2003. In addition to improving efficiency by avoiding duplicative reporting, this change should also reduce costs since several clerks of court have begun charging a fee for filing these reports.

Part 3: Extend Authority to Use Collection Agencies to Collect In-state Tax Debts

Part 3 of this act extends for two years the Department of Revenue's authority to use private collection agencies to collect in-state tax debts. The Department of Revenue has permanent authority to use private collection agencies to collect out-of-state tax debts. The authority to outsource in-state debts was scheduled to expire on October 1, 2003. This act extends it to October 1, 2005. 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 1999, the General Assembly authorized the Department of Revenue to initiate a pilot program whereby the Department would contract for the collection of tax debts owed by nonresidents and foreign entities. 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.

In 2001, the Department of Revenue was authorized to outsource out-of-state tax debts permanently and to outsource in-state tax debts for two years. When outsourcing tax debts, the Department is required to notify 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.

Part 4: Revise Secrecy Provision To Reflect Transfer of DMV Enforcement to the State Highway Patrol

Under the tax secrecy law (G.S. 105-259(b)), an officer, employee, or agent of the State who has access to tax information in the course of service or employment by the State may not disclose the information to any other person except for the purposes expressly authorized by statute. One of the allowed purposes is to exchange information with the Division of Motor

Vehicles of the Department of Transportation when the information is needed to fulfill a duty imposed on the Department of Revenue or the Division of Motor Vehicles.

In 2002, the General Assembly enacted legislation[24] that transferred to the Department of Crime Control and Public Safety the personnel and functions of the Department of Transportation Division of Motor Vehicles Enforcement Section for the regulation and enforcement of commercial motor vehicles, oversize and overweight vehicles, motor carrier safety, and mobile and manufactured housing. The transfer became effective January 1, 2004. In order to preserve the secrecy provision in existing law, Section 4 of the act replaces the phrase "Division of Motor Vehicles of the Department of Transportation" with the phrase "Division of the State Highway Patrol of the Department of Crime Control and Public Safety" because the State Highway Patrol will be performing the functions of the prior DMV Enforcement Section. This change became effective when the act was signed into law by the Governor on July 27, 2003.

Part 5: Base Local Sales Tax Distributions on Taxpayer Data

Pursuant to G.S. 105-472, the Secretary of Revenue makes distributions of local sales and use tax proceeds to cities and counties. In 2001, the General Assembly accelerated these distributions from quarterly to monthly, effective July 1, 2003. This Part provides that each monthly distribution will include tax proceeds for which a return has been filed. Proceeds received the month before the related return is expected to be filed will be held until the month the return is filed. Because the return contains information necessary for determining the distribution formula, distributing some taxes before the related return is filed would result in misallocation of the tax proceeds. This Part became effective July 1, 2003.

As of January 1, 2002, the threshold for taxpayers required to make semimonthly payments of sales and use tax was lowered from $20,000 to $10,000, substantially increasing the total amount of revenues received for processing by the Department on a semi-monthly basis. For semi-monthly filers, sales and use tax revenues collected between the 1st and 15th of the month must be paid by the 25th of the same month and sales and use tax revenues collected the remainder of the month must be paid by the 10th of the following month. The return for the two semimonthly periods is due 10 days later, on the 20th of the month. Consequently, for revenues received for the first half of each month, the return indicating where the funds should be distributed will not be received until the following month.

Section 5 of the act amends the local government sales and use tax distribution statute by stating that amounts collected by electronic funds transfer payments are included in the distribution for the month in which the return that applies to the payment is due. Semimonthly taxpayers are required to pay by electronic funds transfer. This amendment ensures that the Department of Revenue will distribute local sales and use tax proceeds only after they have the necessary information provided on semimonthly returns.

Part 6: Simplify the Procedure for Hold-Harmless Calculation

In 2001, the General Assembly authorized all counties of the State to levy a third one-half cent sales tax.[25] The same legislation also provided local governments an annual hold-harmless distribution from the State's General Fund to ensure that none of them would

[24] S.L. 2002-190, as amended by Section 31.5 of S.L. 2002-159.

[25] Effective July 1, 2004, all 100 counties will have adopted the local option third one-half cent sales tax authorized by Section 34.14 of S.L. 2001-424.

lose money when the local government reimbursements are repealed.[26] The hold-harmless distribution provides that if a county or city's estimated proceeds from the third half-cent tax would be less than the amount it would have gotten under the repealed reimbursements, it will receive a payment equal to the difference. If a county or city's estimated gain from the third half-cent tax exceeds its repealed reimbursement amount, it does not receive a hold-harmless payment from the State. The hold-harmless payment would be the same even if a county had not levied the new tax.

Under prior law, G.S. 105-521(b) directed the Office of State Budget and Management (OSBM) and the Fiscal Research Division of the General Assembly to each submit to the Secretary of Revenue and the General Assembly, by May 1 of each year, a projection of the estimated amount that local governments would be expected to receive from the levy of the third one-half cent local sales and use tax during the upcoming fiscal year. Then, by September 15 of each year, the Secretary of Revenue is required to calculate the hold-harmless distribution amounts, if any, based on the projections and to distribute the funds. If the Secretary does not use the lower of the two projections when making the calculation, the Secretary must report the reasons for this decision to the Joint Legislative Commission on Governmental Operations within 60 days after receiving the projections.

Part 6 of the act requires the Department of Revenue, rather than the OSBM, to provide the estimate. From a practical standpoint, the data needed to make the projections are housed within the Department of Revenue. Making this change simplifies the process by eliminating the need for the OSBM to first obtain the data from Revenue and then make the necessary projection. This change became effective when the act was signed into law by the Governor on July 27, 2003.

Part 7: Clarify That the Filing Fee for an Annual Report is Nonrefundable

G.S. 55-1-22 sets out the fees for filing certain documents with the Secretary of State, including documents such as corporations' articles of incorporation, articles of dissolution, designation of a registered agent, etc. Included on the list is a $20.00 fee for filing an annual report. Each corporation authorized to do business in this State is required to file an annual report, which, unlike the other documents in G.S. 55-1-22, must be delivered to the Secretary of Revenue. [27] The annual report contains the name of the corporation, its address, the name and address of its registered agent, the names and addresses of its principal officers, and a brief description of the nature of its business. Annual reports are due by the due date for filing the corporation's income and franchise tax return. As a practical matter, the annual reports are typically attached to the return along with a check for the filing fee.

Part 7 of the act amends G.S. 55-1-22 by adding a new subsection stating that the annual report fee of $20.00 is nonrefundable. This change became effective when the act was signed into law by the Governor on July 27, 2003. The purpose of this change is to codify the Department of Revenue's existing policy that annual report fees are not refundable. G.S. 55-1-22 does not address whether or under what circumstances the filing fees are refundable. However, it is the policy and practice of the Secretary of State to issue refunds for those fees, if requested and depending on the circumstances. Specifically, if the Secretary of State's

[26] The 2003 General Assembly limited this distribution to two years, 2003 and 2004, but stated the intent that it would continue through 2012. *Part 37 of S.L. 2003-284.*

[27] Nonprofit corporations are exempt from this requirement and insurance companies are required to deliver their annual reports to the Secretary of State.

office has not begun to process or review the document for which the refund is requested, then it will usually refund the filing fee at the filer's request, regardless of whether the fee has been deposited. The Department of Revenue's policy with regard to the annual report is that the fee is nonrefundable.

Part 8: Clarify Eligibility for R&D Credit

The William S. Lee Quality Jobs and Business Expansion Tax Credits, in Article 3A of Chapter 105 of the General Statutes, are allowed only to certain types of businesses.[28] For most of the eligible business types, the law specifies that the taxpayer's primary business must be the designated business. For a few of the business types, including computer services, the law requires only that the taxpayer's primary activity at an establishment be the designated business. In addition, to qualify for the credits, the jobs, investment, or activity must be used in the designated business or activity.

One of the credits under the Bill Lee Act is for research and development. Generally, a taxpayer that claims a federal income tax credit for increasing research activities under section 41 of the Internal Revenue Code is allowed a State credit as well for the eligible research activities conducted in North Carolina. The amount of the credit varies, depending upon which type of federal credit is claimed.[29] Under the Department of Revenue's interpretation of the Bill Lee Act, to satisfy the eligible business requirements, the jobs, investment, and activity must be located at an establishment where the primary activity is an eligible business or eligible activity.

The question arose whether a taxpayer's qualified research expenditures must have occurred on the premises of an establishment that performed an eligible industry activity. Under the Department's past interpretation of the law, the answer was yes. Part 8 of the act purports to clarify the original intent of the General Assembly that research and development activities need not be on the same premises as an eligible activity. It extends this clarification to the legislature's recent relaxation of the eligible business requirements surrounding computer services. The act provides that if the primary activity of an establishment of the taxpayer in this State is computer services, then the taxpayer's qualified research expenditures in this State are considered to be used in computer services. For all other taxpayers, the expenditures are considered to be used in the primary business of the taxpayer. The changes are retroactive to the years the related provisions were effective, 2001 and 1996, respectively.

Part 9: Revenue Laws to Study Data Needed to Estimate Impact of Consolidated Returns

Whenever study committees discuss tax modernization, one of the issues that arises is the State's corporate income tax structure. The corporate tax structure has remained substantially unchanged for years. In the course of these discussions, the Fiscal Research Division and the Tax Research Division of the Department of Revenue have been asked what the fiscal consequences would be if the State allowed consolidated corporate income tax returns. Currently, neither has enough information to form a credible estimate.

[28] Central office or aircraft facility; air courier services or data processing; manufacturing, warehousing, or wholesale trade; computer services or electronic mail order house; customer service center; or warehousing at an establishment.

[29] The credit amount is 5% of the State's apportioned share if the taxpayer claims the credit under section 41(a) of the Code or 25% if the taxpayer claims the alternative incremental credit under section 41(c)(4) of the Code.

Part 9 of the act directs the Revenue Laws Study Committee to establish a study group composed of tax professionals and representatives of the Department of Revenue to gather appropriate data that will allow the Department to estimate the fiscal impact of consolidated returns. Part 9 becomes effective with the 2003 tax year and expires in two years.

Part 10: Motor Fuel Tax Changes

This Part makes several changes to the motor fuel tax laws, effective January 1, 2004. It provides the Department of Revenue with greater enforcement capabilities, it protects the State's interest with a shorter temporary permit for motor carriers and a higher bond requirement for distributors, and it makes the motor fuel statutes more equitable by extending the inspection tax to dyed diesel fuel. It also makes several technical and administrative changes.

This Part strengthens the Division of Motor Fuel's enforcement capabilities in the following ways:

- Sections 10.3 and 10.4 require a taxpayer that imports motor fuel from an out-of-state terminal into North Carolina to be licensed as a distributor. Past statutes made the distributor's license optional. If the product was being imported, the taxpayer was required to register as a licensed importer but none of the importer categories fit a taxpayer obtaining tax-paid fuel from an out-of-state terminal. For example, the taxpayer would not owe tax directly to the Department, but an importer's license requires the taxpayer to file a return on a monthly basis. The Department of Revenue had determined that a distributor's license, which allows the taxpayer to import and export the product but does not require periodic returns, was more appropriate. The Department had implemented this change administratively; Sections 10.3 and 10.4 change the statutes accordingly. Section 10.5 removes the requirement that an applicant for licensure as a distributor or an importer notify the Department of any states to which it plans to export or from which it plans to import motor fuel, because there is no means for tracking this information.

- Section 10.7 enables the Department to deny a motor fuel license to a taxpayer that fails to file a return or pay any tax debt due under Chapter 105 or 119 of the General Statutes.

- Section 10.10 clarifies the Department's authority to investigate illegal use of non-tax-paid fuel for highway use. One way the Department investigates alleged violations is through undercover operations. Investigators will film an operation in which an agent will drive a State truck to a retailer and ask to fill it with dyed (non-tax-paid) fuel. It would be a violation for the retailer to permit the purchase of non-tax-paid fuel for highway use. Technically, however, the fuel in this situation is not taxable because G.S. 105-449.88 exempts motor fuel sold to the State for its use. This section specifies that it is not a valid defense to a violation of the motor fuel tax statutes that the State is exempt from motor fuel tax.

- Sections 10.12 through 10.14 require kerosene terminal operators to be licensed and to file reports. Currently, jet fuel and kerosene are being delivered from the pipeline directly to airports. This method of delivery bypasses the motor fuels terminals and thereby bypasses the record-keeping requirements that help ensure that the Department can uniformly enforce the tax statutes. Kerosene terminal operators are currently subject to tax. The Internal Revenue Service licenses these terminals and the terminal operators must report deliveries to the airports. These sections do not subject the airports to greater tax liability, but require them to be licensed and to file reports so the Department can identify the taxpayers and ensure that they are paying the requisite amount of tax. As a result, the State should begin collecting an unknown amount of inspection tax revenue that was otherwise falling through the cracks. Section 10.16 provides a licensed kerosene distributor the same benefits of deferred payments and discounts that a licensed motor fuel distributor receives. Finally, these sections reorganize and modernizes the language of the kerosene licensing statutes.

Section 10.1 reduces from 20 days to 3 days the maximum time a motor carrier can operate in the State using a temporary permit, rather than obtaining a license. A licensed motor carrier pays tax based on the number of miles driven in the State. The cost of a temporary permit is $50. It would take approximately 1,000 miles to exceed the $50 temporary permit fee in taxes. A motor carrier can drive far more than 1,000 miles in 20 days and thus could get many "free" miles by obtaining a temporary permit. Three days is a better approximation of the time in which a motor carrier would use $50 worth of miles. The Department surveyed numerous states and determined that, of the 26 states where permit information was available, 7 states issued 3-day permits, 5 states issued permits for between 4 and 7 days, 5 states issued 10-day permits, 1 state issued a 13-day permit, and 1 state issued a 20-day permit. Seven states did not issue temporary permits. Section 10.1 could increase Highway Fund revenues by increasing the number of permits issued or the number of permanent licenses issued. No estimate is available for the permit volume.

Section 10.6 increases the cap on the bond amount of motor fuel licensees to $500,000. The most recent bond cap amount of $250,000 was last adjusted in January 1991. The Department believes the maximum bond amount should be increased to $1 million. Since 1991, licensees' tax liabilities have increased to a point that 28% of the current licensees have a monthly tax liability of over $250,000, 18.3% over $500,000, 13.17% over $750,000, and 8.48% over $1 million. In the last six months there have been four bankruptcy cases, two of which exceeded the taxpayer's bond amount. In one of these cases, the potential loss to the State is in excess of $1 million after payment from the surety company. A survey of the surrounding states shows that South Carolina, West Virginia, Kentucky, and Louisiana do not have a cap; Florida has a $100,000 cap; Virginia has a $300,000 cap; Georgia has a $150,000 cap; and Maryland has a $500,000 cap.

Section 10.15 imposes the inspection tax on dyed diesel. The Department of Revenue estimates that this change will yield an additional $1.2 million of inspection tax a year. The inspection tax is currently imposed on all other fuel types at the rate of one-fourth of one cent per gallon[30] including dyed kerosene, which, like dyed diesel, is used for heating and other non-highway purposes. The Department conducts monthly on-road investigations for the misuse of dyed fuels, including dyed diesel. Each sample of fuel withdrawn must be tested by the Department of Agriculture for evidence of dye in the fuel.

[30] The inspection tax is imposed regardless of whether the fuel is exempt from the per-gallon excise tax. The proceeds of the tax are applied first to the cost of administering the Motor Fuels Tax Division. The remainder is credited to the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund and the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund.

Lastly, Part 10 makes the following technical and administrative changes:

- Section 10.2 clarifies that the definition of a tank wagon includes vehicles designed to carry at least 1,000 gallons of motor fuel. The past definition appeared to exclude those vehicles that can carry a total of more than 1,000 gallons but have individual tanks that are less than 1,000 gallons each.
- Section 10.8 conforms the statutes with the legislative change made last session to exempt local governments from the motor fuel tax.
- Section 10.9 removes the requirement that shipping documents must be machine-printed by the operator of a bulk plant. This requirement was imposed inadvertently when the statutes were reorganized. Bulk plant operators do not have the necessary equipment and the Department does not need them to provide machine-printed documents. The act does not change the requirement that terminal operators must machine-print shipping documents.
- Section 10.11 clarifies that storage facilities for dyed kerosene must be clearly marked for non-tax use only, just like the storage facilities for dyed diesel fuel. It also provides that the dispensing device for dyed fuel must be clearly marked as non-tax use only.

Part 11: Charge-off of Bad Debts

Retailers pay sales tax on their gross sales. If accounts of purchasers are found to be worthless and are charged off for income tax purposes, then the retailer may deduct those sales from its gross sales. Municipalities that sell electricity are considered to be retailers and pay State sales tax on their gross sales of electricity. The practice of the Department of Revenue was to allow the municipalities to charge-off their bad debts as other retailers are allowed to do. However, municipalities could not technically meet the conditions of the statute because they do not pay federal income tax. This Part conforms the statute to the Department's practice by clarifying that municipalities that sell electricity may deduct worthless accounts from their gross sales for sales tax purposes. Worthless accounts are determined in the same way as they would be determined under the Internal Revenue Code if municipalities were taxed. As under current law, the accounts that are collected afterwards must be added back to gross sales. Part 11 became effective when the act was signed into law by the Governor on July 27, 2003.

MODIFY UNC BOND LAW.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-357	**SB 633**	**Senator Clodfelter**

AN ACT TO REVISE THE UNIVERSITY OF NORTH CAROLINA SPECIAL OBLIGATION BOND LAW.

OVERVIEW: This act modifies the special obligation bond law that applies to The University of North Carolina system (UNC). It makes the maximum maturity for special obligation bonds more consistent with other University debt obligations by increasing the maximum maturity of special obligation bonds from 25 years to 30 years. It also increases the maximum maturity for special obligation bond notes from 2 years to 30 years, which provides UNC with greater flexibility to provide interim financing at lower costs.

FISCAL IMPACT: This act does not have an impact on the General Fund.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 1, 2003.

ANALYSIS: In 2000, the General Assembly authorized the UNC Board of Governors to issue special obligation bonds payable from any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. The bond proceeds can be used for construction, improvement, and acquisition of capital facilities located at UNC constituent and affiliated institutions. The maximum maturity on the bonds was set at 25 years. Special obligation bonds are not general obligation bonds and thus are not required to be approved by the voters. They are not secured by the full faith and credit or the taxing power of the State; a statement to this effect appears on the face of the bonds. Property cannot be pledged to secure the bonds.

The UNC special obligation bonds can be issued only for projects specifically authorized by the General Assembly. In submitting proposed special obligation bond projects to the General Assembly for approval, the Board of Governors is required to justify the need for each project and to itemize the cost of the project, the estimated operating costs upon completion, and the sources and amounts of resources to be pledged for repayment of the bonds. The Board of Governors can issue special obligation bonds for a project only if the board of trustees of the institution at which the project will be located has approved the project.

This act provides UNC with greater flexibility in amortizing its debt obligations and in structuring interim financing debt obligations. The act does not authorize the University to issue additional debt beyond currently authorized levels and it maintains the requirement that the University obtain explicit approval from the General Assembly to issue debt.

The act changes the maximum maturity on special obligation bonds from 25 years to 30 years. This change makes the maximum maturity of special obligation bonds more consistent with other University debt obligations. The maximum maturity for University revenue bond debt issued for student housing and activities, physical education, and recreation[31] is 50 years. The maximum maturity for University revenue bond debt issued for the Centennial Campus, the Horace Williams Campus, and Millennial Campuses[32] is 40 years.

The act also makes it easier and less costly to provide short-term, interim financing for bond projects authorized by the General Assembly. Under prior law, interim financing was provided through a bond anticipation note that would be issued for each individual project. A bond anticipation note could not exceed two years. The University proposed a less costly method of interim financing under which there would be a one-time issuance of notes.

[31] Article 21 of Chapter 116 of the General Statutes.
[32] Article 21B of Chapter 116 of the General Statutes.

Under the program, interim financing for projects would be drawn down from a line of credit as needed and repaid by draws from the permanent, long-term bond proceeds. This approach creates a pool of resources to provide interim financing that can be used multiple times for many projects. To accomplish this method of pooled financing, the act extends the maximum maturity of bond anticipation notes from 2 to 30 years. Longer-term bond anticipation notes reduce the issuance costs associated with notes that must be reauthorized every two years and allow for better interest rates to be obtained through the long-term market. To ensure that the bond anticipation note proceeds are used for short-term, interim financing needs only, the act provides that if the Board of Governors issues a bond anticipation note for a term in excess of three years, no individual project may be funded from the proceeds of the note for longer than three years.

UNC - NONAPPROPRIATED CAPITAL PROJECTS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-360	**SB 705**	**Senator Kerr**

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS OF THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA.

OVERVIEW: This act authorizes the construction of numerous projects by The University of North Carolina. The projects will be financed through revenue bonds and special obligation bonds. No funds from the General Fund will be appropriated to finance the projects. In addition to bond-financing, the act authorizes the construction and financing of three capital projects at UNC-Chapel Hill through lease arrangements with nonprofit corporations.

FISCAL IMPACT: This act will require 12 new positions at a cost to the General Fund of roughly $500,000 a year beginning January 1, 2005. These positions are required for increased operating costs resulting from The Rizzo Center Expansion and the McColl Building Addition at UNC-Chapel Hill.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 1, 2003.

ANALYSIS: The Board of Governors of The University of North Carolina can issue two types of self-liquidating bonds, revenue bonds and special obligation bonds. Tax revenues may not be used to pay back either type of bond. Article 21 of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for the types of projects enumerated in the Article. The types of projects for which revenue bonds may be issued include educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. The revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility. Article 21B of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for projects at the Centennial Campus, the Horace Williams Campus, and Millennial Campuses. The revenue bonds are payable from rentals, charges, fees, and other income generated by the facility. Article 3 of Chapter 116D of the General Statutes authorizes the Board of Governors to issue special obligation bonds payable with any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. In this instance, the bond proceeds could be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions.

The purpose of this act is to authorize the construction and financing of the capital improvements projects at various constituent institutions of The University of North Carolina. The projects authorized in the act may not be financed with funds appropriated from the State's General Fund, but may be financed with gifts, grants, receipts, self-liquidating indebtedness, other funds available to the constituent institutions, or a combination of any of those financing methods. The new self-liquidating projects that the Board of Governors may finance with revenue bonds, special obligation bonds, or both are listed in Section 2 of the act. Section 3 authorizes revenue bonds and special obligation bonds to be used for eight capital improvements projects for which general obligation bond financing was previously authorized in S.L. 2000-3. This act provides additional options for financing the projects.

Section 4 authorizes the Director of the Budget, at the request of the Board of Governors, to authorize cost increases or decreases, or changes in the method of financing for the projects authorized by the act. The Director of the Budget may consult with the Joint Legislative Commission on Governmental Operations, but consultation is not required.

The current law governing UNC special obligation bonds requires that the specific projects and their costs be set forth in legislation approved by the General Assembly and that the maximum amount of special obligation bonds to be issued to finance the specific projects listed be stated. Sections 2 and 3 set forth the specific projects and their costs. Section 5 expressly states that the maximum principal amount of special obligation bonds to be issued shall not exceed the amounts listed in Sections 2 and 3 plus $15 million for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest.

Section 6 authorizes the financing of three projects at UNC-Chapel Hill through lease arrangements with nonprofit corporations. Over the years, the University system has used lease arrangements with nonprofit corporations to construct facilities necessary to academic life, student support services, physical education and recreation, athletics, and other programs when the facilities are financed by major gifts. The process followed by the State is as follows:

- The State, following guidelines established by the Department of Administration and with Council of State approval, leases land to the nonprofit corporation for the period of time required for the construction of the facility.

- The nonprofit corporation, after review and approval of construction plans by the State Construction Office, builds the facility. Each project is subject to review by the Department of Insurance to ensure that it meets State Building Code requirements.

- When construction is completed and the facility has been deemed acceptable to the State, the lease expires and the land returns to the State's control, along with the newly constructed facility.

The difference between the three projects named in Section 6 of the act and other projects constructed in this manner is that the act authorizes the University to issue long-term debt as a means of financing the indebtedness.

MODIFY STATE FINANCING LAWS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-388	**SB 679**	**Senator Hoyle**

AN ACT TO MODIFY THE PUBLIC FINANCING LAWS OF THE STATE.

OVERVIEW: This act makes the following changes to the State public financing laws, as requested by the State Treasurer's Office:

- Authorizes the use of out-of-state banks as well as in-state banks as trustee under a revenue bond order or a trust agreement securing revenue bonds

- Allows term bonds with sinking fund redemptions to satisfy the statutory requirements for maturities

- Exempts refunding bonds from the "four times" rule

- Allows local governments to use installment purchase debt to refinance debt for purposes for which installment debt is currently authorized

- Clarifies and regulates the authority of a local government to enter into an interest rate swap agreement in connection with bond issuance

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 7, 2003.

ANALYSIS: Section 1 of the act is in response to the recent decline in the number of North Carolina financial institutions offering trustee services as a result of mergers and financial institutions selling their trust businesses. Allowing financial institutions outside of North Carolina to serve as trustee under a revenue bond order or a trust agreement securing revenue bonds gives issuers more choices and also would allow issuers to continue doing business with the same trustee staff person who becomes employed by an out-of-state trustee as a result of a merger or sale of a North Carolina financial institution's trust business. Revenue bonds are bonds that are secured by and repaid from revenues generated by the facility being financed. For example, parking lots generate parking fees, dorms generate dorm fees, and water and sewer infrastructure generate water and sewer fees.

Under current law, the Local Government Bond Act requires each issue of bonds to mature in annual installments with the first installment being paid no more than three years after the date of the bonds. This means that the only type of bonds that can be issued is serial bonds, in which some mature each year. Section 2 of the act would change the requirement so that the bonds themselves do not have to mature in annual installments as long as the principal is paid in annual installments beginning within three years after the date of the bonds. Thus, the purpose of the requirement, to provide for regular payments on the debt, is still met. This will allow a choice between serial bonds as under current law and term bonds with "sinking fund" redemptions. Underwriters have indicated that allowing term bonds in addition to serials would expand the investor base by attracting more institutional investors, thereby possibly resulting in lower rates to the issuer.

Section 2 also exempts refunding bonds from the four-times rule and makes clarifying changes to the statute. The four-times rule provides that no principal installment may be more than four times as great as the smallest prior principal installment. The application of this rule to advance refundings where the refunded bonds are scheduled to mature several years from the issue date means that issuers are often forced to start the maturity of the refunding bonds sooner than would otherwise be required and also may be required to refund some non-callable bonds. This results in increased and unnecessary costs to issuers.

Section 3 of the act amends the language of the local government installment purchase statute to clarify that local governments may use installment contracts to refinance debt originally incurred for purposes for which installment contracts are currently authorized. Installment purchase financing is a type of debt in which a government enters into an installment contract secured by a security interest in the building constructed or renovated. Unlike the issuance of general obligation bonds, installment purchase financing is not subject to a vote of the people. Certificates of participation may be issued as part of the installment purchase financing. A certificate of participation is a document setting out the share of the government's debt that is owed to the holder of the certificate. In practice, the holder receives interest and principal payments in a manner similar to interest and principal payments on a bond issued by the borrowing unit.

According to the State Treasurer's Office, some North Carolina local governmental units have entered into interest rate swap agreements in connection with the issuance of bonds. While there is no express statutory authority, most, if not all, law firms with a North Carolina bond counsel practice have concluded that local governmental units are authorized to enter into these agreements based on their general power to contract. Several questions have remained, however, with respect to certain terms of the swap documentation required by financial institutions. Section 4 of the act makes the following changes:

- Specifically authorizes governmental units to enter into swap agreements in connection with the issuance of obligations, including the details of the terms and conditions.

- Authorizes local governmental units to pledge collateral (concurrently with the entry into the swap transaction or in the future) to secure the local governmental unit's obligations under the swap agreement.

The act provides that a swap agreement is subject to Local Government Commission approval if a local government or other entity that is under the supervision of the Commission enters into it, or if the underlying debt to which it relates is subject to approval by the Commission. Approval is not required for swap agreements relating to conduit financing, where a government incurs debt on behalf of a private entity.

PROPERTY TAX CERTIFICATION PROCEDURE.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-399	**HB 972**	**Representative Culpepper**

AN ACT TO ALLOW AN INTERNET-BASED ALTERNATIVE TO PROPERTY TAX CERTIFICATION PROCEDURES.

OVERVIEW: This act authorizes the governing body of a county or municipality to adopt an ordinance allowing a person to rely on information as to the amount of taxes due on real property obtained from the taxing unit's Internet website to the same extent as a written certification issued by the tax collector.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 7, 2003.

ANALYSIS: G.S. 105-361 provides that upon request of specified persons - including an owner or occupant of real property, a person holding a lien or legal interest in the property, a person with a contract to purchase or lease the property, or a person or firm that has contracted to make a loan secured by the property – the tax collector must furnish a written certificate stating the amount of any taxes and special assessments for the current year and any amounts still pending collection from prior years. When the certificate is issued, all taxes and special assessments that have accrued against the property for the period covered by the certificate cease to be a lien against the property, except to the extent of taxes and special assessments stated to be due in the certificate. This is applicable to all persons and entities who obtain the certificate and who rely on the certificate by either paying the amount of taxes and assessments stated in the certificate to be a lien on the real property, purchasing or leasing the real property, or lending money secured by the real property. The tax collector is liable on the collector's bond for any loss to the taxing unit arising from an understatement of the tax and special assessment obligations in the preparation of a certificate.

This act amends the existing statute concerning the tax collector's statement of the amount of taxes due on real property by adding a provision that allows a person to rely on information obtained from an Internet website maintained by the taxing unit if the governing body adopts an ordinance allowing it. If an ordinance is adopted, then a person may rely on information obtained from the website as if it were a traditional certificate. The ordinance may provide for procedural provisions by which the tax collector may ensure full and accurate payment of all taxes, assessments, and obligations certified via the Internet website. The ordinance may also include disclaimers and the person may only rely on the information obtained from the website to the extent allowed by the disclaimers. The disclaimers must be posted on the website and could include such matters as the date on which the information was posted, the date as of which the information is current, and any special instructions and procedures for accessing complete and accurate information. If the ordinance adopted provides for disclaimers, then the tax collector would not be liable for any loss to the taxing unit arising from an understatement of the tax or special assessment obligations contained in the information available on the website. A person who relies on the website information must keep and present a copy of the information as if the copy were a traditional written certificate issued by the tax collector.

MANUFACTURED HOUSING.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-400	**HB 1006**	**Rep. Hunter, Barnhart, (Primary Sponsors)**

AN ACT TO GRANT GREATER CONSUMER PROTECTION TO RESIDENTS OF MANUFACTURED HOUSING IN NORTH CAROLINA, TO CLARIFY THE SALES TAX ON MODULAR HOMES, AND TO ESTABLISH MINIMUM CONSTRUCTION AND DESIGN STANDARDS FOR SINGLE-FAMILY MODULAR HOMES.

OVERVIEW: This act makes the following changes to laws affecting manufactured homes and modular homes:

- Expands the definition of manufactured homes that qualify as real property under the property tax laws to include manufactured homes on land leased by the manufactured homeowner for a term of at least 20 years and where the lease expressly provides for disposition of the manufactured home upon termination of the lease. This change makes it easier for the owners of manufactured homes placed on the leased land to qualify for Freddie Mac mortgages.
- Authorizes the Division of Motor Vehicles to charge a $5.00 fee for the cancellation of a certificate of title to a manufactured home that qualifies as real property.
- Requires the owner of a manufactured housing community to give prior notice to each owner of a manufactured home in the community if the community owner intends to convert the community to another use that would require movement of the homes.

- Expands consumer protections for purchasers of manufactured homes.
- Requires a criminal history check on an applicant for licensure as a manufactured home manufacturer, dealer, salesperson, or set-up contractor.
- Imposes a 2.5% sales and use tax rate on the sales price of each modular home. This replaces the current practice of applying two different sales tax rates based on whether the modular home is built on a steel frame or a wood frame. This change in sales and use tax treatment of modular homes was proposed by the North Carolina Manufactured Housing Institute (NCMHI) and approved by the Department of Revenue. Both the NCMHI and the Department agreed that the change would simplify the administration of sales and use tax on modular home transactions. The act does not amend the sales and use tax treatment of manufactured homes.
- Amends the definitions of manufactured home and modular home. A manufactured home is a dwelling manufactured to meet or exceed the specifications contained in the Federal Manufactured Housing Code issued by the United States Department of Housing and Urban Development. A modular home is a factory-built dwelling that must (1) be manufactured to meet or exceed the specifications contained in the North Carolina Residential Building Code, and (2) bear a seal or label issued by the Department of Insurance that the modular home meets or exceeds statutory minimum standards for modular homes as enacted in the act.
- Imposes minimum standards for modular homes.

FISCAL IMPACT: The change in the sales tax treatment of modular homes and the $5.00 fee imposed by the North Carolina Division of Motor Vehicles (DMV) are expected to increase revenues to the General Fund and the DMV as follows:

	FY 2003-04	FY 2004-05	FY2005-06	FY 2006-07	FY 2007-08
REVENUES					
General Fund	$579,425	$1,279,488	$1,279,488	$1,279,488	$1,279,488
DMV	17,075	17,075	17,075	17,075	17,075

The change in the sales tax treatment of modular homes is expected to increase sales tax revenues to local governments over the same period as follows:

	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08
REVENUES					
Local Gov.	$ 59,125	$ 119,712	$ 119,712	$ 119,712	$ 119,712

These numbers assume that 70% of current modular homes are sold "on-frame."[33] If the actual "on-frame" percentage is below approximately 50%, the State and local governments will see a net loss. In addition, if growth in the "on-frame" home market occurs at a faster rate than the "off-frame" market, the State will also see a revenue loss. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See Analysis.

[33] An explanation of "on-frame" modular homes is under the subheading, *Sales and Use Tax Treatment of Modular Homes*, found in the analysis of the act.

ANALYSIS:

Expansion of Definition of Manufactured Homes that Qualify as "Real Property"

Under prior law, a manufactured home was considered real property for property tax purposes only if it was a residential structure; had the moving hitch, wheels, and axles removed; and was placed upon land owned by the owner of the manufactured home. The owner of a manufactured home that had been placed on property owned by that owner could convey or encumber the property and manufactured home by a mortgage. If the manufactured home had not yet been placed upon the property and the owner desired to convey or encumber the property with a mortgage, the owner could record in the county register of deeds office a declaration of intent to affix the manufactured home to the real property. If the owner of a manufactured home did not own the land on which the home was located, then the manufactured home was considered tangible personal property for property tax purposes.

If a manufactured home qualifies as tangible personal property, then it is subject to the same registration and certificate of title requirements that apply to motor vehicles. If a certificate of title has been issued for a manufactured home and the home subsequently qualifies as real property, the owner must surrender the certificate of title and file an affidavit with the Division of Motor Vehicles (DMV) indicating that the home meets the statutory definition of real property. The DMV must cancel the title to the manufactured home once the affidavit is filed. The owner of the manufactured home must also file a copy of the affidavit with the register of deeds in the county where the real property and affixed manufactured home are located.[34]

Section 4 of the act expanded the definition of a manufactured home that qualifies as real property to include a manufactured home on land leased by the manufactured homeowner for a term of at least 20 years if the lease expressly provides for disposition of the manufactured home upon termination of the lease. Sections 1, 2, and 3 of the act made conforming changes to the motor vehicle laws and the register of deed laws that require the manufactured homeowner to file an affidavit with the DMV and register of deeds when the manufactured home meets this expanded definition. Section 1 of the act authorizes the DMV to charge a $5.00 fee for the cancellation of a certificate of title to a manufactured home.

Sections 1 through 4 of the act became effective when signed into law by the Governor on August 7, 2003.

Notice of Conversion of Manufactured Home Communities

Section 5 of the act adds a new section to the laws governing landlords and tenants in Chapter 42 of the General Statutes. This new section requires the owner of a manufactured housing community to give 180 days prior notice to each owner of a manufactured home in the community if the community owner intends to convert the community to another use that would require removal of the homes. If the closure is due to a valid order of the State or a local government, then notice of the closure must be given within three days after the date

[34] S.L. 2001-506 codified the policy of the DMV requiring a manufactured homeowner to submit an affidavit and surrender the certificate of title to the DMV when the manufactured home becomes real property. That legislation also required the owner to file the affidavit with the county register of deeds.

of the order. A manufactured home community is defined as a parcel of land designed to accommodate at least five manufactured homes.

Section 5 of the act is effective October 1, 2003.

Consumer Protections for Purchasers of Manufactured Homes

Section 7 of the act expands the protections afforded purchasers of manufactured homes as set out in Article 9A of Chapter 143 of the General Statutes. These new protections are:

- If the manufacturer of a manufactured home publishes the suggested retail price, then that price must also be displayed near the front entrance of the manufactured home.
- A manufactured home dealer must display a sign and provide each buyer with information about the North Carolina Manufactured Housing Board, the procedure for filing a consumer complaint with the Board, and the warranties and protections provided for each new manufactured home under federal and State law.
- A purchase agreement must contain a statement that the purchaser has the right to cancel the purchase within three days after the purchaser has signed the agreement, and that the agreement is canceled if the dealer changes any of the material terms of the agreement. The return of any deposit must be made if either of these actions occurs. Each time the dealer gives the purchaser a new set of financing terms that are less favorable to the purchaser, the purchaser is given another three-day cancellation period.
- The Board must adopt rules concerning deposits, including rules protecting the deposits from the claims of a dealer's creditors in bankruptcy and rules providing for the prompt return of deposits if the purchasers are entitled to their return. These rules may exempt deposits of less than $2,000.

Section 7 of the act became effective October 1, 2003.

Criminal Record Checks

Sections 8 through 11 of the act require applicants for licensure from the North Carolina Manufactured Housing Board to consent to a criminal record check. This requirement applies to a manufactured home manufacturer, dealer, salesperson, or set-up contractor. Refusal of the applicant to consent to a criminal history record check may constitute grounds for the Board to deny licensure. Conviction of a crime specified in the act does not automatically bar licensure, but it is one of the factors the Board must consider when determining whether to grant or deny licensure. The Board may require that the applicant pay a fee to cover the cost of the criminal history record check. Section 12 of the act requires the Board to provide to the Department of Justice the fingerprints of the applicant and a form signed by the applicant consenting to the record check. The State Bureau of Investigation, located within the Department of Justice, will conduct the record check.

Sections 8 through 12 of the act are effective January 1, 2004.

Sales and Use Tax Treatment of Modular Homes

Under the law before January 1, 2004, the sales and use tax treatment of modular homes depends upon the type of frame of the modular home. According to industry representatives, there are two types of modular homes. "On-frame" modular homes are built on a steel chassis and are typically delivered to the home site by means of wheels and axles attached to the steel frames. On-frame modular homes are taxed at the same sales and use tax rate as manufactured homes: 2%, with a maximum tax of $300 per section. The tax derived from these sales goes to the General Fund. "Off-frame" modular homes are typically delivered to the site on a flat bed truck or other carrier. Off-frame modular homes are taxed at the general sales tax rate of 7% (4 ½% State and 2 ½% local), with the tax applying to the cost of the materials used by the seller to create the home.

Section 15 of the act removes this tax distinction and taxes the sales price of both types of modular homes at a rate of 2.5% with no cap.[35] To offset the loss of local sales tax revenue, Section 16 of the act requires that 20% of the taxes collected on modular homes must go to counties and be distributed with local sales tax revenue that is not attributable to a particular county. Section 14 of the act defines a modular home, for sales and use tax purposes, as a factory-built structure that is designed to be used as a dwelling, is manufactured in accordance with the specifications for modular homes under the North Carolina State Residential Building Code, and bears a seal or label issued by the Department of Insurance. The act defines a modular homebuilder as a person who furnishes for consideration a modular home to a purchaser that will occupy the modular home. The purchaser can be a person that will lease or rent the unit as real property. Section 13 of the act amends the definition of "manufactured home" by deleting the reference to modular homes.

Sections 13 through 16 of the act are effective January 1, 2004, and apply to sales of modular homes on and after that date.

Minimum Construction Standards for Modular Homes

Manufactured buildings bearing a label or seal acceptable to the Building Code Council are deemed to meet the requirements of the State Building Code and Article 9 of Chapter 143 of the General Statutes.[36] Section 17 of the act adds new language to Article 9 providing that a single-family modular home will qualify for the label or seal if it meets the following construction and design standards:

- A roof pitch of at least five feet rise for every 12 feet of run.
- Eave projections of at least 10 inches.
- Exterior wall height of at least seven feet six inches for the first story.
- Siding and roofing material commonly used in standard residential construction.
- Foundation supports around the perimeter of the home.

Section 17 of the act is effective January 1, 2004.

[35] Manufactured homes will continue to be taxed at 2% with a $300 cap.

[36] Article 9, *Building Code Council and Building Code*, describes the organization and duties of the Council and the requirements of the Code. The Council's main duty is to prepare and adopt the Code.

WINE SHIPPERS PERMITS.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-402	**SB 668**	**Senator Metcalf**

AN ACT TO AUTHORIZE THE ALCOHOLIC BEVERAGE CONTROL COMMISSION TO ISSUE WINE SHIPPERS PERMITS TO ALLOW THE DIRECT SHIPMENT OF WINES TO RESIDENTS OF NORTH CAROLINA AND TO ESTABLISH A MECHANISM FOR COLLECTING THE TAXES DUE ON WINE SHIPPED TO NORTH CAROLINA.

OVERVIEW: This act remedies an unconstitutional exception in the State's ABC laws that allowed only in-state wineries to ship wine to North Carolina residents. The United States Court of Appeals for the Fourth Circuit recently held that the exception violated the Commerce Clause of the United States Constitution; the court left the task of fashioning the appropriate remedy to the General Assembly. This act creates a new permit under the ABC laws that would allow any winery to ship wine directly to individuals in North Carolina and it provides a mechanism for the collection of excise and sales and use taxes on direct shipments of wine.

FISCAL IMPACT: There will be some General Fund revenue gain from the imposition of the wine shipper permit and from the collection of additional excise and use taxes. However, the amount is undeterminable. Although the potential applicant pool for a wine shipper permit is large (between 1,500 and 3,000 wineries), the actual number that will seek a permit is expected to be small.[37] *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective October 1, 2003.

ANALYSIS: After the end of Prohibition in the 1930s, North Carolina adopted laws to prohibit the importation of wine and other alcoholic beverages except through a highly regulated system. The structure of the ABC system is a three-tiered system. Under this system, an out-of-state producer of wine may sell its products in North Carolina to licensed wholesalers only. Wholesalers may in turn sell the products to other wholesalers or to licensed retailers. Only licensed retailers may sell the products to consumers.

In 1981, the General Assembly enacted an exception to this three-tiered structure. Under that exception, North Carolina wineries were allowed to sell and ship wine directly to North Carolina consumers. This exception did not extend to out-of-state wineries. In 2002, a federal district court held in *Beskind v. Easley*,[38] that this exemption violated the Commerce Clause of the United States Constitution because it clearly favored in-state economic interests over out-of-state interests. The court further held that North Carolina's regulatory

[37] New Hampshire approved a $228 wine shipment permit on July 1, 1998, and had issued only 189 as of May 23, 2003.
[38] 197 F.Supp.2d 464 (W.D. NC, 2002).

interests protected under the Twenty-first Amendment did not outweigh the federal government's interest in regulating interstate commerce in this instance. That court ordered the State not to enforce the ban on out-of-state shipments and to collect the excise tax due on the wine shipped from out of state. North Carolina appealed this decision to the federal Court of Appeals. That court upheld the holding that the exemption violates the Commerce Clause but allowed the General Assembly to fashion an appropriate remedy. *Beskind v. Easley*, 325 F.3d 506 (4^{th} Cir., 2003). In essence, the General Assembly was left with the option of repealing the exemption for in-state wineries or allowing shipments from out-of-state wineries on the same basis as for in-state wineries.

This act establishes a structure through which out-of-state wineries, as well as in-state wineries, may ship wine directly to consumers in North Carolina. Under this act, any winery that holds a federal basic wine manufacturer permit may apply for a North Carolina wine shipper permit for a fee of $100. The annual renewal fee is $25.[39] The permit authorizes the shipment of brands of wine identified in the permit application. The wine shipper permittee may amend the brands identified in the permit at any time. The wine shipper permittee is required to notify any wholesale permittee that had been authorized to distribute those brands in this State of its application to become a wine shipper permittee. If the wine shipper permittee ships more than 1000 cases[40] of wine to addresses in the State during a calendar year, the permittee is required to appoint a North Carolina wholesaler if any North Carolina wholesaler wishes to sell the products.[41] A winery would not be required to obtain a wine shippers permit to ship to addresses in North Carolina wine that was bought on the premises of the winery.

A wine shipper permittee may ship up to two cases of wine per month to any person in North Carolina to whom alcoholic beverages may be sold. Shipment of wine may be made by common carrier only. The common carrier is required to have the recipient demonstrate that he or she is over the age of 21 and sign an acknowledgement of receipt. The common carrier must refuse delivery when the recipient appears to be below 21 years of age and fails to provide sufficient identification.

The act also establishes a mechanism for collecting the excise[42] and use[43] taxes due on the wine. Under the prior law, the direct shipment of wine escaped the imposition of the State excise tax[44] because the tax was payable by the resident wholesaler or importer. Although the consumer is liable for the use tax due on the purchase of the wine, the winery shipping the wine had no affirmative duty to collect and remit the tax if it does not have nexus in this State. Under this act, a wine shipper is required to pay the excise tax due on the wine and to

---

[39] G.S. 18B-903 provides that ABC permits are valid for one year, May 1 to April 30, and that the renewal fee is 25% of the original application fee.

[40] A case is defined as any combination of packages that contains not more than nine liters of wine. Wine purchased by a resident of the State at the premises of the wine shipper permittee and shipped to an address in the State is not included in calculating the total of 1,000 cases.

[41] The wine shipper permittee does not have to appoint the wholesaler that originally contacted it to serve as its appointee.

[42] The excise tax on unfortified wine is 21¢ and the excise tax on fortified wine is 24¢.

[43] Wine is subject to a 4.5% State sales and use tax and a 2.5% local sales and use tax in every county but Mecklenburg County; in Mecklenburg County, the local sales and use tax is 3%.

[44] Although the State collects the excise tax, the State shares the revenues with the counties and cities in which the retail sale of wine is authorized in the entire county or city: these local governments receive 62% of the excise tax collected on unfortified wine and 22% of the tax collected on fortified wine.

collect the use tax due on the wine. Under the Twenty-first Amendment to the United States Constitution, the State has more authority to regulate alcoholic beverages than it generally has to regulate interstate commerce. Because of the greater authority granted to states under the Twenty-first Amendment, it is not as difficult to establish nexus when the product to be taxed is an alcoholic beverage. Because the State would be requiring the out-of-state wineries to obtain a permit to ship to North Carolina addresses, the State would have sufficient nexus with the winery to force the collection of the taxes.

LOCAL OPTION PROJECT DEVELOPMENT FINANCING.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-403	**SB 725**	**Senator Clodfelter**

AN ACT TO AMEND THE NORTH CAROLINA CONSTITUTION TO PERMIT CITIES AND COUNTIES TO INCUR OBLIGATIONS TO FINANCE THE PUBLIC PORTION OF CERTAIN ECONOMIC DEVELOPMENT PROJECTS.

OVERVIEW: This act authorizes the voters of the State to vote in the November 2004 statewide general election on an amendment to the North Carolina Constitution that would allow local governments to finance development within defined districts by issuing tax increment financing bonds without a local referendum.

FISCAL IMPACT: This act has no fiscal impact on the General Fund. It could potentially result in a cost of $100,000 to the State Board of Elections, which will reimburse the counties for the cost of the required notices, advertisements, and publications concerning the statewide referendum. If the constitutional amendment passes, local governments would have additional revenues available to them through the use of this financing tool. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 7, 2003. However, the proposed constitutional amendment to authorize local option project development financing will be subject to voter approval in a statewide general election in November 2004. If a majority of the votes are in favor of the amendment, then the amendment and the corresponding statutory changes would become effective upon certification of the constitutional amendment by the Secretary of State.

ANALYSIS:

Authorization for Local Option Project Development Financing

This act will permit the voters of the State to vote on a constitutional amendment that would allow the General Assembly to enact general laws authorizing counties, cities, and towns to borrow money, without voter approval, to finance the public portion of certain economic development projects within a defined territorial area.[45] This development tool, generally known as tax increment financing but referred to as "project development financing" in the act, would allow local governments to set aside the additional property taxes that are generated by a new investment to pay for public facilities that support that new investment.

The financing, issued in the form of bonds or other debt instruments, could be used for airports, auditoriums and arenas, hospitals, museums, parking facilities, sewer systems, storm sewers and flood control facilities, water systems, street improvements, public transportation facilities, railroads, affordable housing, land development for industrial or commercial purposes, utilities, and redevelopment. Redevelopment includes purchasing and improving property to help local redevelopment commissions. The bonds may also be issued for municipal service district projects.

Constitutional Amendment Required

The Constitution would have to be changed to allow project development financing because under the Constitution as it now reads the General Assembly does not have the power to authorize any unit of local government to issue bonds secured by its property tax revenue without a vote of the people. An amendment is also needed to allow property owners within the development area to agree to a minimum tax assessment on their property. The project development financing constitutional amendment will be placed before the voters in the next statewide general election, to be held in November 2004.

Development Financing District

If the amendment is approved, counties, cities, and towns could create a development financing district and adopt a development financing plan for that district. The total land area of the district may not exceed 5% of the total land area of the unit creating the district. The district also must be comprised of property that is one or more of the following:

- Blighted, deteriorated, deteriorating, undeveloped, or inappropriately developed from the standpoint of sound community development and growth.
- Appropriate for rehabilitation or conservation activities.
- Appropriate for the economic development of the community.

Development Financing Plan

The development financing plan describes the projects the unit of local government desires to finance and how the tax proceeds from the project development financing bonds will be used. The plan must include the costs of the proposed public activities, the sources and amounts of funds to pay for the proposed public activities, the base valuation of the district, the projected incremental valuation of the district, and the estimated duration of the district. The plan must also include a description of how the proposed development, both public and private, will benefit the residents and business owners of the district in terms of jobs, affordable housing, and services. The plan must contain a requirement that initial users of a new manufacturing facility located in the district pay employees of the facility an average

[45] A similar proposed constitutional amendment has been defeated by the voters twice before, on November 2, 1993, and November 2, 1982. In 1993, more than 78% of the voters voted against the constitutional amendment. It failed in every county except Northampton, where the vote was 1,253 for and 1,226 against.

weekly manufacturing wage that is either above the average weekly manufacturing wage paid in the county where the district is located or is at least 10% above the average weekly manufacturing wage paid in the State. A plan may be exempt from the wage requirement if the Secretary of Commerce finds that unemployment in the county in which the district is located is especially severe.

Before adopting a plan for a development financing district, the unit of local government must do all of the following:

- If the unit is a city, town, or incorporated village, send notice of the plan to the board of county commissioners, which has 28 days after the date the notice is mailed to disapprove the plan.
- Submit the plan to the Secretary of Environment and Natural Resources for review to determine if the construction and operation of any new manufacturing facility will have a materially adverse effect on the environment and whether the company operating the facility has operated in substantial compliance with environmental requirements.
- Hold a public hearing on the plan after providing public notice, including written notice to all property owners within the proposed district.

Approval by Local Government Commission

If a local government wants to issue project development financing bonds to finance the public portion of economic development projects within a development financing district, it must have the approval of the Local Government Commission. The Commission cannot approve an application until the development financing plan is adopted. Before approving the bond issuance, the Commission must find, among other things, that the proposed project development financing bond issue is necessary to secure significant new project development for a development financing district and that the private development forecast in the development financing plan would likely not occur without the public projects to be financed by the bonds. The Commission must also find that the taxes on the incremental valuation, together with any proceeds that may be realized from the sale of property in the district and any revenues that may be realized from a public facility in the district, will be sufficient to service the project development financing bonds.

Determination of Base Value and Incremental Value

Once the district has been established and the project development financing debt instruments have been approved by the Local Government Commission, the local government unit must notify the county tax assessor who must determine the base valuation of the district. The base valuation is the assessed value of all taxable property located in the district on the January 1 immediately preceding the effective date of the district. The base valuation may be adjusted if property is removed from or added to the district. Each year the development financing district is in existence, the tax assessor must determine the current assessed value of taxable property located in the district. The assessor must also compute the difference between this current value and the base valuation of the district. If the current value exceeds the base value, the difference is the incremental valuation of the district.

Security for Bonds

The tax assessor must establish a separate fund, known as the Revenue Increment Fund, to account for the proceeds paid to the unit from taxes levied on the incremental valuation of the district. After certain deductions are made from the Fund and transferred to the local government unit, any remaining money in the Fund may be used to finance capital expenditures in the district, to meet principal and interest requirements on project development financing debt instruments, to repay moneys expended on debt service on project development financing debt instruments, and to establish and maintain debt service reserves.

To provide additional security for the bonds, the unit of local government issuing the bonds may pledge the proceeds from the sale of property in the development financing district and the net revenues from public facilities in the development financing district constructed or improved under the development financing plan. The unit of local government may also pledge any other available sources of revenue as long as the agreement to use the sources to make payment does not constitute a pledge of the unit's taxing power. Other available sources of revenues that do not constitute a pledge of a local government's taxing power include taxes levied by the State that are transferred to the local government, such as beer and wine tax revenues, utilities franchise tax revenues, and intangibles tax revenues.

The unit of local government may also enter into agreements with the owners of real property in the development financing district for which the bonds were issued under which the owners agree to a minimum value at which their property will be assessed for taxation. Such an agreement may extend for the life of the development financing district or for a shorter period agreed to by the parties. The agreement may vary the agreed-upon minimum assessed value from year to year. The purpose of such an agreement is to provide additional security for the bonds by assuring that the property tax base in the district would not fall below a certain level.

Duration of District and Term of Bonds

The district may remain in effect for 30 years or until the bonds are retired. The bonds must be retired within 30 years or within the useful life of the projects financed, whichever is shorter. After that, all taxes are paid into the local general fund.

ESC SURTAX DELAY.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-405	**HB 1241**	**Representative Luebke**

AN ACT TO DELAY THE REINSTATEMENT OF THE TWENTY PERCENT UNEMPLOYMENT INSURANCE SURTAX.

OVERVIEW: The purpose of S.L. 2003-405 is to defer imposition of the 20% surtax on employer unemployment insurance contributions if, as of August 1 of the preceding year, the balance in the State Unemployment Insurance Fund is $500 million or less. The delay of the surtax applies only to the 2004 tax year.

FISCAL IMPACT: The State General Fund is not affected. Only the Reserve Fund in the unemployment insurance system will be affected. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 12, 2003, and is repealed for taxes imposed in the 2005 and subsequent calendar years.

ANALYSIS: Unemployment insurance taxes or contributions are paid by employers on a quarterly basis and deposited into the Unemployment Insurance Fund. Pursuant to G.S. 96-6, the Unemployment Insurance Fund is administered by the Employment Security Commission, and disbursed by the State Treasurer under the direction of the Commission. The following three separate accounts are maintained within the Fund: a clearing account, an unemployment trust fund account, and a benefit account. The moneys payable to the Fund are initially deposited in the clearing account. After deducting any refunds payable from the Fund pursuant to G.S. 96-10(f), the money is deposited with the secretary of the treasury of the United States to the credit of this State's account in the unemployment trust fund.[46] Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State Unemployment Insurance Fund to be used to pay benefits to people who lose their job through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the unemployment trust fund account.

There is also an Employment Security Commission Reserve Fund, created in the State treasury, and used by the Commission to bolster the Unemployment Insurance Fund. The moneys in the Reserve Fund consist of proceeds from the 20% surtax on contributions due.[47] This surtax was suspended in 1992, but the surtax is automatically triggered when the balance of the Reserve Fund falls below $163 million. Also, under G.S. 96-9(b)(3)d5, the regular unemployment insurance tax or contribution rate of an employer is reduced by 50% for any year in which the balance in the Unemployment Insurance Fund equals or exceeds $800 million. After a number of years paying the contributions at the 50% rate, employers began paying at the full rate in 2003. The tax will remain at the full rate until the Unemployment Insurance Fund again reaches $800 million, thereby triggering the half rate.

S.L. 2003-405 states that the 20% surtax will not be imposed as long as the Unemployment Insurance Fund balance is at or below $500 million. When the contributions replenish the Fund balance to $500 million, then the 20% surtax will be triggered to start refilling the Reserve Fund. When the Reserve Fund reaches $163 million, the surtax will trigger back off. The intended effect is that the 20% surtax, originally scheduled to go into effect January 1, 2004, because the balance in the Reserve Fund is under $163 million, will not be imposed during the 2004 calendar year.

[46] G.S. 96-10(f) provides for the refund of contributions if a court determines that the contributions were invalid, excessive, or contrary to the provisions of Chapter 96 of the General Statutes.
[47] G.S. 96-5(f) provides that the moneys in the Reserve Fund may be used by the Commission for loans to the Unemployment Insurance Fund, as security for loans from the federal Unemployment Insurance Trust Fund, and to pay any interest required on advances under Title XII of the Social Security Act.

QUALIFIED BUSINESS CREDIT/PORTS CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-414	**HB 1294**	**Representative G. Allen**

AN ACT TO EXPAND THE QUALIFIED BUSINESS INVESTMENTS TAX CREDIT AND TO EXTEND THE SUNSET ON THE STATE PORTS TAX CREDIT.

OVERVIEW: This act does the following:

- Extends the sunset on the State Ports Tax Credit from 2004 to 2009.
- Amends the Qualified Business Investment Tax Credits to:
  - Extend the sunset from 2004 to 2007.
  - Expand the definition of a qualified grantee business to include those that receive grants from entities such as MCNC-Research and Development Institute, a nonprofit corporation formed to enhance economic development in North Carolina through applied research and technology development and commercialization of these technologies.
  - Add a new type of qualified business: a small business that is commercializing technology developed by a research university.

FISCAL IMPACT: The extension of the sunset on the Qualified Business Investment Tax Credit will cost the General Fund an estimated $6 million a year beginning in 2006-2006. The extension of the State Ports Tax Credit will cost the General Fund an estimated $650,000 a year beginning in 2004-2005. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATES: The portions of the act dealing with the qualified business venture tax credits became effective for taxable years beginning on or after January 1, 2004. The portion of the act dealing with the State ports tax credit became effective when the act was signed into law by the Governor on August 14, 2003.

ANALYSIS:

Qualified Business Tax Credits

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture or a qualified grantee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer filed an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed $6 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed with the Secretary of Revenue. If the amount exceeds the cap, then the Secretary allows a portion of the tax credits claimed by allocating the total of $6 million in tax credits in proportion to the size of the credit claimed by each taxpayer. In general, a taxpayer forfeits the credit if the taxpayer transfers the securities within one year or the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made.

Qualified business tax credit sunset. – The qualified business investment tax credit was enacted in August 1987 to promote economic development for North Carolina businesses. The original credits applied to both corporations and individual taxpayers, and there was a $12 million cap on the total amount of all tax credits. In response to a 1996 United States Supreme Court decision in *Fulton Corp. v. Faulkner*, 516 U.S. 325, (1996), which raised the issue of whether the credits unconstitutionally discriminated against out-of-state businesses, the General Assembly reduced the $12 million cap to $6 million, removed the requirement that the qualified businesses be headquartered or operating in North Carolina, and limited the credit to individuals and small pass-through entities. The latter change was based on the theory that these investors are not likely to invest outside a 50-mile radius of their homes.

One of the purposes of the sunset was to determine if the credit is being allowed for investments in non-North Carolina businesses. Because the Constitution does not allow the credit to be restricted to North Carolina businesses, there is the possibility that North Carolina tax dollars may actually be subsidizing investments in out-of-State corporations. The Secretary of State's Office is required to publish a periodic list of businesses that have registered as qualified businesses. The most recent version of this list indicates that most registered businesses are North Carolina businesses.

This act extends the sunset on the qualified business tax credit from January 1, 2004 until January 1, 2007. The credit was originally set to expire for investments made on or after January 1, 1999. In 1998, the credit was extended for four additional years until January 1, 2003. Then, in 2002, it was extended for one additional year, until 2004.

Expand types of qualified businesses. – Under current law, in order to be a business in which investments are eligible for a credit, the business must be either a *qualified business venture* or a *qualified grantee business*. Both types of businesses must be registered with the Secretary of State. The definition of *qualified business venture* includes several general requirements related to the line of business, gross revenues of the business, and the organization date of the business. A *qualified grantee business* is one that has received a grant or other funding in at least one of the three previous years from one of several types of entities that are generally described in the statute. Those descriptions would encompass the following entities that, before 2002, were specifically named in the statute: the North Carolina Biotechnology Center, MCNC, and the Kenan Institute for Engineering, Technology, and Science.

This act further expands one of these descriptions, which currently applies to nonprofits organized to stimulate microelectronics and communications industries, to also apply to nonprofits and their affiliates organized to conduct research and development in, or stimulate the development of, technologies. This language is designed to bring in a new entity called MCNC-Research and Development Institute, which is a nonprofit corporation formed to enhance economic development in North Carolina through applied research and technology development and commercialization of these technologies. The new language will also cover the MCNC Enterprise Fund, which is owned 50% by MCNC and 50% by MCNC-RDI.

<u>*Additional type of qualified business.*</u> – This act also adds a third category of qualified businesses: a *qualified licensee business*. These businesses must have no more than $1 million in gross revenues annually and must be performing under a contract with a UNC system institution or a doctoral research university to commercialize technology developed by the institution or university.

State Ports Tax Credit

The State Ports tax credit is allowed to a taxpayer who loads or unloads waterborne cargo from an ocean carrier at the State-owned port terminal at Wilmington or Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual (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 tax credit to encourage exporters to use the two State-owned port terminals in 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 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. In 2001, the General Assembly extended the sunset to January 1, 2003, and in 2002, extended it to January 1, 2004.

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. Typically, bulk is considered material that is picked up in "scoops" and not in a bag or some other type of binding. Examples of this type of commodity include cement, coal, fertilizer, fishmeal (used for making pet food), grain, salt, sand (used for golf courses and during ice storms), soybean meal, 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. Some examples of break-bulk cargo include cotton, lumber, paper, and rubber.
- 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. Some examples of container cargo include clothing, electronics, frozen poultry, furniture, housewares, meat, seafood, and tobacco.

This act extends the sunset on the tax credit for North Carolina State Ports Authority wharfage, handling, and throughput charges for five years (from January 1, 2004 to January 1, 2009). When first enacted, this credit was effective for taxable years beginning on or after March 1, 1992, and ending on or before February 28, 1996. The sunset has been extended five times.

EXPAND HISTORIC PRESERVATION CREDIT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-415	**SB 119**	**Senator Horton**

AN ACT TO EXPAND THE TAX CREDITS FOR HISTORIC REHABILITATION BY EXTENDING THE SUNSET ON A PROVISION ALLOWING A PASS-THROUGH ENTITY TO ALLOCATE AMONG ITS OWNERS THE TAX CREDIT FOR INCOME-PRODUCING STRUCTURES AND INCREASING THE AMOUNT THAT MAY BE ALLOCATED TO AN OWNER UNDER THIS PROVISION.

OVERVIEW: This act amends the historic preservation tax credit as follows:

- It extends the sunset on the provision that permits a pass-through entity to allocate among its owners the tax credit for income-producing property from January 1, 2004, to January 1, 2008.
- It amends the above-described provision to permit a pass-through entity to allocate the credit to an owner if an owner's adjusted basis in the pass-through entity is at least 40% of the amount of the credit allocated to that owner.

The act also directs the Department of Revenue to modify the income tax forms to provide separate lines for each tax credit claimed by the taxpayer.

FISCAL IMPACT: No estimate can be made of the actual revenue impact of this act. The changes made by this act are intended to increase the likelihood that the historic rehabilitation credits will be fully utilized by taxpayers. However, the General Assembly's

Fiscal Research Division has assumed since 1997, the year the credit was increased to 20%, that 100% of the tax credits have been used and has built into the General Fund availability forecast 100% utilization of the historic credit. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2003 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 10, 2003. The 2003 individual income tax forms will be modified according to the provisions of this act.

ANALYSIS: North Carolina allows an income tax credit[48] to taxpayers that qualify for the federal historic rehabilitation tax credit.[49] The amount of the credit is equal to 20% of the expenses of rehabilitating an income-producing historic structure.[50] A pass-through entity may qualify for the rehabilitation credit and pass the credits on to its owners.[51]

For most State tax credits, a pass-through entity is required to allocate the credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, are allocated under the Internal Revenue Code. Under the Internal Revenue 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, [52] and tax credits are allocated among partners in a partnership in accordance with the partnership agreement.[53] However, in 1999, the General Assembly amended the law to provide for the separate sale of the historic tax credit for income-producing property by allowing a pass-through entity to allocate the tax credit among its owners at its discretion. The allocation of the credit allows the tax credit to be utilized more fully since it can be redistributed to North Carolina investors with State income tax liability. Each year an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return that shows both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 and G.S. 105-269.15. This change in the law would have expired for taxable years beginning on or after January 1, 2002. S.L. 2001-476 extended the provision for two years and this act extends it for four more years, until January 1, 2008.

To further maximize the use of the State historic rehabilitation tax credit for income-producing property, this act increases the amount of the credit that a pass-through entity may allocate among its owners. Prior law provided that the credit could be allocated to an owner of the pass-through entity, as long as the amount of the credit allocated to the

---

[48] G.S. 105-129.35. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.
[49] The federal tax credit is available for rehabilitating only income-producing historic structures. The federal credit amount is equal to 20% of the rehabilitation expenses.
[50] North Carolina also allows an income tax credit of 30% of the expenses of rehabilitating an historic structure that is not income-producing, and thus not eligible for the federal income tax credit.
[51] 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.
[52] State law provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-131.8.
[53] State law provides that the tax credit allowed a partner is based on the partnership agreement, which must have 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. G.S. 105-269.15.

owner did not exceed the owner's adjusted basis in the entity, [54] as determined under the Code. This act provides that the owner's adjusted basis must be at least 40% of the credit allocated to that owner. The General Assembly enacted a similar change in the low-income housing tax credit in 2002.[55]

During the finance committee deliberations, the Department of Revenue was asked to report on the amount of income-producing historic rehabilitation tax credits taken in tax years 2000 and 2001. Although the Department could extrapolate from outside data the amount of tax credits taxpayers were eligible for each year, it could not determine the percentage of tax credits actually claimed each year. The Department's Tax Research Division responded that it could only determine the number of corporate taxpayers that claimed the historic rehabilitation credit because the agency's computer system does not contain information on the individuals that claim the credit. The computer system does not capture data on individual historic rehabilitation credits because the credit is one of a number of credits combined on Form D-400TC as a miscellaneous credit. To remedy this data problem, the act directs the Department of Revenue to change the income tax forms to provide separate lines for each tax credit claimed by a taxpayer, effective for tax years beginning on or after January 1, 2003. This change will provide valuable information to legislative and executive branch analysts tasked with evaluating and estimating the General Fund revenue loss of tax credits.

REVENUE LAWS TECHNICAL CHANGES.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-416	**SB 97**	**Senator Hartsell**

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

OVERVIEW: This act makes technical and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: Section 27, which modifies a distribution of local sales tax revenue initially included in the 2003 Budget Act, becomes effective October 1, 2003. The remainder of the act became effective when signed into law by the Governor on August 14, 2003.

ANALYSIS: S.L. 2003-416 makes technical and clarifying changes to the revenue laws and related statutes, as outlined in the following chart:

Section	Explanation
1 & 3	Section 1 clarifies that the 2002 law modifying the estate tax formula for estates

[54] The adjusted basis is determined at the end of the taxable year in which the historic structure is placed in service.
[55] S.L. 2002-87.

Section	Explanation
	with property in more than one state does not apply to the extent it would create a retroactive increase for estates of decedents dying between January 1, 2002, and the date the act became law. Sections 1 and 3 clarify the effective date of the low-income housing tax credit.
2	Re-enacts a session law that did not receive three roll-call readings on adoption of the conference report.
4	Moves the definition of "pass-through entity" to the general definitions section and makes appropriate cross-reference changes.
5	Modernizes terminology by changing the word "business" to "apportionable" as it relates to the apportionment of corporate income tax.
6	Corrects capitalization.
7	Makes a grammatical change.
8	Clarifies that interest, not the interest rate, for the low-income housing tax credit is computed from the date the Secretary transferred the credit amount to the Housing Finance Agency.
9	Makes a punctuation change.
10	Clarifies that the entire penalty may be waived for the nonpayment of taxes. G.S. 105-357(b)(2) imposes a penalty for nonpayment of taxes of the greater of 10% or $25. However, the prior wording of G.S. 105-358(a) authorized waiver of only the 10% penalty.
11	Supplies missing language.
12	Clarifies that the North Carolina Constitution prohibits the General Assembly from contracting away its taxing power.
13	Conforms effective date language to reflect that adoption of the Streamlined Sales Tax Agreement may be other than by signature.
14	Conforms local law relating to local sales tax distribution to reflect additional local option sales tax enacted in 2001.
15	Undoes drafting error that substituted for a stock ownership test the similar requirements for controlled group membership. The substituted language is not workable because, unlike the stock ownership test, it does not cover non-corporate entities. This corrects a definition in the statute dealing with royalty income reporting option.
16	Conforms terminology to reflect definition changes enacted in 2002.
17	Restores a provision that was deleted in 1997.
18	Conforms sales tax exemption and refund statutes to reflect that exemptions and refunds extend to some taxable services.
19	Sets out in statute the prohibition against levying the scrap tire, white goods, or

Section	Explanation
	dry-cleaning solvent tax on sales the State cannot constitutionally tax.
20	Deletes a provision regarding the property tax value of cotton. The provision is obsolete because cotton is covered by the exemption for inventories.
21	Corrects a cross-reference.
22	Adds "G.S." before a statutory citation.
23	Corrects name of UNC Health Care System.
24	Amends the captions to fit the text of the statutes.
25	Clarifies that the conflict of interest language applies to current members as well as former members of the Economic Investment Committee. This committee administers the Job Development Investment Grant Program.
26	Corrects an effective date for a section of the streamlined provisions in the 2003 Budget Act.
27	Revises the distribution formula for the local sales tax on food effective October 1, 2003, as requested by the NC League of Municipalities and the NC Association of County Commissioners. The modified distribution formula will more accurately reflect the current distribution of those revenues. (*For a more detailed explanation of the distribution, see the summary for S.L. 2003-284, 2003 Budget Act)*
28	Allows a one-time withholding of $25,000 from the local taxes collected on food in order to cover the Department of Revenue's programming costs associated with the distribution of the local taxes collected on food.
29	The 2003 Budget Act transferred all receipts of the Wireless 911 Fund for the 2003-04 fiscal year (estimated at $33 million) and $25 million of the receipts for the 2004-05 fiscal year to the General Fund. Subsection (a) of this section limits that transfer for the 2003-04 fiscal year to $33 million, or the actual fund receipts for 2003-04 less the 1% administrative fee the Wireless 911 Board is authorized to deduct, *whichever is less*. Subsection (b) of this section amends a provision allowing the Wireless 911 Board to reallocate the 60-40% split between the wireless phone service providers and the 911 centers. Prior law allowed that reallocation by the Board when it adjusts the service charge, with the reallocation affecting the subsequent receipts. The amendment allows the reallocation at any time, and allows the reallocation to affect money already in the Fund balance, as well as subsequent receipts. This change allows the Board greater flexibility to meet the financial needs of the wireless providers and the 911 centers as the wireless 911 system is deployed in accordance with the FCC order and in light of the diversion of Wireless 911 Fund receipts in the 2003-05 biennium. When fully deployed, the wireless 911 system will allow automatic location of a person calling 911 with a wireless phone.
30	Section 27 becomes effective October 1, 2003. The remainder of the act became effective when it became law, August 14, 2003.

ECONOMIC DEVELOPMENT DISTRICT.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-418	**SB 168**	**Senator Smith**

AN ACT TO PROVIDE FOR THE CREATION OF ECONOMIC DEVELOPMENT AND TRAINING DISTRICTS.

OVERVIEW: This act authorizes counties to create special tax areas under Section 2(4) of Article V of the North Carolina Constitution. These areas, called economic development and training districts, would be for the purpose of providing a skills training center to prepare county residents to perform manufacturing, research and development, and related service and support jobs in the pharmaceutical, biotech, life science, chemical, telecommunications, and electronics industries. A county may levy property taxes within the district, in addition to those levied throughout the county, in order to finance the skills training center.

The act also defines the property that may be initially included within an economic development and training district located in Johnston County should the board of commissioners of Johnston County elect to establish one. The act states that a municipality cannot annex property within a district located in Johnston County.

FISCAL IMPACT: This act does not affect State revenues.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 14, 2003.

ANALYSIS: Section 1 of the act adds a new Part to the county service district Article in Chapter 153A of the General Statues. It authorizes a county to establish an "economic development and training district." Such a district would be a special tax area pursuant to Section 2(4) of Article V of the North Carolina Constitution. That section authorizes the General Assembly to enact general (statewide) laws giving local governments the authority to establish these areas. A local act would be unconstitutional.

The new law applies statewide but the conditions imposed for creation of a district are so specific that the law is unlikely to apply anywhere but in the intended location, Johnston County. These conditions include the requirement that all of the property in the district be used for specific types of manufacturing, including at least two pharmaceuticals manufacturing or bioprocessing facilities with sites aggregating at least 425 acres owned by publicly held corporations. In addition, the district must include an industrial park of at least 60 acres within a noncontiguous 625-acre parcel now or formerly owned by an airport authority. Section 2 of the act provides that no municipality may annex, other than by voluntary annexation, any property in Johnston County that is located within an economic development and training district. Section 2 of the act also provides that if the board of commissioners of Johnston County elect to establish an economic development and training district, then the district as initially established will consist of certain described real property owned by Bayer Corporation, Novo Nordisk Pharmaceutical Industries, Inc., Fresenius Kabi Clayton, L.P., and the Johnston County Airport Authority.

There are three stated purposes for an economic development and training district: (1) to finance and maintain a skills training center to prepare local residents to perform jobs related to the types of industries within the district; (2) to provide education and related services and facilities; and (3) to provide economic development in the county. The act authorizes the county to levy property taxes within the district at a rate of up to 8¢ per $100 to provide the skills training center, but does not authorize the levy of property taxes for the other two purposes of the district. It goes on, however, to state that the proceeds of the district taxes may be used to pay annual debt service on the skills training center of up to $1.2 million and also to pay "any other services or facilities" provided in response to a recommendation of an advisory committee required to be set up to represent district property owners as well as the county.

The act provides the following procedural requirements relating to an economic development district:

- Creation of District. – Before a district can be created, there must be presented to the board of commissioners a petition signed by the owners of real property in the district representing at least 50% of the total assessed value of real and personal property in the district. Before establishing a district, the county must provide notice to the public and to affected property owners, prepare a report including a map and a plan for the district, hold a public hearing, and make findings that support the need for the district.

- Advisory Committee. – In the resolution establishing an economic development and training district, the board of commissioners must create a five-member advisory committee with three members representing an association of owners and tenants in the district and two members representing the county. The purpose of the committee is to make recommendations to the county on the type and level of services, facilities, or functions to be provided for the district.

- Enlargement of District. – The board of commissioners would be authorized to annex territory to the district subject to conditions and procedural requirements similar to those that apply to establishing the district. If any of the area proposed to be annexed is within the extraterritorial jurisdiction of a municipality, then a majority of the members of the governing body of the municipality must vote in favor of annexation.

- Abolition of District. – The board of commissioners may abolish a district if there is no longer a need for the district and the board has received a petition requesting abolition signed by at least 50% of real property owners in the district who own at least 50% of the real and personal property in the district. There must be notice and a public hearing prior to the adoption of a resolution abolishing a district.

STATE GOVT SALES TAX EXEMPT/SCH COOP REFUND.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-431	**SB 100**	**Senator Kerr**

AN ACT TO PROMOTE EFFICIENCY IN STATE GOVERNMENT BY ALLOWING A SALES AND USE TAX EXEMPTION FOR STATE AGENCIES INSTEAD OF A SALES AND USE TAX REFUND TO STATE AGENCIES AND TO ALLOW A SALES AND USE TAX REFUND TO SCHOOL BOARD COOPERATIVES.

OVERVIEW: This act allows a sales and use tax exemption, instead of a sales and use tax refund, for purchases by State agencies. The act also allows a refund of State and local sales and use taxes by a joint agency created by interlocal agreement among local school administrative units to jointly purchase food service-related materials, supplies, and equipment on their behalf.

FISCAL IMPACT: The primary impact of the legislation on expenditures is the reduction in agency budgets to reflect the sales tax exemption. The act requires the Office of State Budget and Management to reduce each agency's certified budget by an amount that will offset the reduction to the General Fund from the loss of sales tax revenue. Some organizational efficiencies are also expected. Therefore, the net impact of the act is significant change to the General Fund.

The annual revenue loss associated with the second part of the bill, which authorizes a refund of state and local sales tax for school board cooperatives, is expected to be less than $20,000 annually. However, no impact is expected until FY 2004-05. *(For a more complete fiscal analysis, see the Overview: Fiscal and Budgetary Actions, 2003 Session. Available in Legislative Library.)*

EFFECTIVE DATE: The exemption from State and local sales tax for State agencies becomes effective July 1, 2004. The refund of State and local sales and use taxes for school board cooperatives became effective for taxes paid on or after July 1, 2003.

ANALYSIS:

State Government Exemption

Currently, all major State agencies except the Department of Transportation[56] are subject to State and local sales taxes. However, the State receives a quarterly refund of the local sales taxes paid by its agencies[57] with the proceeds of the refund going to the General Fund.

The current refund process is time-consuming for the Office of the State Controller, the agencies, and the Department of Revenue. To relieve the agencies of this burden, the Office of the State Controller recommended changing the refund process to a sales and use tax exemption for State agencies.[58] The term "State agency" is currently defined for sales and use

[56] The Department of Transportation is exempt from State and local sales and use tax.
[57] Each State agency is suppose to file with the Secretary of Revenue a written application for a refund of the local sales taxes paid by it. The application is due within 15 days after the end of each calendar quarter. *G.S. 105-164.14(e).*
[58] Refunds for purchases by the North Carolina Low Level Radioactive Waste Management Authority, the North Carolina Hazardous Waste Management Commission, the constituent institutions of the University of North Carolina paid for with contract and grant funds, and The University of North Carolina Hospitals at

tax purposes as a unit of the executive, legislative, or judicial branch of State government, such as a department, commission, board, council, or The University of North Carolina. The term does not include local boards of education[59] or local boards of trustees for the community college system.

This act changes the current refund process to an exemption for State agencies. To qualify for the exemption, the items must be purchased by a State agency and the purchase must meet one of the following conditions:

- The items are purchased pursuant to a purchase order of the State agency that contains the exemption number of the agency and a description of the items purchased.
- The items purchased are paid for by a State-issued check, electronic deposit, credit card, procurement card, or credit account of a State agency and the agency provides to or has on file with the retailer the agency's exemption number.

The act incorporates all of the various payment and purchase mechanisms where accounting system controls are in place to verify purchases and prevent possible misuse of the agency's sales tax exemption by its employees. The only type of direct purchases not included within this exemption is employee expense reimbursements.

The sales tax exemption applies only to direct purchases of tangible personal property. State agencies will continue to apply for refunds of local taxes paid on indirect purchases of building materials, supplies, fixtures, and equipment that become a part of a structure owned or leased by the State.

A State agency will be liable for items purchased with its exemption number that it does not use. The liability will include not only the tax that should have been paid on the items purchased, but also interest calculated from the date the tax would otherwise have been paid.

To be eligible for the sales and use tax exemption, a State agency must obtain from the Department of Revenue a sales tax exemption number through an application process. The part of the act that provides for this application process becomes effective January 1, 2004, so that State government agencies can begin the process of obtaining their exemption certificates from the Department of Revenue. The section of the act granting the exemption becomes effective July 1, 2004, and applies to sales made on or after that date.

The act also provides that the Office of State Budget and Management must reduce each State agency's certified budget for fiscal years 2003-04 and 2004-05 by an appropriate amount to reflect the tax savings generated by the sales and use tax exemption allowed under this act.

Sales Tax Refund for School Board Cooperatives

Under Chapter 160A of the General Statutes, units of local government[60] may enter into contracts or agreements with each other in order to execute any undertaking. Since 1996, several boards of education in the eastern part of the State have participated in an agreement

---

Chapel Hill are made on an annual basis and are refunded directly to the state agency. The act does not change the refund status of these purchases at the suggestion of the Office of State Budget and Management.

[59] Local school administrative units are allowed an annual refund of State and local sales taxes paid.

[60] G.S. 160A-460 includes a local board of education within its definition of "unit of local government."

under the authority of Part 1 of Chapter 160A in order to operate a cooperative program known as the Southeast Cooperative Utilizing Resources Efficiently (SECURE). The purpose of SECURE is to coordinate the acquisition of food service-related materials, supplies, equipment, and services. The school districts in SECURE now are Wayne, Pitt, Greene, Lenoir, Onslow, Sampson, New Hanover, Guilford, and Cumberland Counties.

Local school boards are allowed to seek an annual refund of State and local sales and use taxes. Since SECURE serves as a conduit for several local school boards to join together to increase their buying power, it applied for a sales tax refund on behalf of the school boards. However, the Department of Revenue found that it was not included in the list of entities entitled to a refund: SECURE is not a local board of education and it is not a charitable nonprofit organization.

This act allows SECURE and any other joint agency created by interlocal agreement among local school administrative units to jointly purchase food service-related materials, supplies, and equipment on their behalf to qualify for an annual refund of State and local sales and use taxes paid by it. The refund request must be made in writing and must include any information and documentation required by the Secretary. This section of the act became effective for taxes paid on and after July 1, 2003.

Appendix A

TABLE OF CONTENTS

(Sorted by Bill #)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2003-418	SB 168	Economic Development District.	Senator Smith	63
S.L. 2003-5	SB 235	One-Time Rental Car Tax Election Exception.	Senator Hoyle	1
S.L. 2003-349	SB 236	Revenue Administrative Changes.	Senator Kerr	27
S.L. 2003-264	SB 511	Publish Revenue-Neutral Property Tax Rate.	Senator Rucho	4
S.L. 2003-333	SB 529	Water & Sewer Authority Setoff.	Senator Hartsell	25
S.L. 2003-357	SB 633	Modify UNC Bond Law.	Senator Clodfelter	36
S.L. 2003-402	SB 668	Wine Shippers Permits.	Senator Metcalf	48
S.L. 2003-388	SB 679	Modify State Financing Laws.	Senator Hoyle	40
S.L. 2003-360	SB 705	UNC - Nonappropriated Capital Projects.	Senator Kerr	38
S.L. 2003-403	SB 725	Local Option Project Development Financing.	Senator Clodfelter	50
S.L. 2003-300	SB 936	Waive Deadlines for Troops.	Senator Kerr	19

Appendix B

TABLE OF CONTENTS

(Sorted by Short Title)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
amended by S.L. 2003-284			G. Allen, Fox, Luebke (Primary Sponsors)	
S.L. 2003-264	SB 511	Publish Revenue-Neutral Property Tax Rate.	Senator Rucho	4
S.L. 2003-414	HB 1294	Qualified Business Credit/Ports Credit.	Representative G. Allen	55
S.L. 2003-349	SB 236	Revenue Administrative Changes.	Senator Kerr	27
S.L. 2003-416	SB 97	Revenue Laws Technical Changes.	Senator Hartsell	60
S.L. 2003-431	SB 100	State Govt Sales Tax Exempt/Sch Coop Refund.	Senator Kerr	65
S.L. 2003-360	SB 705	UNC - Nonappropriated Capital Projects.	Senator Kerr	38
S.L. 2003-300	SB 936	Waive Deadlines for Troops.	Senator Kerr	19
S.L. 2003-333	SB 529	Water & Sewer Authority Setoff.	Senator Hartsell	25
S.L. 2003-402	SB 668	Wine Shippers Permits.	Senator Metcalf	48

Appendix C

TABLE OF CONTENTS

(Sorted by Sponsor)

SESSION LAW #	BILL #	SHORT TITLE	SPONSOR	PAGE
S.L. 2003-415	SB 119	Expand Historic Preservation Credit.	Sen. Horton	58
S.L. 2003-5	SB 235	One-Time Rental Car Tax Election Exception.	Sen. Hoyle	1
S.L. 2003-388	SB 679	Modify State Financing Laws.	Sen. Hoyle	40
S.L. 2003-300	SB 936	Waive Deadlines for Troops.	Sen. Kerr	19
S.L. 2003-349	SB 236	Revenue Administrative Changes.	Sen. Kerr	27
S.L. 2003-360	SB 705	UNC - Nonappropriated Capital Projects.	Sen. Kerr	38
S.L. 2003-431	SB 100	State Govt Sales Tax Exempt/Sch Coop Refund.	Sen. Kerr	65
S.L. 2003-402	SB 668	Wine Shippers Permits.	Sen. Metcalf	48
S.L. 2003-264	SB 511	Publish Revenue-Neutral Property Tax Rate.	Sen. Rucho	4
S.L. 2003-418	SB 168	Economic Development District.	Sen. Smith	63