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2004 Finance Law Changes

Job Growth and Infrastructure Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2003-435	**HB 2**	**Representative G. Allen**

AN ACT TO MAKE THE FOLLOWING CHANGES RECOMMENDED BY THE GOVERNOR: (1) APPROPRIATE TWENTY-FOUR MILLION DOLLARS FOR INDUSTRIAL SITE INFRASTRUCTURE FOR MAJOR PROJECTS; (2) MODIFY THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; (3) PROVIDE INCENTIVES FOR MAJOR PHARMACEUTICAL AND BIOPROCESSING FACILITIES BY EXTENDING THE BILL LEE ACT SUNSET FOR THESE INDUSTRIES AND AUTHORIZING SALES TAX REFUNDS FOR CONSTRUCTION MATERIALS FOR THESE INDUSTRIES; (4) EXTEND THE SUNSET ON AND MODIFY THE CIGARETTE EXPORTATION TAX CREDIT AND MODIFY THE BASE YEAR, (5) CREATE AN ENHANCED TAX CREDIT FOR CIGARETTE EXPORTATION, AND (6) CREATE A LIFE SCIENCES REVENUE BOND AUTHORITY.

OVERVIEW: This act makes the following economic development changes:

- Appropriates $24 million to a nonreverting fund to be used for site infrastructure for major industrial projects.
- Makes various changes to the Job Development Investment Grant (hereinafter JDIG) Program.
- Extends the William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) sunset and other deadlines for major pharmaceutical manufacturing and bioprocessing facilities.
- Authorizes annual sales tax refunds for construction materials for major pharmaceutical manufacturing and bioprocessing facilities.
- Extends the sunset on the cigarette exportation tax credit from 2005 to 2018 with the additional requirement that the taxpayer use the North Carolina State Ports. This part also allows the credit to be claimed by successors in business and modifies the base year determination.
- Allows a corporate income tax credit for tobacco manufacturers who export cigarettes to foreign countries, who use the North Carolina State Ports, and who maintain employment levels in this State that exceed the corporation's employment level in this State at the end of 2004.

- Establishes the Life Sciences Revenue Bond Authority to study and make recommendations for creating a credit enhancement program for financing construction of infrastructure for life sciences manufacturing facilities.

FISCAL IMPACT:

Description and Effective Dates	*General Fund Impact*
Expansion of Bill Lee Credits	$1 million loss beginning in 2007-2008
Major Industrial Facility Sales Tax Refunds	$1.5 million loss for 2005-2006 $2.3 million loss for 2006-2007 $2.6 million loss for 2007-2008 Will also create local government revenue losses
Changes to the existing cigarette exportation tax credit	$12 million loss for 2005-2006 $12 million loss for 2006-2007 $12 million loss for 2007-2008
New enhanced cigarette exportation tax credit	$4 million loss for 2006-2007 $4 million loss for 2007-2008.

(For a more compete fiscal analysis, see Overview Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library)

EFFECTIVE DATE: *See Analysis for effective dates.*

ANALYSIS: The Governor convened the Second Extra Session of the 2003 General Assembly to consider specific economic development changes. The following changes were enacted:

Major Industrial Site Infrastructure

Part 1 of the act creates a nonreverting Site Infrastructure Development Fund in the Department of Commerce to fund site acquisition and development and other capital expenses related to major industrial development.[1] The act appropriates $24 million to the Fund for the 2003-2004 fiscal year. A Site Infrastructure Development incentive may be in the form of a restricted grant or forgivable loan directly to a business or a grant to a government or nonprofit agency to administer the incentive.

Projects built with this appropriation are exempted from State construction requirements and State purchase requirements, with one exception. When public funds are expended, the State's policy of minority participation and the State's minority participation goal of 10% apply. Projects are also exempted from the part of the State Environmental Policy Act that requires detailed environmental impact statements when public funds or public lands are used for projects and programs significantly affecting the quality of the environment.

[1] Section 6.26 of S.L. 2004-124, the 2004 Appropriation Act, amended the Fund to also allow moneys in the Fund to be used to acquire options and hold options for the purchase of land for an anticipated industrial site if certain conditions are met.

Eligible businesses may apply for site development incentives. To qualify for the incentive, a business must employ at least 100 new full-time employees and invest at least $100 million of private funds in the project. A business must also provide health insurance for its full-time employees and have a history of compliance with the Occupational Safety and Health Act and programs implemented by the Department of Environment and Natural Resources.

The Department of Commerce and the Economic Investment Committee[2] will administer the selection process, including developing appropriate criteria for evaluating applicants. Section 1.3 of the act exempts them from rulemaking procedures in administrating the site infrastructure development program. Before recommending a project for site development, the Committee must make several findings, including a finding that site development is necessary for completion of the project in this State and a finding that the price to be paid for the site is appropriate and not excessive. Section 1.4 of the act provides that the JDIG conflict of interest restrictions will apply to the site infrastructure development program as well.[3]

Once an incentive is awarded, the Department will enter into an agreement with the business to provide site development within available funds. The agreement must include a provision prohibiting a business from receiving a payment or other benefit under the agreement when the business has received notice of an overdue tax debt and the overdue tax debt has not been satisfied or otherwise resolved. The agreement is binding on both parties. The agreement must include performance criteria, remedies, and other safeguards to protect the State's investment. The Attorney General must review and approve each agreement.

After a site development incentive is in effect, the Department of Commerce is responsible for monitoring the business' compliance with performance criteria and for administering the repayment of State funds by a business that has failed to meet these criteria. The Department of Commerce is required to report quarterly to the Joint Select Commission on Governmental Operations on the details of the program, including projects that receive incentives and any defaults and repayments. This report must also be made available to the public.

Part 1 of the act became effective when signed into law by the Governor on December 16, 2003.

Job Development Investment Grant Changes

[2] The Economic Investment Committee, which administers the JDIG program, is a five-member committee consisting of the Secretary of Commerce, the Secretary of Revenue, the Director of the Office of State Budget and Management, one member appointed by the General Assembly upon the recommendation of the Speaker of the House of Representatives, and one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate.

[3] Members of the Economic Investment Committee are forbidden to work for a business that receives a grant or loan under the program for at least two years after the member is no longer on the Committee. A former member of the Committee who violates this prohibition must forfeit any compensation received for that work and is prohibited for an additional two years from working for a business that receives a grant under the program.

Part 2 of the act makes several changes to the JDIG program.[4] Section 2.2 provides that, in determining whether a business has increased or maintained employment, the Economic Investment Committee can decide to look at a division or unit of a business rather than the entire business. Choosing this option means that if the entire business decreases employment, it may still qualify for a grant for a division or unit within the business that increases employment. The Committee can choose this option only if it is necessary to secure the project and the community economic development agreement contains terms to assure that the business does not create eligibility by transferring existing jobs to the project.

Section 2.3 of the act repeals the wage standard as it applies to the JDIG program. There were several reasons for this change. First, at the time a business applies for a JDIG grant, the wages to be paid are just projections. Second, the law had been interpreted to require the jobs to meet not only the current wage standard, but also future wage standards, which can fluctuate annually. This interpretation created a great deal of uncertainty as to the prospect of actually receiving a grant in future years of the agreement. Third, while there is no wage standard for tiers one and two and the wage standard is set below the county average for prosperous tier five counties, the mid-range counties had to meet the actual county average. With sudden and severe dislocation, the wage standard could have blocked incentives for a project that would be vital to economic recovery for a county suffering from the loss of manufacturing industries. Finally, because grants are awarded at the discretion of the Committee, the Committee can use its judgment to assure that grants are not awarded to inappropriate, low-wage projects.

Sections 2.1, 2.4, and 2.5 of the act are more technical. Section 2.1 clarifies that the base period for measuring performance under a grant agreement can be any 24 months starting when performance begins. This base period is not limited to calendar years. Section 2.1 also adds the definition of enterprise tier to the statute. Section 2.4 clarifies the procedure for public notice and public comment on proposed changes to the JDIG criteria. Section 2.5 clarifies that payments under a grant can begin on a future date after it is awarded, as long as they begin within six years.

Part 2 became effective when the act was signed into law by the Governor on December 16, 2003.

Extend Bill Lee Credits for Certain Major Industries

In 2002, the General Assembly extended the sunset date on the Bill Lee Act until January 1, 2010, for certain interstate air couriers and also increased various time frames in the Bill Lee Act from two years to seven years.[5] The rationale for these extensions was that the interstate air courier industry, and the construction of a hub in particular, face many regulatory, administrative, and legal hurdles not generally faced by other industries. Due to these extra burdens, there is generally a longer period between the time a project is announced and a location is selected and the time the facility is placed in service.

Part 3 of the act makes the same extensions for eligible major industries, effective beginning with the 2004 taxable year. An eligible major industry is either of the following two

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[4] The 2004 Appropriation Act made subsequent changes to the JDIG program. A description of the program and the changes made by the 2004 Act are described in the analysis of S.L. 2004-124, the 2004 Appropriations Act.

[5] See S.L. 2002-146.

industries if the taxpayer will invest at least $100 million in acquiring, constructing, or equipping a facility to engage in the industry:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

If the taxpayer does not in fact invest the required amount, the taxpayer forfeits the benefits of the extensions and must repay the credits.

Major Industrial Facility Sales Tax Refunds[6]

Part 4 of the act creates an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

The taxpayer must apply for the sales tax refund within six months after the end of the State's fiscal year. The refund is effective for sales taxes paid on or after January 1, 2004. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

Cigarette Exportation Tax Credit

Part 5 of the act extends for thirteen years the sunset of the corporate income tax credit for manufacturing cigarettes for exportation. As enacted in 1999, this credit is a dollar amount per cigarette exported for those manufacturers who export at least 50% as many cigarettes in the taxable year as they did in calendar year 1998. The dollar amount ranges from forty cents to twenty cents per 1,000 cigarettes exported. The credit is capped at the lesser of $6 million per year or 50% of the manufacturer's corporate tax liability for any given year. The credit was set to sunset for cigarettes exported on or after January 1, 2005. Part 5 of the act changes the sunset to 2018.

Part 5 of the act also makes five other substantive changes to the credit for manufacturing cigarettes for exportation:

- It changes the base year for determining the exportation volume from 1998 to 2003, effective for cigarettes exported on or after January 1, 2005.
- It provides that the taxpayer must export cigarettes through the North Carolina State Ports, effective for cigarettes exported on or after January 1, 2005.
- It allows a successor in business to a corporation that claimed the credit to continue to claim the credit. In this case, the amount of the credit allowed is determined by comparing the exportation volume of the corporation in the year for which the credit is claimed with all of the corporation's predecessor corporations' combined base year exportation volume. This provision is effective for cigarettes exported on or after January 1, 2005.

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[6] S.L. 2004-124, the 2004 Appropriations Act, expanded this provision.

- It expands the credit by allowing the credit to be claimed for the exportation of cigarettes to a possession of the United States or a commonwealth of the United States that is not a state. This provision is effective for taxable years beginning on or after January 1, 2004.
- It increases the carryforward period of any unused portion of the credit from five to ten years, effective for cigarettes exported on or after January 1, 2005.

Enhanced Cigarette Exportation Tax Credit

Part 6 of the act creates a new, alternative corporate tax credit for tobacco manufacturers who export cigarettes to foreign countries, who use the North Carolina State Ports, and who maintain employment levels in this State that exceed the manufacturer's employment level in this State at the end of 2004 by at least 800 full-time employees.[7] The credit is effective for taxable years beginning on or after January 1, 2006, and expires for exports occurring on or after January 1, 2018.

This new credit is a dollar amount per cigarette exported for those manufacturers who meet the above eligibility requirements. The credit amount is 40¢ per 1,000 cigarettes exported. The credit is capped at the lesser of $10 million per year or 50% of the manufacturer's tax liability for any given year. The credit may be taken against the corporate income tax or the franchise tax, or a combination of the two, at the election of the taxpayer. Once made, an election is binding and applies to all carryforwards of the credit. The taxpayer may, however, make a different election each year for credits earned during that year. Unused portions of a credit may be carried forward for 10 years. Part 6 of the act would also allow a partial credit for taxpayers who had previously met all eligibility requirements but who fail to maintain the required employment level. In computing the partial credit, the credit that would otherwise have been allowed is reduced in proportion to the amount by which the taxpayer's employment level is below the required level.

The credit created in Part 6 of the act differs from the credit allowed under G.S. 105-130.45 in several key ways. This new credit has a higher cap ($10 million as opposed to $6 million) and may be taken against the income tax and/or franchise tax (as opposed to only the income tax). In addition, the new credit requires job creation whereas the credit allowed under G.S. 105-130.45 does not. The new credit applies to cigarettes exported only to foreign countries (as opposed to foreign countries, to possessions of the United States, or to United States commonwealths that are not states) and requires the taxpayer to "export" through the North Carolina Ports (as opposed to "waterborne export" through the North Carolina Ports). A taxpayer may take either the new credit in this part or the original credit in G.S. 105-130.45, but may not claim both credits for the same activity.

While the original cigarette exportation tax credit was being considered during the 1999 Session, the issue was raised as to whether the credit would violate the General Agreement on Tariffs and Trade (GATT). The General Assembly staff was of the opinion that the tax credit would violate GATT, while counsel for one of the four tobacco manufacturers disagreed. This issue has not been resolved with respect to the original credit, and the new tax credit added by this part presents the same issue. It is clear, however, that any challenge

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[7] Section 16 of S.L. 2004-170 amended the new credit to provide that in determining whether a taxpayer is eligible for the credit, positions located within North Carolina for six months or less are not considered to be part of the taxpayer's employment level.

to either the original credit or the new credit must come from a foreign government. If a foreign government were to challenge the credit, then the United States Justice Department could sue North Carolina. If the State were to lose, the federal statute provides that relief would be prospective only and persons who had already used the credit could not be required to repay it. Private citizens have no cause of action on the issue.

Life Sciences Revenue Bond Authority

Part 7 of the act creates a Life Sciences Revenue Bond Authority in the Department of State Treasurer, effective when signed into law by the Governor on December 16, 2003.[8] This provision is step one of a two-step process. First, the Authority will study the best method for establishing a credit enhancement program for construction of infrastructure for life sciences manufacturing facilities. After the Authority reports its findings and recommendations to the General Assembly by May 1, 2004, the act anticipates that in the second stage the Authority would administer any program enacted by the General Assembly.[9]

This Part of the act does not require an appropriation. The Authority is expected to perform its duties during the first phase using funds raised from private sources. In addition, the Authority is authorized to charge fees for one part of the study, in which it will accept test applications (pro forma applications) to evaluate the need for the proposed credit enhancement program. The act directs the Authority to cooperate with appropriate government agencies, the University of North Carolina system, the Biotechnology Center, and others in developing its recommendations.

One example of a credit enhancement vehicle would be revenue bonds. Under existing law, the State and local governments can issue tax-exempt industrial revenue bonds for manufacturing and pollution control facilities. The bonds are retired with payments from the private business that will use the facility. The private business benefits from paying tax-exempt rates, rather than the taxable rates it would pay if it borrowed the money itself. Under Part 7 of the act, the Authority will consider using industrial revenue bonds and other approaches to credit enhancement in order to encourage the expansion of the life sciences manufacturing industry in this State.

The findings portion of Part 7 of the act identifies the life sciences as including biology, zoology, agronomy, biochemistry, genetics, and molecular biology. The commercialization of life sciences products to diagnose and treat diseases and provide other benefits is identified as having significant economic benefit to the State. The stated intent is to encourage the development of the bioprocess manufacturing industries in order to achieve a position of national leadership and innovation in this field.

[8] Senate Bill 75, introduced by Senator Rand during the 2003 Session, would also have created the Life Sciences Revenue Bond Authority. The bill was in a conference committee at the end of the 2003 Session.
[9] As of August 2004, no report had been made because the members of the Authority's Board of Directors had not been appointed.

Allow Family Business to Lease Farmland.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-8	**HB 1465**	**Representative Brubaker**

AN ACT TO ALLOW FARMLAND OWNED BY A FAMILY BUSINESS TO KEEP ITS PRESENT-USE VALUE TAX STATUS WHEN LEASED FOR FARM USE.

OVERVIEW: This act allows farmland owned by a business entity to keep its present-use value status when the land is leased to a nonmember of the entity, as long as all members of the business entity are relatives and the land is leased for agricultural, horticultural, or forestry purposes.

FISCAL IMPACT: This act addresses a property tax issue, thus no General Fund impact is expected. The act will result in a loss of revenue to local governments; the loss of revenue is expected to be fairly small because of the limited nature of the tax law change. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxes imposed for taxable years beginning on or after July 1, 2004.

ANALYSIS: Agricultural land, horticultural land, and forestland that meet certain size, income, and ownership requirements may qualify as a special class of property subject to taxation at its present-use value rather than its fair market value. If the property is owned by a business entity, then the members of the business entity or their relatives must be actively engaged in the business of farming for the property to qualify for the use value program. By contrast, the law does not require a natural person who owns farmland to be actively engaged in the business of farming. In 1987 the Property Tax Commission determined that leasing land in and of itself does not qualify as 'actively engaged' in the business of farming.[10] This distinction has resulted in a different tax treatment of leased farmland owned by a person and farmland owned by a family business. For example, an individual who owns farmland may negotiate a lease for the land to be farmed by another but a limited liability company's land would lose it use-value status if it were leased to a non-relative.

This act removes this distinction and allows property owned by a family business to keep its present-use value tax status if the members do not want to physically participate in farming the land or to make decisions about the farming activity. The act specifies that the terms "having as its principal business" and "actively engaged in the business of the entity" include the leasing of land for agriculture, horticulture, or forestry as long as all members of the business entity are relatives. As a result of this tax law change, farmland owned by a limited liability company whose members are all related will not lose its present-use value status if

[10] The case before the Property Tax Commission in 1987 involved agricultural land owned by a corporation. The corporation leased the property to a non-member who provided the capital equipment, bore the risks associated with the farming operation, and made the decisions as to the crops to be planted, the equipment needed, and the labor to be hired. The Commission concluded the corporation was engaged in the business of leasing land and was not in the principal business of and actively engaged in the commercial production of growing crops, plants, or animals. The Commission found that the county in that case correctly denied present-use value status to the property.

one family member, who has been physically farming the land, dies and the surviving relatives decide to lease the land to a nonmember to handle all farming activity.

Under the existing law, a person must file for preferential property tax classifications during the regular listing period, which ends January 31. A county may extend the listing period up to 30 days in nonrevaluation years and 60 days in revaluation years.[11] In addition, for good cause, a county may extend the listing period for a specific taxpayer until April 15. The legislation, which became law on June 17, 2004, did not extend the application deadline. Any application filed after the act became law would be untimely and of no effect for the 2004 tax year. Thus, a taxpayer must have applied for the preferential treatment before the act became law in order to take advantage of the act for the 2004 tax year.[12]

Adopt Flat Fee for Debt Collection.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-21	**HB 1497**	**Representative Wainwright**

AN ACT TO ADOPT A FLAT COLLECTION ASSISTANCE FEE UNDER THE SETOFF DEBT COLLECTION ACT.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, adopts a flat collection assistance fee of $5.00 for debts collected by the Department of Revenue under the Setoff Debt Collection Act.

FISCAL IMPACT: Not determined. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for fees assessed on or after January 1, 2005.

ANALYSIS: This act modifies the Setoff Debt Collection Act by imposing a flat $5.00 collection assistance fee on each debt collected through setoff. Under that Act, if an individual owes money to a State or local agency, the Department of Revenue sends the individual's income tax refund to that agency in payment of the debt rather than to the individual. Thus, the debt the individual owes to the agency is set off against the individual's income tax refund.

The Department of Revenue recovers its costs of running the program by charging a collection assistance fee as a percentage of each debt collected. The fee is added to the debt and paid by the debtor from the refund. Before this act went into effect, the Department would calculate its actual costs for the previous year and adjust the fee amount to reflect those costs.

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[11] If a county allows electronic listing of business personal property, it may extend the period for electronic listing until as late as June 1. G.S. 105-307(b).

[12] The use-value law provides an exception to the application deadline in cases where a transfer of property results in eligibility. In those cases, the application may be filed at any time within 60 days after the transfer. G.S. 105-277.4.

The change to a flat fee of $5.00 was recommended to the Revenue Laws Study Committee by the Department of Revenue. According to the Department, the process to determine "actual cost" is tedious and quite cumbersome because many different areas of the Department are affected. Thus, the "actual cost" is an estimate at best. The collection assistance fee determined by the Department for the four latest calendar years has been less than $5.00, and collection costs are not expected to grow.

Notice Period for Sales and Use Tax Refunds.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-22	**HB 1448**	**Representative Luebke**

AN ACT TO REQUIRE THAT SELLERS BE PROVIDED WITH NOTICE AND A SIXTY-DAY PERIOD TO RESPOND TO A REQUEST FOR A REFUND OF OVER-COLLECTED SALES OR USE TAXES BEFORE A PURCHASER MAY BRING A CAUSE OF ACTION AGAINST THE SELLER.

OVERVIEW: This act, which is a recommendation of the Revenue Laws Study Committee, requires a purchaser seeking a refund of over-collected sales or use tax to provide written notice to the seller and to allow the seller 60 days to respond before the purchaser may bring a cause of action against the seller. This requirement is necessary to conform to the Streamlined Sales Tax Agreement.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 25, 2004.

ANALYSIS: Under the Streamlined Sales Tax Agreement, purchasers seeking a refund of over-collected sales or use taxes must give the seller written notice and allow the seller 60 days in which to respond before bringing a cause of action against the seller.

Earlier in 2004, the Department of Revenue adopted this provision as part of a technical bulletin. However, the retailers expressed a preference for having the provision codified in statute. Therefore, the act codifies the Department's policy regarding refund procedures for over-collected sales and use tax.

Amend Franchise Tax Loophole.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-74	**SB 51**	**Senator Clodfelter**

AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE PROVISIONS THAT COULD RESULT

IN FRANCHISE TAXES ON UNRELATED LIMITED LIABILITY COMPANIES.

OVERVIEW: This act makes several changes to the 2001 and 2002 legislation that established attribution rules intended to close a loophole that allows corporations to escape franchise tax by having a controlled limited liability company (LLC) hold their assets.

- It removes attribution rules for certain related members and for individuals. Ownership interests in LLC assets would be attributed to corporations and to and from partnerships, estates, trusts, LLCs, and other entities.
- It provides that federal rules relating to constructive ownership of stock govern attribution of ownership interests in LLC assets.
- It attributes only a proportion of the LLC assets to the controlling corporation, rather than all of the assets.
- It exempts LLCs that have no more than $150,000 of assets.
- It simplifies and corrects the test for determining whether an LLC's assets are attributable to a corporation.
- Beginning in 2005, it reduces from "70% or more" to "more than 50%" the minimum percentage of an LLC's assets a corporation must control to trigger the franchise tax requirement.
- It removes membership in the LLC as an additional condition for attribution.

FISCAL IMPACT: No estimate available. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The changes become effective for taxes due on or after January 1, 2003.

ANALYSIS: Under North Carolina law, limited liability companies (LLCs) [13] are not subject to the franchise tax.[14] In 1997, the North Carolina law regarding LLCs was changed to allow for a single-member LLC. This change had the unintended consequence of allowing a corporation subject to North Carolina franchise tax to set up an LLC and transfer assets to the LLC in a tax-free transfer. The assets then held by the LLC would not be subject to the franchise tax. Thus, the corporation could avoid a significant portion of its franchise tax liability by transferring assets into a wholly owned LLC without affecting its income tax liability.

In 2001, the General Assembly enacted S.L. 2001-327 to close this loophole. The 2001 legislation tried to address the problem by requiring a corporation to pay tax on assets owned by a LLC if the corporation, including its affiliated corporations, indirectly owned[15] at least 70% of the LLC's assets. Unfortunately, tax planners found that the tax could still be avoided by using an additional paper transaction. If the corporation interposed a partnership

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

[14] The franchise tax is a tax on S Corporations and C Corporations for the privilege of doing business in the State. The tax rate is $1.50 per $1,000 of value of the greatest of (1) apportioned net book value of the corporation; (2) 55% of appraised value of real and tangible personal property in North Carolina; or (3) total actual investment in tangible property in North Carolina.

[15] Indirect ownership of an LLC's assets is determined based on who is entitled to receive those assets upon dissolution of the LLC.

between itself and the LLC holding its assets, then technically the 2001 legislation would not apply and the assets would continue to escape franchise tax.

In 2002, the General Assembly enacted S.L. 2002-126 to tighten the 2001 law. The 2002 legislation required attribution through "related members" (other entities and individuals) who may cooperate with one or more corporate entities to own the LLC that will hold the corporate assets. "Related members" is a defined term and includes certain shareholders, partnerships, estates, trusts, and corporations. If a corporation and its related members together indirectly own at least 70% of an LLC's assets, the 2002 legislation provided that each corporation would pay franchise tax on its relative share of the LLC's assets. The relative share was calculated after excluding those related members that are not corporations. Thus, the entire assets were subject to franchise tax, with the tax burden shared proportionally by the corporations involved in the ownership scheme.

After the 2002 legislation was enacted, it became apparent that it not only failed to close the loophole but also extended the franchise tax to situations that did not involve corporate control of LLC assets. The loophole remained open because there were additional paper transactions that can be interposed between the corporation and the LLC in order to circumvent the attribution of the LLC's assets to the corporation. For example, control could be passed through a business trust.[16] The 2002 legislation apparently went too far because it extended the franchise tax to assets owned by individuals or entities over which the corporation has no control.

The 2003 Revenue Laws Study Committee recommended legislation to the 2003 legislative session to correct the LLC franchise tax loophole.[17] The proposal was introduced as Senate Bill 51. Each house passed a version of Senate Bill 51 but they were unable to resolve the differences between the two versions. After the 2003 session adjourned, the Revenue Laws Study Committee appointed a working group including the Department of Revenue, certified public accountants, and tax attorneys, which recommended a new approach that they thought would be effective, workable, and fair. During the 2004 Session, the recommendation was enacted as a conference committee substitute for the 2003 bill, Senate Bill 51.

This act closes the LLC franchise tax loophole by extending the franchise tax to all LLC assets the corporation controls through trusts and other entities. The Revenue Laws Study Committee determined that franchise tax is appropriate if a corporation controls assets owned by a related LLC, but not if the corporation gives up both control and ownership of the assets. By limiting the scope of the 2002 legislation to only those LLC assets the corporation controls, the act also has the effect of removing it from situations where it went too far. The act further limits the reach of the 2002 act by exempting small LLCs. These changes are retroactive to 2003.

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[16] A business trust is not considered a related member, as that term is defined in G.S. 105-130.7A, because it would be the corporation, not the shareholders, that would form the trust.

[17] The Department of Revenue, in its 2003 reports to the Revenue Laws Study Committee, noted that there exists a general franchise tax inequity because the imposition of the tax depends on the type of entity. The Governor's Commission to Modernize State Finances recommended that the State impose the franchise tax on all types of business entities, not just on traditional corporations. The Commission recommended that the revenues generated from this base broadening could be used to establish a minimum net worth threshold for payment of the tax.

The concept of control is determined by tracing ownership of the capital interests in the LLC's assets. A capital interest is the right to receive some or all of the assets under the LLC's governing law if the LLC were dissolved. Ownership of the capital interests in an LLC is traced, using the principles of constructive ownership, through any noncorporate entities. The chain of constructive ownership can run through layers of noncorporate entities but not through individuals. The franchise tax is payable by the corporation or affiliated group of corporations to which ownership of the capital interests is traced.

Ownership of capital interests in an LLC is determined as of the last day of the LLC's tax year. If an LLC and a corporation engage in a pattern of trading assets back and forth so that neither owns them on its respective trigger date, the determination must be made as of the last day of the corporation's tax year.

If the capital interests in an LLC are owned by an affiliated group of corporations, the value of the assets is allocated among the members of the group for franchise tax purposes so that there will not be double taxation of any assets. The allocation is in proportion to each affiliate's ownership interest.

The act exempts from the attribution rules those LLCs whose total assets do not exceed $150,000. Under the laws governing business entities, an LLC pays an annual report fee of $200 while corporations pay an annual report fee of $20. The approximate threshold at which there would be no tax advantage from transferring corporate assets to an LLC is $130,000.

The act also makes a number of other changes to the law. It reduces the threshold percentage of an LLC's assets that a corporation must control before the franchise tax is triggered. The current threshold is 70% or more but applies to a much broader realm of parties through whom ownership may be attributed. This act sets the threshold percentage at more than 50% beginning in 2005. The act also corrects the formula for tracing ownership to remove the 2002 law's potential effect of attributing 100% of an LLC's assets when the corporation controls less than 100%. Finally, the act removes membership in the LLC as an additional condition for attribution. That condition created a loophole and served no purpose.

Reduce Privilege and Excise Taxes.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-84	**HB 1303**	**Representative Starnes**

AN ACT TO REDUCE PRIVILEGE AND EXCISE TAXES.

OVERVIEW: This act reduces certain privilege and excise taxes as follows:

- It exempts two additional types of activities from the 3% privilege tax on amusements:
  - o A youth athletic contest with an admission price that does not exceed $10, with participating athletes younger than 20 years of age, and that is sponsored by a person exempt from income tax.

- All exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from income tax.
- It reduces the excise tax on cigarettes, other tobacco products, wine, beer, and spirituous liquor by allowing a 2% discount on the tax due.

FISCAL IMPACT: No exact fiscal estimate is possible with regard to the privilege license tax exemptions because the Department of Revenue cannot estimate how many organizations would be affected and is not certain that all potentially affected organizations have been paying the tax owed. The 2% excise tax discount results in a loss to the General Fund of $760,000 from tobacco products and $1.8 million from alcoholic beverages for fiscal year 2004-2005. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The section regarding the privilege license tax exemptions for certain amusements became effective July 1, 2004. The section allowing the excise tax discounts became effective for reporting periods beginning on or after August 1, 2004. The act was signed into law by the Governor on July 8, 2004.

ANALYSIS:

Privilege Tax Exemptions

The State levies a privilege tax at the rate of 3% on the gross receipts derived from amusements that a person gives, offers, or manages unless the amusement is exempted by statute.[18] G.S. 105-40 exempts several forms of amusements from the privilege tax, including local talent shows, elementary and secondary school athletic contests and dances, and certain arts and community festivals.

The act creates two new exemptions from the amusements tax. First, the act exempts a youth athletic contest with an admission price that does not exceed $10 and that is sponsored by a person exempt from income tax. Each participating athlete must be younger than 20 years of age. Second, the act exempts all exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from corporate income tax.. This exemption does not apply to athletic contests, but applies regardless of where the amusement is held, the amount of compensation paid to provide the amusement, or the amount of the receipts derived from the amusement. The amusement tax exemptions became effective July 1, 2004.

Excise Tax Reductions

Before August 1, 2003, distributors and wholesalers who timely paid the excise taxes on cigarettes, other tobacco products, wine, beer, and liquor were eligible for a discount equal to 4% of the tax due. In 2003, the General Assembly eliminated these discounts (S.L. 2003-284). This act reinstates the discounts, but at a rate of 2% of the tax due. The cigarette and tobacco discounts are 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. The discounts became effective for reporting periods beginning on or after August 1, 2004.

[18] The amusement tax was originally intended to piggyback the sales tax. The law taxed entertainment "at the rate of tax levied" by the sales tax statutes. In 1989, when the sales tax rate was 3%, the piggyback language was changed to a stated 3% rate. When the sales tax was increased from 3% to 4%, the amusement tax should have been increased as well, but due to oversight, the change was not made.

Emergency Funding/Continuing Provisions.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-88	**HB 1352**	**Representative Owens**

AN ACT TO PROVIDE EMERGENCY FUNDING FOR THE ONE NORTH CAROLINA FUND AND THE NEW AND EXPANDING INDUSTRY TRAINING PROGRAM, TO CODIFY PROVISIONS RELATED TO THE ONE NORTH CAROLINA FUND, TO APPROPRIATE FUNDS TO THE RURAL ECONOMIC DEVELOPMENT CENTER TO BE USED FOR ECONOMIC INFRASTRUCTURE, AND TO MAKE NECESSARY TRANSITIONAL ADJUSTMENTS TO THE STATE BUDGET.

OVERVIEW: The act establishes funding programs and makes appropriations as follows:

- Establishes the One North Carolina Fund as a special reserve fund, codifies the provisions related to the Fund, and appropriates $20 million to the Fund for the 2003-2004 fiscal year.
- Appropriates $4.1 million to the Community Colleges System for the 2003-2004 fiscal year for new and expanding industry training.
- Appropriates $20 million to the Rural Economic Development Center for the 2003-2004 fiscal year to:
  - Establish the North Carolina Infrastructure Program.
  - Provide matching grants to local governments in distressed areas and equity investments in public-private ventures that will reuse vacant buildings.
  - Provide research and demonstration grants.
- Appropriates $20 million to the Teachers' and State Employees' Retirement System Fund in the 2003-2004 fiscal year to partially pay back the debt owed to the Fund.

The remainder of the act sets out temporary year-end transitional provisions that were in effect until the passage of The Current Operations and Capital Improvements Appropriations Act of 2004.

FISCAL IMPACT: There are no finance provisions in this act. The appropriations in the act reduced the 2003-2004 end-of-year General Fund balance because they were made for the 2003-2004 fiscal year. Due to the late passage of the act, the appropriated moneys will be expended beginning in the 2004-2005 fiscal year. See the Analysis for further explanation of these appropriations.

EFFECTIVE DATE: The sections of the act dealing with the One North Carolina Fund, the New and Expanding Industry Training Program, the Rural Economic Center, and the Teachers' and State Employees' Retirement System Fund became effective June 30, 2004.

ANALYSIS:

One North Carolina Fund

Section 1 of the act appropriates $20 million in non-reverting funds to the One North Carolina Fund for the 2003-2004 fiscal year. The Department of Commerce may use up to $300,000 of this appropriation for administering the Fund and other economic development incentive grant programs during the 2004-2005 fiscal year. The act also expresses the intent of the General Assembly that there be an annual recurring appropriation of $10 million beginning in the 2006-2007 fiscal year. The codification of and appropriation to the One North Carolina Fund were proposed by the Joint Select committee on Economic Growth and Development, except that the Committee proposed appropriating $10 million to the Fund for the 2004 2005 fiscal year.[19]

The One North Carolina Fund was created in 1993 and was originally known as the Industrial Recruitment Competitive Fund. The Fund was established in order to provide a source of funding to be used by the Governor and the Department of Commerce in recruiting or retaining new and expanding businesses. Moneys in the Fund may be used only for the following purposes:

1. Installation or purchase of equipment.
2. Structural repairs, improvements, or renovations to existing building to be used for expansion.
3. Construction of or improvements to new or existing water, sewer, gas, or electric utility distribution lines or equipment for existing buildings.
4. Construction of or improvements to new or existing water, sewer, gas, or electric utility distribution lines or equipment for new or proposed buildings to be used for manufacturing and industrial operations.
5. Any other purposes specifically provided for by an act of the General Assembly.

Appropriations to the Fund have been sporadic since its inception in 1993. The Fund received a $5 million appropriation in 1993-1994 and a $7 million appropriation in 1994-1995. Over the next six fiscal years, the Fund received an appropriation of either $1 million or $2 million each year. For the 2001-2002 fiscal year, the General Assembly appropriated $15 million to the Fund. No appropriations to the Fund were made in the 2002-2003 or 2003-2004 fiscal years. Although the Fund was never set up as a non-reverting account, each year the General Assembly allowed the moneys remaining in the Fund to be carried over to the next fiscal year.

Moneys from the Fund are allocated only to local governments for use in connection with securing commitments for the recruitment, expansion, or retention of new and existing businesses. Over the years, the Department of Commerce has developed a set of guidelines relating to disbursements from the Fund. These guidelines include the following:

- Any disbursement of State funds must be matched by a local contribution. The local contribution can take the form of cash, fee waivers, in-kind services, donation of assets, provision of infrastructure, or a combination of these.
- Grants are made from the Fund only as certain performance goals are met, generally in four installments.

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[19] The Joint Select Committee on Economic Growth and Development is an interim committee consisting of 28 members appointed by the President Pro Tempore of the Senate and the Speakers of the House of Representatives. The Committee issued a report to the 2003 General Assembly and is to terminate upon the convening of the 2005 General Assembly.

- Funds are disbursed only in accordance with two separate agreements: a company performance agreement entered into by the grantee business and the local government, and a local government grant agreement entered into by the Department of Commerce and the local government.
- Receipt of a grant under the Fund generally requires job creation, but may be based on retention of existing jobs.
- Generally, jobs that are to be created or retained must meet the William S. Lee Act wage standard and provide health insurance.

The act codifies the One North Carolina Fund in the General Statutes as a special revenue fund in the Department of Commerce. Special revenue funds are non-reverting funds that are tracked differently for budgetary purposes. The act further codifies the purposes of the Fund as well as the existing guidelines regarding local match, job creation or retention, written agreements, disbursement only following performance, and purposes for which grants may be made. The wage standard and health insurance guidelines were not codified.

The act also provides that the Department of Commerce and the Governor's Office will develop program guidelines for the funds, as was done under prior law, and provides an exemption from the Administrative Procedure Act's rulemaking procedures in developing these guidelines. Guidelines that are in effect for the Fund when this act became law will continue in effect until the new guidelines are adopted.

The Department of Commerce must publish a report at the end of each fiscal quarter providing information on the commitment, disbursement, and use of funds allocated under the Fund. This report must be submitted to the Joint Legislative Commission on Governmental Operations, the House of Representatives and Senate Finance Committees and Appropriations Committees, and the Fiscal Research Division of the General Assembly.

New and Expanding Industry Training Program

Section 1 of the act appropriates $4.1 million in non-reverting funds to the Community Colleges System Office for the 2003-2004 fiscal year for new and expanding industry training. The New and Expanding Industry Training (NEIT) Program, started in 1958, supports the economic development efforts of the State by providing education and training opportunities for new and expanding businesses. Companies creating 12 or more production jobs in excess of their previous 3-year maximum employment level are eligible for assistance through the NEIT Program.

Rural Economic Development Center

Section 2 of the act appropriates $20 million to the Rural Economic Development Center for the 2003-2004 fiscal year to be allocated as follows:

- To establish the North Carolina Infrastructure Program. This Program will provide grants to local governments to construct critical water and wastewater facilities and to provide other infrastructure needs, including technology needs, to sites where these facilities will generate private job-creating investment. At least $15 million of the appropriated funds must be used to provide these grants. The Center must make annual reports of the Program's progress to the Joint Legislative Commission on Governmental Operations. The initial report is due no later than January 15, 2005. The Joint Select Committee on Economic

Growth and Development had proposed that $15 million be appropriated to the Center to establish the North Carolina Infrastructure Program for the 2004-2005 fiscal year.

- To provide matching grants to local governments in distressed areas and equity investments in public-private ventures that will productively reuse vacant buildings, with priority given to towns with a population of less than 5,000.
- To provide research and demonstration grants.

Teachers' and State Employees' Retirement System Fund

Section 3 of the act appropriates $20 million to the Teachers' and State Employees' Retirement System Fund for the 2003-2004 fiscal year to partially pay back the debt owed to this Fund. In the 2000-2001 fiscal year, the Governor took $130 million from this Fund to help cover the budget shortfall.

The remaining sections of the act make necessary transitional adjustments to the State Budget pending the passage of The Current Operations and Capital Improvements Appropriations Act of 2004.

IRC Update and Other Tax Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-110	**HB 1430**	**Representative Miner**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS, TO SET THE PUBLIC UTILITY AND INSURANCE REGULATORY FEES, TO EXTEND THE SUNSET ON THE LOW-INCOME HOUSING TAX CREDIT, TO CLARIFY THE SALES TAX INCENTIVES FOR MAJOR PROJECTS, TO MAINTAIN THE CURRENT SALES TAX RATES ON ELECTRICITY USED BY MANUFACTURERS, AND TO ESTABLISH FAMILY COURT FEES.

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part	*Description and Effective Dates*	*General Fund Impact*
1	**IRC Update** Changes the reference date to the Internal Revenue Code from June 1, 2003, to May 1, 2004. This part became effective when signed into law by the Governor on July 17, 2004. However, any amendments to the Internal Revenue Code enacted after June 1, 2003 that would have increased North Carolina taxable income for the 2003	**Military Family Tax Relief Act of 2003** $1.2 million loss in 2004-2005 700,000 annual loss thereafter **Medicare Prescription Drug, Improvement, and Modernization Act of 2003** $1.4 million loss in 2004-2005

Part	Description and Effective Dates	General Fund Impact
	taxable year are effective beginning with the 2004 taxable year.	$4.3 million loss in 2005-2006 **Pension Funding Equity Act of 2004** No Revenue Estimate Available
2	**Regulatory Fee for Utilities Commission** Sets the electric membership corporation regulatory fee at $200,000 and the percentage to be used in calculating the public utility regulatory fee at 0.12%. This part became effective July 1, 2004	$12.6 million gain in 2004-2005
3	**Insurance Regulatory Charge** Sets the percentage to be used in calculating the insurance regulatory charge at 5%. This part is effective for the 2004 calendar year.	$24.1 million gain in 2004-2005
4	**Extend Low-Income Housing Credit Sunset** Extends the Low-Income Housing Tax Credit Program from 2006 to 2010. This part became effective when signed into law by the Governor on July 17, 2004.	$18.6 million loss in 2007-2008 $37.5 million loss in 2008-2009 $38.7 million loss in 2009-2010 $40.4 million loss in 2010-2011 $20.7 million loss in 2011-2012
5	**Sales Tax Clarification** Clarifies that the sales tax refund for purchase of building materials on certain industrial projects applies only to materials purchased for initial construction. This part became effective July 1, 2004.	No fiscal impact.
6	**Maintain Current Sales Tax Rates on Electricity Used by Manufacturers** Repeals the graduated sales tax rate on electricity used by manufacturers and enacts a lower rate for electricity used in an aluminum smelting facility. This part becomes effective October 1, 2004.	**Repealing Graduated Rate** $9.6 million gain beginning with the 2005-2006 fiscal year. **Lower Rate for Aluminum Smelting Facilities** No estimate available, possible annual losses of $800,000.
7	**Family Court Fees** Allows the Administrative Office of the Courts to establish a fee of up to $30 for the use of supervised custody/exchange centers. This part became effective when signed into law	No estimate available

Part	Description and Effective Dates	General Fund Impact
	by the Governor on July 17, 2004.	

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)

ANALYSIS:

Part 1: IRC Update

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.[20] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[21] Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law tracks federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made. Under North Carolina law prior to the enactment of this act, the reference date to the Code was June 1, 2003. Part 1 of this act changes the reference date to May 1, 2004. Changing the reference date to May 1, 2004, incorporates federal changes made in the three following acts: the Military Family Tax Relief Act of 2003 (P.L. 108-121), the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173), and the Pension Funding Equity Act of 2004 (P.L. 108-218).

Military Family Tax Relief Act of 2003 (MFTRA), (P.L. 108-121). – The Military Family Tax Relief Act of 2003 made numerous changes to federal tax laws. These changes include the following:[22]

- Adoption of special rules regarding the exclusion of gain on sale of a principal residence by a member of the uniformed services or the Foreign Service, effective for sales occurring on or after May 6, 1997.[23]
- Exclusion from gross income of certain death gratuity payments.
- Exclusion from gross income of amounts received under the Department of Defense Homeowners Assistance Program
- Expansion of combat zone filing rules to contingency operations.

[20] North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

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

[22] A more detailed analysis of these provisions may be obtained from *Technical Explanation of H.R. 3365, The "Military Family Tax Relief Act of 2003," as Passed by the House of Representatives and the Senate*, Joint Committee on Taxation, November 7, 2003, JCX-99-03.

[23] The federal legislation provided a one-year period for taxpayers to file an amended return that would otherwise have been barred by the statute of limitations. That one-year period will end on November 11, 2004. This act allows a taxpayer an exception to the State statute of limitations as long as the taxpayer files the claim by the same date, November 11, 2004.

- Modification of veterans' organizations' membership requirements for tax-exempt status.
- Exclusion from gross income of Dependent Care Assistance Program payments to members of the uniformed services.
- Suspension of tax-exempt status of terrorist organizations.
- Above-the-line deduction of overnight travel expenses of National Guard and Reserve members.
- Extension of certain tax relief provisions to astronauts.

Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173). – The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) contained one significant tax provision. As part of that law, Congress created Health Savings Accounts (HSAs). The federal legislation allows a person to accumulate funds on a tax-preferred basis to pay for certain medical expenses. An employer, an eligible individual, or both may make contributions to the account. The earnings in the account grow tax-free. Employer contributions to an HSA are excludable from gross income and contributions by an eligible individual are deductible in computing adjusted gross income.

Distributions from an HSA for medical expenses are excludable from income, except for amounts distributed to pay most health insurance premiums. However, tax-free distributions from an HSA may be used to pay the following health insurance premiums: retiree health insurance premiums for individuals who have reached Medicare eligibility; premiums for COBRA coverage; premiums for qualified long-term care insurance contracts; and premiums for a health plan during a period in which an individual is receiving unemployment. Distributions from an HSA for non-medical expenses are includible in gross income.

Pension Funding Equity Act of 2004 (P.L. 108-218). – The Pension Funding Equity Act of 2004, signed by the President on April 10, 2004, made changes to the Internal Revenue Code and the Employee Retirement Income Security Act (ERISA). The federal legislation allows employers (both pension plan sponsors across the board as well as those in specifically targeted industries) to lower the amount of both their pension contributions and premiums paid to the Pension Benefit Guaranty Corporation (PBGC). By lowering the amount of required payments to pension plans and to the PBGC, the federal legislation could result in higher taxable income for the affected companies. The PBGC is the government agency that insures certain underfunded benefits in defined benefit plans. Underfunded single employer defined benefit plans, those plans that do not have sufficient assets to pay benefits if the plan were to terminate, provide the greatest risk to the PBGC. Sponsors of plans that are considered underfunded must make contributions to their plans in addition to paying variable-rate premiums to the PBGC based on the amount of underfunding. Pension plan benefits promised to employees remain the same. The federal legislation specifically provides the following temporary relief for many pension plans:

- For years 2004 and 2005, the federal legislation replaces the 30-year Treasury bond rate used to calculate employer's pension contributions and premiums paid to the PBGC with a long-term corporate bond rate. The 30–year Treasury bond, last issued in 2001, has had an historically low interest rate. A lower interest rate requires pension plans to make higher contributions because they are assuming a lower rate of return. The new rate is based on the four-year weighted average of high quality bond yields. Plans with funded current liabilities of less than 100%

must estimate quarterly payments for the plan year. Failure to make required payments subjects the employer to excise taxes. If a plan's assets are not sufficient to cover at least 90% of its current liability, it is subject to additional funding requirements. The federal legislation will allow more plans to meet the 90%-funded threshold and avoid additional contributions.

- The federal legislation provides deficit reduction contribution (DRC) relief to under-funded plans in the airline and steel industries and to the Transportation Communications Union plan. The DRC is a payment required from pension plans that are significantly underfunded. Plans that are less than 90% funded on a current liability basis generally are subject to an additional minimum funding requirement. A DRC payment is required in addition to the pension plan sponsor's normal annual contribution. The federal legislation allows plan sponsors that would normally be subject to DRC liability to reduce their payments by 80% for two years. During the two years of DRC relief, plan sponsors are precluded from increasing benefits for those two years except for benefit increases required by collective bargaining agreements and increases that will be paid for by increased contributions. Plan sponsors are required to notify plan participants that the sponsor has taken DRC relief within 30 days of filing that election, thereby putting the employees on notice that the plan sponsor is not fully funding the plan. Any plan that takes DRC relief must also report to the PBGC the amount of DRC contributions the sponsor was spared, how long it would take the company to become fully funded if only regular, required contributions were made, and how the amount by which the plan is underfunded compares with the capitalization of the company.

In addition, the federal legislation allows an eligible multi-employer plan to elect to defer amortization of up to 80% of the 2002 net experience losses for two plan years. Under previous law, if a multi-employer plan had a net experience loss for a plan year, the plan's funding standard account was charged with the amount needed to amortize the net experience loss over 15 years. The federal legislation defers funding of 80% of the 2002 actuarial loss for up to two years. It is expected that very few of the 1,600 plus multi-employer plans will meet the eligibility requirements for this relief.[24] If the eligible plan elects to defer charges attributable to its 2002 net experience loss, the plan must provide written notice of the election within 30 days to participants and beneficiaries, to each labor organization representing participants and beneficiaries, to each employer that has an obligation to contribute under the plan, and to the PBGC.

Part 2: Regulatory Fee for Utilities Commission

Part 2 of this act sets the rate for the public utility regulatory fee for the 2004-2005 fiscal year at 0.12%**.** The rate for 2003-2004 was the same. The rate for this fee must be set each year by the General Assembly. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on

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[24] Eligible multi-employer plans are those that experienced an investment loss of at least 10% of assets in the plan year beginning in 2002 and for which the negotiated contributions are expected to be insufficient to satisfy minimum funding requirements in a plan year beginning after June 30, 2003 and before July 1, 2006. Multi-employer plans are not subject to the DRC. Instead, employers paying into a multi-employer plan are subject to excise taxes if the multi-employer plan is not fully funded.

all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is derived from providing utility service in North Carolina.

In addition to funding the State's cost in regulating public utilities, the money in the Utilities Commission and Public Staff Fund is currently used to finance the work of the Study Commission on the Future of Electric Service in North Carolina. The General Assembly established the Commission in 1997 to examine the cost, adequacy, availability, and pricing of electric service in North Carolina to determine whether legislation is necessary to assure an adequate and reliable source of electricity and economical, fair, and equitable rates for all consumers of electricity in North Carolina. Section 14.10 of S.L. 2000-67, the Current Operations and Capital Improvements Appropriations Act of 2000, extended the life of the Study Commission and its funding from the Utilities Commission and Public Staff Fund through June 30, 2006.

Part 2 of this act also sets at $200,000 for the 2004-2005 fiscal year the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale**.** The new rate is the same as the rate in effect for the preceding three fiscal years. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations.

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

Part 3: Insurance Regulatory Charge

Part 3 of this act sets the insurance regulatory charge at 5% for the 2004 calendar year, the same as the rate set for the 2003 calendar year. The insurance regulatory charge was first enacted in 1991 to defray the State's cost of regulating the insurance industry. The charge is a percentage of each insurance company's gross premiums tax liability. The insurance regulatory charge is imposed on insurance companies that pay the gross premiums tax and, beginning in 2000, on health maintenance organizations and medical service corporations. Insurance companies and medical service corporations pay a 1.9% gross premium tax rate.[25] For health maintenance organizations, the charge is levied on each organization's

[25] The premium tax rate for medical service corporations was increased from 1% to 1.9%, effective January 1, 2004. (S.L. 2003-284)

hypothetical gross premiums tax liability determined at the 1.9% gross premiums tax rate applied to its premiums base. The hypothetical calculation is necessary because health maintenance organizations pay premiums tax at the lower rate of 1%.

Part 4: Extend Low-Income Housing Credit Sunset

Part 4 of this act extends the sunset on the low-income housing tax credit from January 1, 2006, until January 1, 2010. Developers of low-income housing begin their work months in advance and need to know what financing will be available as they secure options on sites. This act also makes a technical correction to the credit by replacing the term 'eligible basis' with the term 'qualified basis'.

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

In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit. To benefit from the credit, a project developer had to sell the tax credits to receive funds to finance the project; developers indicated that the State tax credit sold for no more than 45 cents on the dollar. In 2002, the General Assembly changed the State credit so that a taxpayer may elect to receive the credit in the form of either a credit against tax liability or a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount.[26] Neither a tax refund generated by the credit nor a loan received as a result of the transfer of the credit is considered taxable income by the State. Although a State tax refund would be considered taxable income by the IRS if the taxpayer itemizes deductions, a private letter ruling from the IRS provides that the loan proceeds would not.

The purpose of the 2002 changes was to promote efficiency and cost savings. The modified credit eliminated the need to sell the credit and ensured that each State dollar dedicated for low-income housing is used to develop that housing. It is saving the State revenue over a five-year period while maintaining the same level of investment in low-income housing developments.[27] The innovative approach adopted by the General Assembly in 2002 has received a national award. The HFA found that in 2003 the percentage of federal credits used to develop projects in rural counties rose from about 25% to about 50% and it found that all urban projects have some units affordable to families below 30% of the median income for the area. The HFA also notes that the federal credits have become attractive to more purchasers since the buyer does not need to also purchase a state credit. The resulting higher prices for federal credits increase the amount affordable housing for North Carolina.

Part 5: Sales Tax Clarification

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

[27] From 2000 to 2002, the State housing credit leveraged $420 million of rental development. A total of 120 projects with 5,900 units were awarded $140 million of State housing credits for an average of $24,000 per unit in State investment. In 2003, the credit leveraged $197 million of rental development. A total of 49 projects with 2,336 units were awarded $33.2 million of State housing credit for an average of $14,200 per unit of State investment.

During the 2nd Extra Session of 2003[28] the General Assembly created an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

The refund became effective for sales taxes paid on or after January 1, 2004. The taxpayer must apply for the refund within six months after the end of the State's fiscal year. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

Part 5 of this act clarifies that the sales tax refund is allowed only for materials and fixtures purchased during the initial construction of the facility and not for purchases made for subsequent repairs, renovation, or equipment replacement.

Part 6: Maintain Current Sales Tax on Electricity Used by Manufacturers

Generally, electricity that is sold to a manufacturer for use at a manufacturing facility and is separately metered or measured is subject to the sales and use tax at a rate of 2.83%. Most other sales of electricity are taxed at the rate of 3%. In 2001, the General Assembly reduced to 0.17% the sales tax rate on electricity sold to manufacturers that use more than 900,000 megawatt-hours of electricity annually, effective January 1, 2002.[29] As part of the 2001 legislation, the General Assembly also established a rate schedule that would reduce the sales tax on electricity sold to manufacturers who use more than 5,000 megawatt-hours annually but less than 900,000, effective July 1, 2005.[30]

Part 6 of this act repeals the 2001 legislation, effective October 1, 2004. The taxation of electricity used by manufacturers will remain at the rate of 2.83%. At the time this act was enacted, there were no manufacturers in the State that used a volume of electricity annually to qualify for the 0.17% rate.[31] This part also provides that electricity sold to an aluminum smelting facility for use in connection with the operation of that facility and measured by a separate meter or measuring device would be taxable at 0.17%. The provision establishing the lower rate for an aluminum smelting facility sunsets for sales made on or after October 1, 2007. At this time this act was enacted, the State did not have an aluminum smelting facility. Aluminum smelting facilities use a high volume of electricity and would have been eligible for the former 0.17% rate repealed by this part. Thus, the retention of a lower sales tax rate for an additional three years encourages the operation of such a facility in North Carolina.

Part 7: Family Court Fees

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[28] S.L. 2003-435.

[29] S.L. 2001-476, as amended by S.L. 2001-487

[30]

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

[31] The only manufacturer that used this volume of electricity at the time the General Assembly changed the law in 2001 was the aluminum manufacturer, Alcoa.

Part 7 of this act authorizes the Administrative Office of the Courts (AOC) to charge a fee to persons receiving services of a supervised visitation and exchange center through a family court program. These centers provide a safe pick-up and drop-off place for custody exchanges between estranged parents. There are only a few of these centers in North Carolina. Before the enactment of this act, the programs were funded by federal Violence Against Women Act funds. With that funding, the centers were able to serve only families with a history of domestic violence. This act will allow some centers to broaden their reach to serve other clients involved with custody issues.

The fee may not exceed $30 per hour and the Director of the AOC may establish a procedure for a person to apply for a reduction in the fee, based upon the person's ability to pay as a result of indigence, status as a victim of domestic violence, or other circumstances. The fee revenue will be used to support the continued operation of these centers. The use of the services is permissive.

2004 Appropriations Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-124	**HB 1414**	**Rep. Sherrill, Crawford**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL APPROPRIATIONS ACT OF 2003 AND TO MAKE OTHER CHANGES IN THE BUDGET OPERATIONS OF THE STATE.

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part	*Description and Effective Dates*	*Fiscal Impact*
32B	**Sales Tax Refunds and Exemptions** **Refunds –** Expands the refund of State and local sales and use taxes paid on construction materials and fixtures for certain industrial facilities in three ways: • Reduces from $100 million to $50 million the required investment amount for refund eligibility if the facility is located in a tier one, two, or three area, effective January 1, 2004. • Expands the list of eligible industries to include manufacturing of aircraft, computers, motor vehicles, and semiconductors, effective July 1, 2004, until July 1,	**Refunds** – The expansion of this refund will reduce General Fund revenues by $2.4 million in FY 2004-05 and by $4.6 in FY 2005-06.

Part	Description and Effective Dates	Fiscal Impact
	2009. • Clarifies what items are eligible for the sales and use tax refund, effective October 1, 2004. **Exemptions** – Exempts the following items from the sales and use tax. Except as otherwise noted, each exemption is effective October 1, 2004. (1) Tangible personal property sold to interstate air business that becomes component part or is dispensed into commercial aircraft. (2) Plastic mulch and plant bed covers sold to a farmer for agricultural purposes. (3) Delivery charges for direct mail. (4) Sales to a professional land surveyor of tangible personal property on which custom aerial data is stored. (5) Free distribution periodicals, effective July 1, 2005.	**Exemptions** - (1) FY 2004-05: -$2 million FY 2005-06: -$2.7 million (2) FY 2004-05: -$400,000 FY 2005-06: -$500,000 (3) FY 2004-05: -$300,000 FY 2005-06: -$400,000 (4) FY 2004-05: -$100,000 FY 2005-06: -$100,000 (5) FY 2005-06: -$4.6 million The total loss to the General Fund for these sales tax refunds and exemptions will be $4.7 million in FY 2004-05 and $7.4 million in FY 2005-06.
32C	**Qualified Business Investment Credit** Increases from $6 to $7 million the total amount of all qualified business investment credits that may be taken each year and extends the sunset on the credit from 2007 to 2008. Effective for investments made on or after January 1, 2004.	There is no fiscal impact in FY 2004-05, but the change will reduce General Fund revenues by $1 million in FY 2005-06.
32D	**Research and Development Tax Credit** Creates a new research and development tax credit as an alternative to the Bill Lee R&D credit. Effective May 1, 2005 and sunsets in 2009.	This new credit will reduce General Fund revenues as follows: FY 2004-05: $4.5 million FY 2005-06: $18.5 million FY 2006-07: $22 million FY 2007-08: $23.4 million FY 2008-09: $24.7 million

Part	*Description and Effective Dates*	*Fiscal Impact*
32F	**Insurable Interest of Charitable Organizations** Deems certain entities that are formed, in part, for the purpose of generating funds for charitable organizations to have an insurable interest in an individual's life and allows those entities to invest in pools of life insurance, as long as at least part of the proceeds is directed to charitable organizations. Effective July 20, 2004 and sunsets October 1, 2007.	No fiscal information available.
32G	**Job Development Investment Grant Program** • Extends from 2005 to 2006 the sunset of the Job Development Investment Grant (JDIG) Program. • Increases from 15 to 25 the number of agreements that the Economic Investment Committee (EIC) may enter into each year, effective July 20, 2004. • Increases from $10 million to $15 million the maximum annual availability that the EIC may commit under the program, effective January 1, 2004. • Makes various administrative changes such as clarifying that the JDIG agreements are binding, changing the date and required contents of annual reports, and requiring that agreements include a provision encouraging the use of small businesses headquartered in North Carolina. Except for the clarification that the agreements are binding, which is retroactive to October 1, 2002, these changes became effective July 20, 2004.	The expected reduction in General Fund revenues is $500,000 for FY 2004-05 and approximately $20 million in FY 2005-06.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)

ANALYSIS:

Part 32B: Sales Tax Refunds and Exemptions

During the 2003 2nd Extra Session, the General Assembly created an annual refund of State and local sales taxes paid on construction materials and fixtures for facilities that involve the investment of more than $100 million by the taxpayer and are primarily used for either of the following two industries:

- Bioprocessing
- Pharmaceutical and Medicine Manufacturing and the Distribution of Pharmaceuticals and Medicines.

The taxpayer must apply for the sales tax refund within six months after the end of the State's fiscal year. The refund became effective for sales taxes paid on or after January 1, 2004. If, after obtaining a refund, the taxpayer does not end up investing the required amount, the taxpayer forfeits the refund.

Section 32B.1 of this act expands that refund in three ways. First, if the facility is located in an enterprise tier one, two, or three area, a taxpayer is eligible for the refund if the taxpayer had an investment of at least $50 million in the facility rather than $100 million as was required under the 2003 law. This change is effective for sales occurring on or after January 1, 2004. Second, this act expands the list of eligible industries to include aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, and semiconductor manufacturing, effective July 1, 2004, and sunset effective July 1, 2009. Third, the act makes some clarifying changes regarding what items are eligible for the sales tax refund, effective January 1, 2004.

Part 32B of this act also contains numerous sales and use tax exemptions. This act exempts the following things from the sales and use tax effective October 1, 2004:

- Tangible personal property that is sold to an interstate air business and becomes a component part of or is dispensed as a lubricant into commercial aircraft during its maintenance, repair, or overhaul. This exemption supplements an existing sales tax exemption for sales of aircraft lubricants, aircraft repair parts, and aircraft accessories to an interstate air courier or a passenger air carrier for use at the courier's or carrier's hub. The new exemption is broader in that it (1) eliminates the requirement that the items be for use at a hub, (2) allows the exemption for sales to an interstate freight carrier, and (3) expands the types of property that are exempt. The new exemption is narrower in that it is limited to items related to commercial aircraft, which are large aircraft regularly used for carrying for compensation passengers, freight, or packages and letters.
- Plastic mulch and plant bed covers that are sold to a farmer for agricultural purposes.
- Delivery charges for delivery of direct mail if those charges are separately stated. Delivery charges, including postage, are taxable in North Carolina.[32] "Delivery charges" are those charges imposed by the retailer for preparation and delivery of

[32] At least one state Supreme Court has found that the United States Constitution prohibits the taxation of pass-through postage charges on catalogs and fliers mailed by a retailer (*H.J. Wilson Co. Inc. v. Mississippi State Tax Commission*). The court held that postage is an obligation of the federal government and that the state is constitutionally prohibited from taxing postage charges.

personal property services to a location designated by the consumer. The proposed exemption is not required by the Streamlined Sales Tax Agreement for compliance, but is a permissible exemption. Before 2002, delivery charges were not taxable for in-state transactions subject to sales tax where the title to the property passed at the point of origin. Under the Streamlined Agreement, all delivery charges are included in the sales price of an item and therefore subject to tax. In order to conform to the Agreement, the General Assembly removed the sales tax exemption for delivery charges on in-state transactions, effective January 1, 2002.

- Sales to a professional land surveyor of tangible personal property on which custom aerial data is stored in digital form or is depicted in graphic form.

Section 32B.4 exempts certain free distribution periodicals from sales tax effective July 1, 2005. To qualify for the exemption, the periodical must be a publication that is published on a periodic basis at recurring intervals monthly or more frequently, is free, and is distributed in any manner other than by mail.

Under current law, supplies (paper, ink, and other tangible personal property) sold for free publications are subject to sales and use tax. Before October 1, 1999, a sales tax exemption was given for sales of paper, ink, and other tangible personal property to commercial printers and publishers for use as component parts in free circulation publications that contained advertising of a general nature. The exemption applied to general shoppers guides, but not to more specialized guides, such as real estate guides, because the statute specifically required that the free circulation publication contain advertising of a general nature. The exemption was repealed because it was believed to be unconstitutional. The first amendment of the United States Constitution generally does not allow a state to discriminate between publications based on content. A 1987 U.S. Supreme Court decision held that a similar tax provision was unconstitutional.[33]

Part 32C: Qualified Business Investment Credit

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture, a qualified grantee business, or a qualified licensee business directly from that business. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by "pass-through entities" of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer files an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years.

The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed a maximum amount set in the statute. Part 32C of this act increases the maximum amount from $6 million to $7 million. The Secretary of Revenue calculates the

[33] In *Arkansas Writer's Project, Inc. v. Ragland*, 481 US 221, the United States Supreme Court invalidated an Arkansas sales tax scheme that taxed general interest magazines but exempted single topic printed material. The North Carolina tax exemption operated in the opposite manner: it taxed component parts used in single topic advertising publications but exempted component parts used in advertising publications that contained advertising of a general nature. Constitutionally, these distinctions appear meaningless.

total amount of tax credits claimed from applications filed. If the amount exceeds the maximum, then the Secretary allows a portion of the tax credits claimed by allocating the statutory maximum amount in tax credits in proportion to the size of the credit claimed by each taxpayer.

The credit was set to expire as of January 1, 2007. Part 32C of this act extends one year, until January 1, 2008.

Part 32D: Research and Development Tax Credit

Part 32D of this act creates a new research and development tax credit as an alternative to the Bill Lee research and development credit, which is set to expire along with the entire Bill Lee Act as of January 1, 2006. A taxpayer is not be allowed to take both the new credit and the Bill Lee Act credit for the same activity.

The Bill Lee research and development tax credit uses the federal credit for research and development as its starting point. In order to be eligible for the research and development credit under the Bill Lee Act, a taxpayer must meet all of the general eligibility requirements of that Act. These include satisfying requirements related to employee wages, the principal activity of the establishment, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, the taxpayer's environmental record, and the absence of overdue tax debts. Under the Bill Lee Act, the research and development credit may be applied against the income tax, the franchise tax, or the gross premiums tax. The amount of credit taken in a particular year may not exceed 50% of the liability for the tax against which it is claimed and any excess may be carried forward for 15 years.

The alternative credit created in this part, which becomes effective for expenses on or after May 1, 2005, differs from the research and development credit allowed under the Bill Lee Act in the following ways:

- Bill Lee limitations on the principal activity of the establishment at which the research and development is conducted do not apply. This change will make more taxpayers eligible for the new credit for research and development expenditures than for the existing Bill Lee Act credit.
- The taxpayer is not required to have no overdue tax debts. The taxpayer must still satisfy Bill Lee Act requirements related to employee wages, the principal activity of the establishment, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, and the taxpayer's environmental record.
- In the case of research and development conducted in North Carolina by a research university, the new credit is 15% of the amount the taxpayer paid to the university for the research and development.
- For other research and development, the new credit is based on North Carolina research and development expenditures rather than on an apportioned share of nationwide increases in expenditures. The rate is determined as follows:
    - For small businesses, the rate is 3%.
    - For research and development conducted in enterprise tiers one, two, or three, the rate is 3%.
    - For other research and development expenditures, the rate ranges from 1% to 3% as the amount of those expenditures increases.

- The new credit will sunset with the 2009 taxable year, rather than with the 2006 taxable year.

This part specifically sunsets the existing Bill Lee research and development credit January 1, 2006. Although the entire Bill Lee Act is set to sunset January 1, 2006, if that date is extended, this part provides that the Bill Lee Act research and development credit will nonetheless be repealed, allowing only one year of overlap with the new credit.

This part requires the Department of Revenue to make annual reports regarding the new credit to the Revenue Laws Study Committee and the Fiscal Research Division.

Part 32F: Insurable Interest of Charitable Organizations

In general, one must have an insurable interest in the life of another in order to purchase a life insurance contract on the life of that person. An "insurable interest" is a reasonable expectation of pecuniary benefit from the continued life of another. The concept of insurable interest has been developed, in part, in response to public policy concerns about wagering on the life or well-being of strangers or mere acquaintances. Under North Carolina law, an organization described in section 501(c)(3) of the Internal Revenue Code may have an insurable interest in an individual if that individual consents to the purchase or assignment of life insurance proceeds to that organization. This conclusion is supported by the argument that a charity could face a significant loss of revenue at the time of death of a key donor.

Part 32F of this act deems certain entities to have an insurable interest in an individual's life. In order to be deemed to have an insurable interest in an individual's life, an entity must satisfy all of the following conditions:

- The entity is a trust, business trust, corporation, limited liability company, or similar entity that is approved in writing by the individual as the beneficiary and owner of a life insurance policy and annuity contract on the life of the insured.
- The entity is formed for the purpose, in part, of generating funds for one or more charitable organizations described in section 501(c)(3) of the Internal Revenue Code.
- The payments to the entity under the annuity contract must be reasonably anticipated to fund the premiums on the life insurance policy beginning with the second year.
- Either each benefited charitable organization provides an affidavit to the entity stating that it has been in existence for at least three years and has at least $5 million in assets or the insured provides an affidavit to the entity stating that he or she is an accredited investor.
- The insured has provided an affidavit to the entity that neither the insured, a relative, or an entity controlled by the insured or a relative has received any monetary remuneration in connection with the consent to purchase the life insurance policy and annuity contract.
- Prior to the ownership or purchase of the life insurance policy and annuity contract, each benefited charitable organization is provided a written description of the minimum percentage or amount of the life insurance proceeds that is reasonably anticipated to be paid to the organization.

In essence, this change allows individual and institutional investors the opportunity to invest in pools of life insurance, as long as at least a portion of the proceeds is to be directed to charitable organizations. The provision will expire on October 1, 2007.

Supporters of this type of arrangement have argued that it provides a low cost, or no cost, way of directing current or future income to charitable organizations. Opponents of this type of arrangement have argued that it could pose a threat to the stability of the life insurance industry, that it is against public policy in that it promotes wagering on human life, and that the arrangement may harm individuals in that they may later be unable to obtain enough life insurance to meet their own personal needs.

Part 32G: Job Development Investment Grant Program

Part 32G of this act extends the sunset of the Job Development Investment Grant (JDIG) Program and allows the Economic Investment Committee to enter into more agreements and commit more funds under the program. It also clarifies that the JDIG agreements are binding, adds a requirement for an additional provision in each agreement, makes two technical corrections, and changes the date and required contents of annual reports.

The JDIG Program is an economic development incentive program that was created by the General Assembly in 2002. Under the program, grantee businesses are given a grant paid for a period of up to 12 years. The grant is based on a percentage of personal income tax withholdings from new positions created by the grantee business.

When the JDIG Program was created in 2002, the General Assembly put some significant limitations on the program in order to give the General Assembly time to evaluate it before a significant amount of funds had been committed. First, the General Assembly put a sunset on the ability of the Economic Investment Committee (EIC) to enter into new agreements under the program. The authority of the EIC to enter into new agreements did not begin until January 1, 2003, and was set to expire January 1, 2005. Second, the EIC could enter into no more than 15 new agreements each year. Third, the maximum annual liability for agreements entered into during any calendar year could not exceed $10 million.

Part 32G eases these three restrictions. First, the act extends the authority of the EIC to enter into new agreements by one year – until January 1, 2006. Second, the EIC is allowed to enter into a maximum of 25 new agreements a year rather than 15. Third, the cap on the maximum annual liability from grants entered into during any particular year is increased from $10 million to $15 million. These changes became effective July 20, 2004, when the bill was signed into law by the Governor.

In addition, this part makes several administrative changes requested by the Department of Commerce. It changes the date upon which reports under the program are due from the grantee business and the requirement that the grantee business submit a copy of its State and federal returns each year. The reporting date is changed from February 1 to March 1. The grantee business is required to submit a copy of its State and federal tax returns only upon request of the EIC. The Department of Commerce has found that the federal and State tax returns provide little information that is directly relevant to the administration of the program. In addition, some grantee businesses have reported that their tax returns, particularly federal tax returns, are extremely voluminous. The Department felt that in most cases this requirement would be a burden on both the grantee business and the EIC and that it would yield little, if any, relevant information.

This part makes two technical corrections to the way employment is measured. In addition, it clarifies that commitments made under the JDIG program are binding commitments of the State and are not subject to annual appropriations.

This part requires each community economic development agreement to include a provision encouraging the business to contract with small businesses headquartered in North Carolina. The 2002 law already required agreements to contain several provisions encouraging, but not requiring, grantee businesses to act in certain ways. This provision expresses the desire of the State that the grantee businesses contract with local small businesses. This provision was a recommendation of the Joint Select Committee on Small Business Economic Development.

This part also contains language expressing the intent of the General Assembly that the EIC should give priority consideration for grants to projects located in less prosperous parts of the State. Finally, the part directs the chairs of the House and Senate Finance Committees to conduct a comprehensive, systematic study of the JDIG program and to report by April 1, 2005.

Modify Youth Facility Debt Authorization.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-126	**HB 1795**	**Representative Luebke**

AN ACT TO MODIFY THE AUTHORIZATION FOR SPECIAL INDEBTEDNESS FOR YOUTH DEVELOPMENT CENTERS.

OVERVIEW: This act modifies the 2003 authorization[34] for special indebtedness for youth development centers to reflect the changes in the project's scope and reduces the amount authorized from $6,780,000 to $4,460,000.

FISCAL IMPACT: The act generates General Fund savings because it reduces the debt amount authorized in 2003 by $2,320,000. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when it was signed into law by the Governor on July 22, 2004.

ANALYSIS: Section 46A.2 of the 2003 Budget Act authorized issuance of up to $6,780,000 in special indebtedness[35] for the cost of design, construction drawings, and administrative funds for solicitation of bids for up to three new juvenile Youth Development Centers and up to 500 beds and for utility work and site preparation for one of the three centers. The Department of Juvenile Justice and Delinquency Prevention (DJJDP) began preliminary planning using funds on hand soon after the 2003 Session. This planning process resulted in a consensus finding of DJJDP and its Advisory Council that the State should build smaller facilities located closer to a juvenile's family and local services. In 2004, DJJDP changed its recommendation to construction of up to 512 beds at up to 13 facilities.

[34] Section 46A.2 of S.L. 2003-284, the 2003 Budget Act.

[35] See the summary for S.L. 2004-179 for an explanation of special indebtedness.

The debt authorized in 2003 had not been issued when the 2004 Regular Session convened because DJJDP used internal funds to complete its preliminary planning. The Department of the State Treasurer and the State Bond Counsel indicated that before debt could be issued to continue the planning process, the language in the 2003 provision would have to be modified to reflect any expansion in project scope. This act makes those modifications by expanding the maximum number of facilities from 3 to 13 and the maximum number of beds from 500 to 512.[36]

This act does not authorize any new debt. It reauthorizes the same type of debt but at a lower amount due to the change in project scope and schedule. The act reduces the amount authorized from $6,780,000 to $4,460,000. The act restricts the use of these funds to design, construction drawings, and bid solicitation, repealing the original authorization for utility infrastructure and site work for one of the centers.[37] The reduced amount of $4,460,000 is the actual amount needed to complete all planning and design steps prior to starting construction according to the State Construction Office.

Eliminate IRB Wage Standard.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-132	**SB 1063**	**Senator Hartsell**

AN ACT TO ELIMINATE THE WAGE STANDARD FOR INDUSTRIAL REVENUE BONDS.

OVERVIEW: This act eliminates the wage standard for industrial revenue bonds and directs the North Carolina Department of Commerce to encourage projects applying for these bonds to locate the projects in development zones. The Act was recommended by the Joint Select Committee on Economic Growth and Development.

FISCAL IMPACT: The Department of Commerce believes that the impact of the additional financing on State personal income tax collections (from the tax-exempt interest) will be insignificant, because practically all of the industrial revenue bonds are purchased by large nationwide mutual funds. Consequently, the share of the new projects held in mutual funds by North Carolina residents will be small.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 29, 2004.

ANALYSIS: Industrial revenue bonds offer manufacturing companies long-term debt financing at interest rates substantially below the prime rate. Under the industrial revenue bond program in North Carolina, a local financing authority may enter into a financing agreement to provide revenue bond proceeds to a company engaged in some manner of

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[36] Section 16.3 of S.L. 2004-124, the 2004 Budget Act, outlines the type of planning and design information that DJJDP is required to submit to various committees before starting construction.

[37] The General Assembly determined that the cost of site work and infrastructure should not be authorized at the planning stage; it felt these costs should be included as part of construction costs. In S.L. 2004-179, the General Assembly authorized $35 million of special indebtedness for the construction of up to five youth development centers totaling up to 224 beds.

manufacturing to be used only to finance capital expenditures such as fixed assets, land, buildings, new equipment, existing equipment, architects and engineer's fees, and issuance costs. The amounts payable by the company to the authority under the financing agreement must be sufficient to pay all of the principal and interest on the bonds. The bonds are tax-exempt, and do not constitute a debt of the State.

Prior to this act, the manufacturing company for whom the bonds were to be issued was required to pay an average weekly manufacturing wage that was either above the average weekly manufacturing wage in the county or was at least 10% above the average weekly wage in the State.[38] Upon the recommendation of the Joint Select Committee on Economic Growth and Development, the act eliminates this wage standard for industrial revenue bonds.[39] Several local economic developers, as well as the North Carolina Department of Commerce, recommended this change to the Joint Select Committee. Manufacturers and economic developers reported that it is often difficult to meet the wage standard because the companies that can most benefit from industrial revenue bond financing are often those in manufacturing sectors that pay lower wages than manufacturers as a whole. The Joint Select Committee believed that the removal of the wage standard from the industrial revenue bonds would help support small and medium-sized manufacturing companies that need to retool to remain competitive in the global market.

The act also directs the North Carolina Department of Commerce to encourage projects applying for industrial revenue bonds to locate the projects in development zones. Development zones are economically distressed areas located within cities.

Delays $ Limit on Credit for Partnerships.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-134	**HB 1602**	**Representative McComas**

AN ACT TO DELAY THE IMPOSITION ON PARTNERSHIPS OF THE DOLLAR AMOUNT LIMITATION ON THE CREDIT ALLOWED FOR REAL PROPERTY DONATIONS.

OVERVIEW: This act was a recommendation of the Environmental Review Commission. It postpones from 2005 until 2006 the imposition on partnerships and limited liability companies of the dollar amount limitation on the credit allowed for real property donations and provides that the Revenue Laws Study Committee should study the credit.

FISCAL IMPACT: Assuming 20 donations per year, this act would result in a General Fund revenue loss of approximately $3.7 million annually. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

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[38] The William S. Lee Quality Jobs and Business Expansion Act also requires certain taxpayers to meet a wage standard to be eligible for the credits under the Act. A taxpayer located in enterprise tiers three through five must pay at least 110% of the applicable weekly wage to be eligible for a credit.

[39] The Joint Select Committee on Economic Growth and Development is an interim committee consisting of 28 members appointed by the President Pro Tempore of the Senate and the Speakers of the House of Representatives. The Committee issued a report to the 2003 General Assembly and is to terminate upon the convening of the 2005 General Assembly.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 29, 2004.

ANALYSIS: The income tax credits in G.S. 105-151.12 and G.S. 105-130.34 are allowed to individual and corporate taxpayers who make a qualified donation of an interest in North Carolina real property that is useful for conservation purposes. The tax credit is equal to 25% of the fair market value of the property donated to the State, a local government, or an entity that is both organized to receive and administer lands for conservation purposes and qualified to receive tax deductible charitable contributions. The credit for a corporation may not exceed $500,000. The credit for an individual may not exceed $250,000. Both corporate and individual taxpayers are allowed to carry forward for five years any unused portion of the credit.

In S.L. 2001-335, the General Assembly corrected and clarified the law governing allocation of partnerships' tax credits, so that any dollar amount limitation on a credit applies to the total credit allowed to a partnership. The limited amount is then allocated by the partnership among the partners on a proportional basis. Before this change, the limit applied separately to each partner. The 2001 act delayed this dollar amount limitation until 2005 for partnerships that are allowed a credit for real property donations. This act postpones for one more year the imposition of the dollar amount limitation on partners taking this credit. As a result, the maximum dollar amount limits on this credit will continue to apply separately to each partner until 2006.

This act also authorizes the Revenue Laws Study Committee to study the credit and report its findings to the 2005 General Assembly by February 1, 2005.

N.C. Vineyard Amendments.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-135	**SB 74**	**Senator Rand**

AN ACT CONCERNING WINERY PERMITS.

OVERVIEW: This act redefines the terms "fortified wine" and "unfortified wine" and provides that ABC stores may continue to sell those wine products that met the definition of "fortified wine" before the change. This act also allows unfortified wineries to receive and sell wine produced under contract with the winery and allows those wineries to sell the contract wine at affiliated retail outlets.

FISCAL IMPACT: No estimate available. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act becomes effective October 1, 2004

ANALYSIS: Under North Carolina law before the enactment of this act, "unfortified wine" was defined as a wine that has an alcoholic content produced only by natural fermentation or by the addition of pure cane, beet, or dextrose sugar. "Fortified wine" was defined as any wine made by fermentation from grapes, fruits, berries, rice, or honey, to which nothing had been added other than pure brandy made from the same type of grape, fruit, berry, rice, or honey that is contained in the base wine, and which had an alcoholic content of not more

than 24% alcohol by volume. The law made no distinction between unfortified wine and fortified wine on the basis of alcoholic content. This act changes the definitions of "unfortified wine" and "fortified wine" so that the distinction between the two is based solely on alcoholic content. Under this act, both unfortified wine and fortified wine are defined as any wine made by fermentation from grapes, fruit, berries, rice, or honey regardless of whether pure cane, beet, or dextrose sugar is added and regardless of whether pure brandy from the same type of grape, fruit, berry, rice or honey is added. Under the new definitions, the distinguishing feature between fortified and unfortified wine is the alcoholic content. Unfortified wine has an alcoholic content of less than 16% whereas fortified wine has an alcoholic content of between 16% and 24%. A wine that has an alcoholic content in excess of 24% continues to be classified as a spirituous liquor.

In North Carolina, unfortified wine is taxed at a rate of 21 cents per liter whereas fortified wine is taxed at a rate of 24 cents per liter. This act will change the classification of some products, resulting in a different rate of tax being imposed on those products.

Under North Carolina law before the enactment of this act, ABC stores were allowed to sell fortified wine in addition to spirituous liquor. This act contains a savings clause that allows ABC stores to continue to carry products that were classified as fortified wine by the ABC Commission prior to July 7, 2004, regardless of whether the products would have a sufficient alcoholic content to meet the new standard for fortified wine.

This act also allows the holder of an unfortified winery permit to receive and sell at the winery and at certain affiliated retail outlets unfortified wine produced under contract with the winery. The winery must also make this wine available to wholesalers. In general, the holder of an unfortified winery permit may manufacture unfortified wine and may sell, deliver, and ship the wine in closed containers to licensed wholesalers. The winery is allowed to make retail sales of wine "owned" by the winery if it obtains the appropriate permits. This act expands the class of wine that a winery may own and sell at retail and wholesale. Before the enactment of this act, under limited circumstances, the winery could also receive and sell at wholesale unfortified wine produced under the winery's label outside North Carolina from fruits owned by the winery.

Finally, this act restricts the ability of a holder of an unfortified winery permit to obtain a wine wholesaler permit. Under North Carolina law prior to the enactment of this act, the holder of an unfortified winery permit could obtain a wine wholesaler permit when that permittee had annual sales of less than 300,000 gallons of wine manufactured by it at the winery to people other than exporters or nonresident wholesalers. This act tightens that restriction by allowing a wine wholesaler permit only to those permittees that have annual sales of less than 100,000 gallons of wine manufactured by it at the winery to people other than exporters or nonresident wholesalers.

Renewable Fuel Tax Credits.

Session Law	Bill #	Sponsor
S.L. 2004-153	HB 1636	Representative Tolson

AN ACT TO PROVIDE TAX CREDITS FOR DISPENSING AND PROCESSING RENEWABLE FUELS.

OVERVIEW: This act creates two new income or franchise tax credits for constructing renewable fuel facilities effective beginning in 2005: a 15% credit for a facility to dispense renewable fuel and a 25% credit for a facility to produce renewable fuel. Renewable fuel is defined as biodiesel or ethanol.

FISCAL IMPACT: Not determinable. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2005.

ANALYSIS: Article 3B of Chapter 105 of the General Statutes allows an income or franchise tax credit of 35% of the cost of constructing or purchasing renewable energy property, up to $250,000 per installation for non-residential property. Renewable energy property may include equipment for producing biodiesel or ethanol.

This act adds two new credits to Article 3B, a 15% credit for the costs of constructing a facility for dispensing renewable fuel and a 25% credit for the costs of constructing a facility for producing renewable fuel. Unlike the other Article 3B renewable energy property credit, these credits are not limited to a certain amount per facility. The dispensing credit must be taken in three annual installments and the production credit must be taken in seven annual installments. There is no double credit – the taxpayer must choose between any available credits and take only one with respect to the same costs.

Like the other credits in Article 3B, the new credits enacted by this act may be claimed against income tax or franchise tax. Each credit is limited to 50% of the amount of tax liability against which it is claimed. Any excess may be carried forward for up to five years. Although Article 3B is set to sunset January 1, 2006, the sunset for these two new credits would be 2008.

Revenue Laws Technical Changes.

Session Law	Bill #	Sponsor
S.L. 2004-170	SB 1145	Senator Hartsell

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, TO CLARIFY THAT THE CREDIT FOR CREATING JOBS IS ALLOWED ONLY FOR NEW JOBS CREATED IN THIS STATE,

AND TO PROHIBIT THE USE OF FUTURE ROOM TAX COLLECTIONS IN CERTAIN COUNTIES AND CITIES TO DEVELOP OR CONSTRUCT A HOTEL OR SIMILAR LODGING FACILITY.

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

FISCAL IMPACT: The estate tax clarification in Section 4 is expected to cause a General Fund revenue gain of $5.4 million in fiscal year 2005-2006. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise provided, the act became effective when signed into law by the Governor on August 3, 2004.

ANALYSIS: This act makes three substantive changes and makes the following technical and clarifying changes to the revenue laws and related statutes. The substantive changes are in Sections 16, 42, and 43. The Revenue Laws Study Committee recommended the changes in Sections 1-8, 9-22, and 33-39.

Section	Explanation
1	Clarifies that estate tax changes have uniform sunset date.
2	Supplies a missing cross-reference in the University of North Carolina self-liquidating bond legislation.
3	Reenacts the 2003 session law relating to ESC surtax delay, in order to correct a technical omission. Effective as of date 2003 act became law, August 12, 2003, and repealed when the 2003 act is repealed.
4	Clarifies that calculation of State estate tax without regard to federal phase-out and termination of federal credit for state death taxes includes disregarding the federal deduction that replaces the federal credit January 1, 2005. North Carolina's estate tax is calculated based upon the federal estate tax base. Effective January 1, 2005, federal law will allow a deduction for State death taxes paid in lieu of the previously allowed credit for State death taxes paid. To prevent a circular calculation for State estate tax purposes, Section 4 clarifies that the State estate tax is calculated without regard to the federal deduction. This clarification results in an addition to the federal taxable estate for North Carolina estate tax purposes that is equal to the amount of the federal deduction for State death taxes paid. The estates affected by the enactment of this section are those for deaths occurring between January 1, 2005, and June 30, 2005. Effective July 1, 2005, the North Carolina will estate tax will sunset unless the General Assembly enacts legislation.
5	Deletes obsolete provisions.
6	Deletes definition of term no longer used in statutes.
7	Corrects grammatical issue.
8	Updates terminology in controlled substance tax law and clarifies provision complying with Fifth Amendment protection against self-incrimination.
8.1	Clarifies the mechanism for calculating the franchise tax on LLC assets attributed to a controlling corporation.
9	Adds cross-reference to defined term.

Section	Explanation
10	Provides that Bill Lee Act health insurance requirement begins when jobs are created or when qualifying investment is made and continues when credit, installment, or carryforward is claimed. Before this change, the statute referred only to when installment or carryforward is claimed. This change conforms to the current practice of the Department.
11	Clarifies that Bill Lee Act tax debt requirement begins when credit is claimed and continues when installment or carryforward is claimed. Before this change, the statute referred only to when installment or carryforward is claimed.
12	Delays report deadline by one month in order to allow time for quality of report to be improved.
13	Clarifies that loss of the Bill Lee machinery and equipment tax credit because property is disposed of is the same if the property is taken out of service or moved out of state.
14	Corrects incorrect cross-reference
15	Updates terminology. In 1977, the Federal Energy Regulatory Commission replaced the Federal Power Commission established in 1920. It is responsible for issuing licenses for the development of water and electrical power and prohibiting operators from restricting output or restraining trade in electrical energy.
16	Provides that in determining whether a taxpayer is eligible for the new tobacco export credit, positions located within North Carolina for six months or less are not considered to be part of the taxpayer's employment level. Eligibility is based on maintaining an employment level that exceeds by a certain amount the taxpayer's employment level at the end of 2004. Also corrects cross-references. Effective on the same dates as the new credit it amends.
17	Deletes cross-reference to repealed statute.
18	Clarifies the prepared food definition exception for food that is sliced, repackaged, or pasteurized by the retailer.
19	Restores provision inadvertently deleted in earlier legislation.
20	Corrects erroneous language.
21	Removes extraneous language that resulted from redlining conflicts between two laws enacted in 2003. Effective on same date as 2003 laws, July 1, 2004.
22	Corrects cross-reference.
22.5	Clarifies prohibition against using debt collection fee for any purpose not directly related to collecting overdue tax debts. If the fee were used for another purpose, it would be a penalty and all proceeds would be required by the Constitution to go to public schools.
23	Restores reference to the Division of Motor Vehicles that was inadvertently deleted from secrecy provision by 2003 legislation.
24	Removes administration option that is not used and is not allowed by the International Fuel Tax Agreement, which North Carolina has followed since 1992.
25	Clarifies when penalty applies and expands who the penalty is paid to, in order to reflect recent reorganization of the Division of Motor Vehicles.
26	Modernizes language.
27	Adds additional examples of fuels included in definition of diesel fuel. This definition applies in the fuel tax and inspection tax statutes.

Section	Explanation
28	Extends to letters of credit the condition requirements that apply to bonds.
29	Provides that licensee rather than Department of Revenue will make extra copies of license when there is more than one place of business.
30	Clarifies that biodiesel and all fuel alcohols are treated the same as fuel grade ethanol. This change conforms to the practice of the Department of Revenue.
31	Corrects incorrect terminology.
32	Adds missing reference to Mecklenburg one-cent sales tax.
33	Corrects incorrect terminology.
34	Conforms cross-references to reflect statutes repealed and added in 2003.
35	Provides that the property tax subcommittee of the Revenue Laws Study Committee may consist of up to eight members.
36	Conforms the date for filing a local occupancy tax return to the recently amended date for filing a monthly sales tax return. The provision is intended to conform both the filing date and the payment date. Effective October 1, 2004.
37	Conforms title of Article to reflect addition of Part 3 in 2003.
38	Clarifies that county economic development and training districts are special tax areas authorized by Section 2(4) of Article V of the N.C. Constitution.
39	Conforms purposes for which economic development and training district taxes may be levied to match the purposes for which the districts may be created.
40, 41	Codifies uncodified portions of a 1987 Session Law and reorganizes the codified portions of the same law.
42	For local occupancy taxes subject to the uniform provisions for occupancy taxes, this section prohibits the use of the tax proceeds to develop or construct a hotel or similar facility.[40] The rationale for this change is that local occupancy taxes collected by hotels and motels should not be used to subsidize their competitors. This change applies only to future collections of tax. The change does not affect Wake or Mecklenburg County. It affects only those local governments that are subject to the uniform provisions governing occupancy taxes. The governments covered by the uniform provisions as of August 2004 are listed below: Anson, Brunswick, Buncombe, Cabarrus, Camden, Carteret, Craven, Cumberland, Currituck, Dare, Davie, Durham, Granville, Madison, Montgomery, Nash, New Hanover, Pender, Person, Randolph, Richmond, Rowan, Scotland, Stanly, Transylvania, Tyrrell, Vance, and Washington Counties. The Cities of Gastonia, Goldsboro, Greensboro, High Point, Kings Mountain, Lexington, Lincolnton, Lumberton, Monroe, Mount Airy, Shelby, Statesville, Washington, and Wilmington, the Towns of Beech Mountain, Blowing Rock, Carolina Beach, Carrboro, Kure Beach, Jonesville, Mooresville, North Topsail Beach, Selma, Smithfield, St. Pauls, Wilkesboro, and Wrightsville Beach, and the municipalities in Avery and Brunswick Counties.
43	Amends the Bill Lee Act credit for creating new jobs to allow the credit only for jobs created in a taxable year that represent a net increase over the number of North Carolina employees the taxpayer had during the 12 months preceding the

[40] Section 60 of S.L.2004-199, 2004 Technical Corrections, amended this section by deleting the phrase 'directly or indirectly'.

Section	Explanation
	taxable year. If the taxpayer cut jobs in one year and then added jobs in the next year, the credit would be allowed only to the extent of a net increase over the previous year. Effective beginning with the 2004 tax year.

Exempt Higher Ed. Property.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-173	**SB 277**	**Senator Rand**

AN ACT TO EXEMPT FROM PROPERTY TAX EDUCATIONAL PROPERTY HELD BY A NONPROFIT ENTITY FOR A PUBLIC OR PRIVATE UNIVERSITY OR COMMUNITY COLLEGE LOCATED IN NORTH CAROLINA.

OVERVIEW: This act expands the property tax exemption for educational property by (1) exempting property held by a nonprofit entity for the sole benefit of a public or private university located in the State, a community college, or a combination of these entities and (2) expanding the definition of educational purposes to include the operation of a student housing facility or a student dining facility.

FISCAL IMPACT: The act does not affect General Fund revenues. It may result in a local government revenue loss. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxes imposed for taxable years beginning on or after July 1, 2004.

ANALYSIS: This act expands the property tax exemption for educational institutions to include real property owned by a non-profit entity for the sole benefit of any one or more of the following:

- A constituent or affiliated institution of The University of North Carolina.
- An institution as defined in G.S. 116-22 which includes an institution with a main permanent campus in the State that is not owned or operated by the State and is accredited by the Southern Association of Colleges and Schools, awards a postsecondary degree, and is not a seminary, Bible school, Bible college or similar religious institution.
- A community college.

To be exempt, the property must be exclusively used for an educational purpose. An "educational purpose" is defined as one that has as its objective the education or instruction of human beings, or comprehends the transmission of information and the training or development of knowledge or skills of individual persons. The term specifically includes the operation of a golf course, tennis court, sports arena, similar sports property, or similar recreational sport property for the use of students or faculty, regardless of the extent to which the general public uses the property. This act amends the definition of "educational purpose" to include the operation of a student housing facility or a student dining facility.

Finance Vital Projects/Studies.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-179	**HB 1264**	**Representative Miner**

AN ACT TO AUTHORIZE THE ISSUANCE OF SPECIAL INDEBTEDNESS TO FINANCE VITAL STATE FACILITIES FOR HEALTH CARE AND BIOTECHNOLOGY RESEARCH, TO CREATE THE DEBT AFFORDABILITY ADVISORY COMMITTEE, AND TO DIRECT THE BOARD OF GOVERNORS OF THE UNIVERSITY OF NORTH CAROLINA AND THE STATE BOARD OF COMMUNITY COLLEGES TO CONTRACT WITH A PRIVATE CONSULTING FIRM TO STUDY UNIVERSITY AND COMMUNITY COLLEGE PROGRAMMING AND CAPITAL NEEDS.

OVERVIEW: This act does all of the following:

- Authorizes the State to use special indebtedness to finance construction of five new projects in the University of North Carolina (UNC) system and land acquisition and planning for five other projects in the UNC system.
- Authorizes the State to use special indebtedness to finance construction of up to five youth development centers.
- Requires the Health and Wellness Trust Fund and the Tobacco Trust Fund[41] each to transfer to the General Fund annually one-half the estimated debt service on the UNC and youth facility indebtedness. The amount transferred each fiscal year is capped at 30% of the trust fund's receipts through 2006-2007 and 65% beginning in 2007-2008.
- Authorizes the State to use special indebtedness for capital projects (1) for the State Parks System, (2) for parks, recreation, and the preservation of natural heritage, and (3) for clean water conservation. Repayment of the debt for these purposes would be made from existing revenue streams dedicated to the Parks and Recreation Trust Fund, the Natural Heritage Trust Fund, and the Clean Water Management Trust Fund, respectively. The authorization is limited to a total of $45 million: $20 million to acquire land near military bases and $25 million for land acquisition for new and existing State parks and gamelands and capital improvements for existing State parks.

[41] In late 1998, forty-six states and several U.S. territories reached an agreement to settle the lawsuits they had filed against the major cigarette manufacturers. The terms of the settlement were incorporated into an agreement known as the Master Settlement Agreement. The Master Settlement Agreement contractually imposes some restrictions on tobacco marketing and requires the tobacco companies to make annual payments to the states. As part of the North Carolina consent decree, the judge (at the request of the Attorney General) awarded 50% of the settlement funds to the State's Settlement Reserve Fund and 50% to a nonprofit corporation, the Golden L.E.A.F. Foundation, that will assist tobacco-dependent and economically-affected communities. The 50% that is paid to the Settlement Reserve Fund is divided equally between the Health and Wellness Trust Fund and the Tobacco Trust Fund.

- Requires the Parks and Recreation Authority to allocate funds from the Trust Fund with a geographic distribution across the State to the extent practicable.
- Clarifies that revenue in the trust funds is annually appropriated for the purposes for which expenditures are authorized.
- States the intent of the General Assembly that the purposes for which parks, heritage, and clean water indebtedness may be incurred include, as a high priority, acquiring land near military bases to prevent encroachment.
- Provides that none of the parks, heritage, and clean water debt proceeds may be used to acquire property by eminent domain.
- Creates a Debt Affordability Advisory Committee, which would be responsible for preparing an annual debt affordability study and establishing guidelines for evaluating the State's debt burden.
- Directs the UNC Board of Governors and the State Board of Community Colleges to contract with a consultant to study higher education program and facility needs.[42]
- Enacts a statutory framework for a new type of State special indebtedness called "RECOP indebtedness," which would involve lower debt service payments during the term of the debt in exchange for a larger payment due at maturity. RECOP indebtedness could not be issued unless the General Assembly enacted legislation specifically providing for the projects or refunding to be financed with RECOPs.
- Directs the Treasurer to study RECOP indebtedness and report to the Joint Legislative Commission on Governmental Operations by February 1, 2005.

FISCAL IMPACT: The net General Fund cost is expected to be zero because the act requires the annual transfer of revenue from other sources to the General Fund in an amount to cover the estimated debt service. The maximum annual debt service is $47.4 million in fiscal year 2010-2011. The total interest on the $468 million of debt is $310.2 million. The annual debt service amounts are affected by the cash flow needs of each project as well as the $310 million limit on the amount of debt that may be issued during the 2004-2005 fiscal year. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise indicated, this act became effective when signed into law by the Governor on August 5, 2004.

ANALYSIS: This act authorizes the State to issue up to $468 million of special indebtedness to finance various capital projects; no more than $310 million of the special indebtedness may be issued during the 2004-2005 fiscal year. The debt service for the UNC System facilities and the Youth Development Centers will be reimbursed from the Health and Wellness Trust Fund and the Tobacco Trust Fund. The debt service for the Parks, Natural Heritage, and Clean Water management projects is fully funded by the streams of revenue available to the Parks and Recreation Trust Fund, the Natural Heritage Trust Fund, and the Clean Water Management Trust Fund.

Health, Education, and Youth Facilities

This act authorizes the issuance of special indebtedness for constructing the following capital projects:

[42] See Section 51 of S.L.2004-199, the 2004 Technical Corrections.

Purpose	Amount in Millions
Cancer Center at UNC-Chapel Hill	$180
Cardiovascular Institute at Eastern Carolina University	60
Bioinformatics Center at UNC-Charlotte	35
Facility for Pharmacy Program at Elizabeth City State University	28
UNC-Asheville Health Center	35

It also authorizes the issuance of special indebtedness for land acquisition, site preparation, and planning for the following capital projects:

Purpose	Amount in Millions
Fayetteville State University Teaching/Nursing Center	$10
North Carolina A&T/UNC-Greensboro Millennial Campus	10
Optometry School at UNC-Pembroke	10
Western Carolina University for joint Health & Aging Center	10
Winston-Salem State University/School of Arts Design Center	10

In addition to the issuance of $388 million of special indebtedness authorized for higher education projects, the act authorizes the issuance of up to $35 million of special indebtedness to construct up to five youth development centers. The timing for the issuance of the debt for these purposes is limited so that no more than $278 million in debt can be issued before July 1, 2005. The remainder can be issued on or after that date.

The act provides that a portion of the funds available to the Health and Wellness Trust Fund[43] and the Tobacco Trust Fund[44] will be used to reimburse the General Fund each year for debt service on the UNC and youth facility debt. Each trust fund is required to transfer to the General Fund annually one-half of the debt service amount certified by the Treasurer. The required transfer from each trust fund is capped, however, at a percentage of current year receipts. The percentage is 30% through 2006-2007 and then increases to 65% in 2007-2008. The cap allows the trust funds to retain a portion of their funding to develop future programs and award grants.[45] These provisions became effective July 1, 2004.

Commonly referred to as "certificates of participation," special indebtedness is nonvoted debt that maybe secured only by an interest in State property being acquired or improved. There is no pledge of the State's faith and credit or taxing power to secure the debt. 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 State property that serves 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.

[43] The Health and Wellness Trust Fund receives annual tobacco settlement payments to be used to improve the health and wellness of North Carolinians. In order to build up a fund reserve for future projects, the governing body of the Trust Fund has been required to reserve 50% of each annual payment since 2001. This act eliminates the requirement that 50% of the Trust Fund's annual receipts be reserved.

[44]The Tobacco Trust fund receives annual tobacco settlement payments to be used to assist tobacco producers, tobacco allotment holders, and persons engaged in tobacco related businesses.

[45] The Tobacco Trust Fund awards grants on an annual basis based on availability of funds. The bulk of the Heath and Wellness Trust Fund's current commitments is the Senior Cares prescription drug program; this program is scheduled to terminate in fiscal year 2005-2006 at which time the Medicare senior prescription drug program will be available for seniors.

The term "special indebtedness" is employed 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 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 special indebtedness may be the least expensive and most practical for the State to utilize. Article 9 of Chapter 142 of the General Statutes prohibits the issuance of special indebtedness except for projects specifically authorized by the General Assembly.

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

Parks Renovation and Acquisition

The act authorizes the State to issue or incur up to $45 million of special indebtedness to finance the acquisition of property for three programs:

- The Parks and Recreation Trust Fund for repairs and renovations of park facilities and capital projects and land acquisition for the State Parks System.
- The Natural Heritage Trust Fund to acquire land that represents the ecological diversity of the State and land for State parks, wildlife areas, and similar public purposes.
- The Clean Water Management Trust Fund for capital projects to acquire riparian buffers, acquire property interests to conserve surface water and drinking water supplies, coordinate with other public programs for lands adjoining water bodies, and restore the ability of degraded lands to protect water quality.

The proceeds of the indebtedness may not be used to acquire property by eminent domain. The act states the intent of the General Assembly that the purposes for which the debt proceeds may be used include, as a high priority, acquiring land near military bases to prevent encroachment.

The amount of debt that may be incurred is limited to the lesser of a dollar amount for each purpose authorized and the amount that can be supported by the funds set aside from the three Trust Funds for annual debt service payments. The three trust funds will have to work together to keep the total debt below the maximum dollar amounts for the authorized projects, which are as follows:

$20 million	Acquire property near military bases to prevent encroachment
$25 million	Land acquisition for existing and new State parks and capital projects for an existing State park

The timing for the issuance of the debt for these purposes is limited so that no more than $32 million in debt can be issued before July 1, 2005. The remainder can be issued on or after that date.

These three Trust Funds have dedicated revenue sources. The Parks Fund and the Natural Heritage Fund both receive a stream of revenue from the State excise tax on conveyances (the "deed stamp tax") and from vanity license plate fees. The Clean Water Management Trust Fund receives a statutory annual appropriation of $100 million. This act authorizes the governing body of each Fund to allocate a portion of its stream of income for debt service on debt incurred to acquire property.[46]

In the case of the Parks and Recreation Trust Fund, the Authority can allocate up to 50% of the two-thirds portion of their income designated for repairs and renovations of park facilities and capital projects and land acquisition for the State Parks System for debt service. The Authority may not allocate any of the income currently designated for local government grants or for beach access. In addition to authorizing use of a portion of the Fund for debt service, the act also requires any allocations from the Fund to be geographically distributed across the State to the extent practicable. Under prior law, the governing body of the Fund had to 'consider' geographic distributions across the State to the extent practicable.

In the case of the Natural Heritage Trust Fund, up to 50% of the annual receipts may be allocated for debt service. In the case of the Clean Water Management Trust Fund, the $45 million cap on outstanding debt automatically limits the allocation to a small fraction of the annual income stream.

The governing body of each trust fund can select a project and allocate a portion of the fund's revenue stream for special indebtedness to finance the project. Once the debt is issued, the governing body is required to credit the debt service amount to the General Fund each year.

Debt Affordability Advisory Committee

The act creates a Debt Affordability Advisory Committee to annually advise the Governor and the General Assembly on the estimated debt capacity of the State for the upcoming 10 fiscal years. The Committee must undertake an annual debt affordability study and establish guidelines for evaluating the State's debt burden.

The Committee consists of the State Treasurer, the Secretary of Revenue, the State Budget Officer, the State Auditor, the State Controller, and four members of the public – two appointed by the President Pro Tempore of the Senate and two appointed by the Speaker of the House of Representatives. The State Treasurer serves as the chair of the Committee and the Committee meets upon the call of the chair. The Committee must report its findings and recommendations to the Governor, the General Assembly, and the Fiscal Research Division by February 1 of each year.

In March 2003, the State Treasurer presented to the House and Senate Finance Committees a debt affordability study for North Carolina. The study evaluated the State's current and

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[46]The three Trust Funds receive annual statutory transfers and/or appropriations that they are authorized to use for the purposes provided by statute. The Parks and Recreation Trust Fund statute specifically provides that the moneys in the trust fund are annually appropriated for those purposes. This act adds similar language to clarify that the moneys in the Natural Heritage Trust Fund and the Clean Water Management Trust Fund are also annually appropriated for the purposes authorized by statute.

projected debt burden using indicators such as tax-supported debt to personal income, debt per capita, debt service to tax revenue, and rapidity of principal repayment ratios. The study recognizes that debt capacity is a limited and scarce resource and that an evaluation of the State's debt position can help policymakers evaluate the long-term impact of financing decisions and assist in prioritizing capital spending. The State Treasurer also noted in the report that credit rating agencies consider a debt affordability study as a positive factor when they evaluate issuers and assign credit ratings. The State Treasurer published a revised debt affordability study in 2004.

Study of Higher Education Program and Facility Needs

The act directs the UNC Board of Governors and the State Board of Community Colleges to contract with a consultant to conduct a comprehensive study of the mission and programming needs for the UNC system and the Community Colleges system, and to study facility needs related to the identified program needs. The act specifically states that the historically Black colleges and universities and UNC-Pembroke are valuable and indispensable assets of the UNC system and should not be diminished or eliminated. The boards and their consultant are required to make periodic reports to a subcommittee created by the Joint Legislative Education Oversight Committee and submit to the Committee and the General Assembly a preliminary report by April 15, 2005, and a final report by December 31, 2005.

Statutory Framework for RECOPS

The act establishes the statutory framework for a new type of special indebtedness to be called Real Estate Certificates of Participation (RECOP) indebtedness. RECOP indebtedness is a form of special indebtedness that is intended to be structured so that the principal and a portion of the interest are not paid in installments over the term of the debt. That portion of the interest compounds and is payable, along with the principal, only at maturity or earlier redemption. This structure is intended to reduce ongoing debt service payments and provide for payment of the remaining obligation at a time when the property securing the debt will most likely have appreciated substantially in value.

Like other special indebtedness, RECOP indebtedness may be incurred only if the amount and specific purposes have been authorized in an act of the General Assembly. RECOP indebtedness differs from traditional special indebtedness in several ways:

- Special indebtedness may be incurred only for capital projects. RECOP indebtedness may be incurred to retire existing State debt as well as for capital projects.
- Special indebtedness may be secured only by the capital facilities being constructed, renovated, or repaired with the proceeds of the debt. RECOP indebtedness may be secured by these projects but may also be secured by any other State property. The property to serve as collateral would be selected by the Governor after first consulting with the Joint Governmental Commission on Governmental Operations. The choice of collateral must also be approved by the Council of State.
- State property law does not apply to a transfer of an interest in State property to secure special indebtedness or, in the case of default, to repay special indebtedness. With RECOP indebtedness, there is an additional exemption from

State property law for transfers when the proceeds are used first to pay RECOP indebtedness, even if there is no default.

A major difference between RECOP indebtedness and the types of debt the State and local governments normally incur involves the payment of principal and interest. The usual practice is for the governmental entity to pay off the principal during the term of the debt while also paying interest. Normally, the outstanding principal balance declines relatively steadily during the term of the debt. With RECOP indebtedness, it is intended that no principal would be paid off during the term of the debt. In addition, it is intended that only part of the interest would be paid during the term of the debt. Postponing these payments until maturity makes the debt service payments during the life of the debt much lower than with traditional debt. The entire principal becomes due at maturity along with that portion of the interest that was not paid in installments.

Treasurer Study

The act requires the State Treasurer to conduct a study of RECOP indebtedness. The act states that there may be circumstances in which the State would benefit from taking advantage of flexible financing tools such as RECOPs, but that more information is needed for the General Assembly to consider such a policy decision. The act directs the State Treasurer to study the effects of using RECOPs either for new projects or refunding outstanding debt and to report the results of the study and any recommendations by February 1, 2005, to the Joint Legislative Commission on Governmental Operations.

Wetlands Reimbursement/Local Tax Base.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-188	**SB 933**	**Senator Hargett**

AN ACT TO REQUIRE STATE AND LOCAL GOVERNMENT AGENCIES THAT ACQUIRE LAND FOR WETLANDS MITIGATION TO REIMBURSE THE COUNTY IN WHICH THE LAND IS LOCATED FOR ITS LOST TAXES DUE TO THE ACQUISITION.

OVERVIEW: This act requires State and local government agencies that acquire land for wetlands mitigation in an enterprise tier one or tier two county to reimburse the county in which the land is located a sum equal to the estimated amount of property taxes that would have accrued to the county for the next 20 years. The requirement does not apply when the land purchased and the wetlands permitted to be lost are located in the same county.

FISCAL IMPACT: No General Fund impact. The Fiscal Research Division estimates the costs associated with this act to be $137,088 annually. Approximately 75% of this amount is expected to come from the Department of Transportation, with the balance drawn from the Wetlands Trust Fund. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective when it was signed into law by the Governor on August 17, 2004. It applies to transfers made on or after that date.

ANALYSIS: The Wetlands Restoration Program and Wetlands Trust Fund were established by the General Assembly in 1996 to restore wetlands[47] lost or impaired through human activities and to assist those who must meet wetlands mitigation requirements imposed by the United States Army Corps of Engineers as a condition of obtaining Section 404 permits for wetlands alteration.[48] Under federal environmental regulations, when wetlands are lost or impaired, other land in the same river basin or sub-river basin must be set aside to "make up" for the lost wetlands. This practice is referred to as compensatory wetland mitigation, and the State is subject to these federal requirements.

When a State agency or local government acquires wetlands for wetlands mitigation, that property becomes exempt from tax and is removed from the county's tax base. This act requires that the State and local governments reimburse a tier one or two county when they acquire[49] property within the county for the purpose of wetlands mitigation. The reimbursement amount is a sum that is equal to the estimated amount of property taxes that would have accrued to the county for the next 20 years had the land not been acquired by the State agency or local government. If a State agency acquires property in a county for future wetlands mitigation and later uses the property to mitigate wetlands permitted to be lost in the same county, then the county must return a portion of the reimbursement payment to the State. The amount reimbursed to the State agency is a percentage based upon the number of years the State agency held the land before the wetlands were lost.

The requirement for reimbursement does not apply to the condemnation or acquisition of land by a city or special district if the land is located in the corporate limits of the city or special district, or within the county where the city or special district is located. The reimbursement requirement also does not apply to land acquired by a State agency when the land purchased by the State agency and the wetlands permitted to be lost are located in the same county. Lastly, the governing board of the county and the State agency may agree in writing to waive the payment.

The act further provides that if a State agency acquires wetlands in a tier one or two county from a private mitigation banking company, the agency must pay a sum in lieu of property tax to the county where the wetlands are located. However, as a condition of accepting the donation from the private mitigation banking company, the State agency may require the company to make adequate provisions for the long-term maintenance and management of wetlands. These provisions may include reimbursement to the agency for payment of a sum in lieu of property taxes. A private mitigation banking company trades in properties that may be eligible as mitigation lands.

Historically, the primary State agency purchasers of wetlands mitigation properties have been the North Carolina Department of Transportation, making purchases to mitigate road activity, and the Wetlands Restoration Program. In 2003, the compensatory mitigation efforts of these two agencies were joined through a Memorandum of Agreement between the parties and renamed the "Ecosystem Enhancement Program".

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[47] Wetlands include pocosins, freshwater marshes, swamp forests, and bottomland hardwood forests.
[48] Section 404 of the United States Clean Water Act, which controls the placement of dredged or fill materials in the waters of the United States and adjoining wetlands, is the nearest thing to a national wetlands law.
[49] The acquisition may be made through condemnation or by purchase.

NC Cemetery Act/Fees/Bill Lee Tiers.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-202	**SB 1244**	**Senator Hoyle**

AN ACT AUTHORIZING THE NORTH CAROLINA CEMETERY COMMISSION TO INCREASE CERTAIN FEES, MAKING CLARIFYING CHANGES UNDER THE NORTH CAROLINA CEMETERY ACT, AND MODIFYING THE FORMULA USED TO DETERMINE THE ENTERPRISE TIER DESIGNATION OF A COUNTY.

OVERVIEW: This act gives the North Carolina Cemetery Commission the authority to increase several fees and increases the amounts that must be deposited into care and maintenance trust funds. This act also modifies the tier structure in the Bill Lee Act to be more responsive to changes in a county's economic outlook by ranking a county's unemployment rate and per capita income annually as opposed to using a 3-year average.

FISCAL IMPACT: It is not possible to determine the impact of this act on the General Fund. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2004 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 17, 2004.

ANALYSIS: This act gives the North Carolina Cemetery Commission the authority to increase the following fees:

- Annual renewal fee for licensed cemeteries.
- Inspection fee for each grave space, niche, or mausoleum crypt.
- Inspection fee for each vault, belowground crypt, memorial, or opening and closing of a grave space included in a preneed cemetery contract.
- Initial application and filing fee for cemetery company.
- Initial application and filing fee for cemetery sales organizations and cemetery management organizations.
- Initial application and filing fee for cemetery brokers.
- Annual renewal fee for cemetery sales organizations, cemetery management organizations, and cemetery brokers.
- Initial application and filing fee for persons selling preneed grave space.
- Biennial renewal fee for persons selling preneed grave space.
- Application and filing fee for approval of a change of control.

The Cemetery Commission is receipt supported and receives no State General Fund appropriations. At the time this act was enacted, the Commission had a negative fund balance. Therefore, the fee increases were necessary to fund continuing operations of the Commission.

To increase a fee amount, the North Carolina Cemetery Commission must go through the administrative rules process. In addition to the notice and public comment provided for under the administrative rules process, the Commission must also appear before the Joint Legislative Commission on Governmental Operations before an increased fee amount may become effective.

Cemetery companies must make timely deposits to a care and maintenance trust fund and must file with the North Carolina Cemetery Commission annual financial reports of the funds. This act increases the amounts that must be deposited into a care and maintenance trust fund for each grave space, niche, or mausoleum that is sold or is converted from a public or nonprofit cemetery to a private cemetery.

The act also changes the consequences of failing to make timely deposits or file timely financial reports. Under law prior to the enactment of this act, a cemetery company that failed to make a timely deposit in a trust fund was subject to a penalty of $1.00 per day for each day the deposit was delinquent and a cemetery company that failed to file timely annual financial reports was subject to a penalty of $25 per day for each day of delinquency. The proceeds of these penalties were not retained by the Cemetery Commission because under Article IX, Section 7 of the North Carolina Constitution, the clear proceeds of all penalties must be credited to the county's school fund. The Cemetery Commission incurs additional expenses when a person fails to submit deposits and reports in a timely fashion. Before the enactment of this act, this expense was borne by the Commission through the general licensing revenues. This act changes each penalty to a late filing fee. As a result, the Commission will be able to retain the fee proceeds to recover its additional expenses from the person who creates the need for the expense. This act also changes the late fee for failure to file timely financial reports from $25 a day to $25 a month.

Section 10 of the act modifies the formula used to determine the enterprise tier designation of a county under the Bill Lee Act. By December 31 of each year, the Department of Commerce is required to assign a tier designation to each of the 100 counties in the State. In order to make these assignments, the Department must rank all counties based on three factors, average rate of unemployment over the preceding three years, average per capita income over the preceding three years, and percentage growth in population. Each of these factors is given equal weight. Tier designations are assigned based on the ranking, although there are numerous exceptions to this formula. A county designated as enterprise tier one or two may not be designated a higher tier until it has been at its current tier for at least two consecutive years. There are also exceptions for certain lower-population counties that could result in those counties receiving a lower designation.

This act changes the time frames for measuring each of the three factors. Under this act, in ranking counties on the basis of unemployment and per capita income, the Department will use the average figure over the last 12 months rather than over the past three years. In ranking the counties on the basis of population growth, the Department will use the population growth percentage over the past 12 months. Previously the statute specified no time frame for measuring population growth. In ranking counties on the percentage of population growth, the Department had compared the most recent estimate of population to the last decennial census figure. Thus, the period of time over which population growth was measured varied each year.

It is believed that these changes will make the Bill Lee tier designation more sensitive to changes in economic conditions in the counties. Because of various exceptions to the ranking formula, the distribution of counties will still be skewed toward the lower tiers.

Bill Lee tier designation affects a number of different State programs, including the following: Job Development Investment Grant (JDIG) Program, One North Carolina Fund, Industrial Development Fund, Community Development Block Grant funds, certain sales tax refunds, low-income housing tax credits, purchase of agricultural conservation easements, and distributions from the Spay/Neuter Account.

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