2005

FINANCE LAW CHANGES

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2005 Finance Law Changes

Computer Manufacturing Tax Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2004-204	**S 2 Extra Session**	**Sen. Hoyle**

AN ACT TO PROVIDE A TAX CREDIT FOR CERTAIN MAJOR COMPUTER MANUFACTURING FACILITIES AND TO ENHANCE CERTAIN EXISTING TAX INCENTIVES FOR THOSE FACILITIES.

OVERVIEW: The act provides the following income, franchise, and sales tax incentives for a computer manufacturing facility that, along with related parties and strategic partners, is expected to invest at least $100 million of private funds in a facility in the State over a five-year period and employ at least 1,200 people within five years after the facility is used as a computer manufacturing and distribution facility:

- A new tax credit based upon the unit output and increased employment level of a major computer manufacturing and distribution facility. This credit may be used to eliminate 100% of a taxpayer's income and franchise tax liability. Any unused portion of the credit may be carried forward for the next succeeding 25 years.
- Enhanced Bill Lee Act tax credits that entitle a taxpayer to claim the credit amounts allowed for facilities located in a development zone regardless of the county in which the facility is located. The act also provides that the wage standard does not apply to the activities of a taxpayer at a major computer facility.
- An expansion of the sales tax refund, enacted by the 2003 General Assembly[1] for building materials purchased to build a computer manufacturing facility.

FISCAL IMPACT:

Description	*General Fund Impact*
Computer Manufacturing Credit	$10 million loss for 2005-2006 $10 million loss for 2006-2007 $20 million loss for 2007-2008 $20 million loss for 2008-2009 $20 million loss for 2009-2010
Bill Lee Act Changes Jobs Credit Machinery/Equipment Credit	 $600,000 loss for 2008-2009 $1 million loss for 2009-2010 $300,000 loss for 2007-2008

[1] S.L. 2003-435

Worker training Credit Real property Credit	$500,000 loss for 2008-2009 $900,000 loss for 2009-2010 $500,000 loss for 2007-2008 $400,000 loss for 2008-2009 $600,000 loss for 2009-2010 $1.3 million loss for 2006-2007 $1.3 million loss for 2007-2008 $2.6 million loss for 2008-2009 $2.6 million loss for 2009-2010
Sales Tax Refund Expansion	No fiscal impact anticipated
Grand Total of losses	$11.3 million loss for 2006-2007 $22.1 million loss for 2007-2008 $24.1 million loss for 2008-2009 $25.1 million loss for 2009-2010

The amount of the computer manufacturing credit expected to be taken between 2005 and 2020 is $450 million. The amount of the Bill Lee Act credits expected to be taken between 2005 and 2020 is $42.8 million.

(For a more complete 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 Extra Session of the 2004 General Assembly to consider new and enhanced incentives for an eligible computer manufacturing and distribution facility. The following incentives were enacted by the General Assembly to persuade Dell Computer Corporation to locate a manufacturing facility in North Carolina:

Tax Credit based upon Unit Output of a Computer Manufacturing and Distribution Facility

Section 1 of the act creates a new tax credit for an eligible computer manufacturing and distribution facility.[2] The amount of the credit is based upon the facility's unit output and increased employment level. The credit is effective for business activities occurring on or after November 1, 2004, and for taxable years beginning on or after January 1, 2005. The credit expires for business activities occurring in taxable years beginning on or after January 1, 2020.

The tax credit may be taken against the taxpayer's franchise tax or income tax. The taxpayer must elect the percentage of the credit to be applied against the franchise tax with any remaining percentage to be applied against the taxpayer's income tax liability. Unlike other incentive tax credits, the election is NOT binding for either the year in which it is taken or for any carryforwards of the credit. A taxpayer may elect a different allocation for each year the taxpayer qualifies for a credit. A taxpayer may not claim a credit that exceeds 100% of the taxpayer's tax liability. Most other tax incentives allow the taxpayer to offset no more

[2] "Computer manufacturing" is defined in G.S. 105-164.14, as amended by this act. "Facility" is also defined in the act.

than 50% of its tax liability. Any unused portion of a credit may be carried forward for the next succeeding 25 years.

Credit Eligibility – To be eligible for this credit, the taxpayer must meet the following employment conditions:

- The Department of Commerce must make a written determination that the taxpayer has or is expected to have an increased employment level of at least 1,200 new full time jobs OR new permanent part-time jobs converted into full-time equivalences within five years after the facility is operational.
- The taxpayer may meet this employment threshold either directly or indirectly through one or more related entities and strategic partners.[3] In order for a taxpayer to include jobs created by related entities and strategic partners in its increased employment level, the taxpayer must obtain their written consent to do so. Once granted, this consent is irrevocable. A job may not be included in the increased employment level of more than one entity. This credit is the first one the State has enacted that allows a taxpayer to meet an employment threshold indirectly through related entities and strategic partners.
- The taxpayer and the taxpayer's related entities and strategic partners must provide health insurance[4] for all of the full-time jobs each year it claims a credit or carryforward of a credit. The taxpayer does not have to provide health insurance for its part-time jobs. This condition is the same as the health insurance condition under the Bill Lee Act.

To be eligible for this credit, the taxpayer must meet the following investment condition:

The Secretary of Commerce must make a written determination that the taxpayer has invested or is expected to invest at least $100 million of private funds in a computer manufacturing and distribution facility over a five-year period. The investments may be made either directly or indirectly through related entities and strategic partners.

To be eligible for the credit, the taxpayer must also meet the following conditions that are typically required under other State tax incentives:

- The taxpayer and the taxpayer's related entities and strategic partners have no pending administrative, civil, or criminal enforcement actions based on alleged significant environmental violations, nor have they had a final determination of responsibility for any significant environmental violation within the past five years.
- The taxpayer and the taxpayer's related entities and strategic partners have no citations under the Occupational Safety and Health Act that have become a final

[3] The act defines a "related entity" as an entity for which the taxpayer possesses directly or indirectly at least 80% of the control and value. The act defines "strategic partner" as a business that is engaged in activities at the facility that directly contribute to the manufacture and distribution of computers and computer peripherals and with whom the taxpayer has contracted to provide those activities at the facility in direct support of its manufacturing and distribution activities.

[4] An entity provides health insurance if it pays at least 50% of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125. This provision is the same as the insurance provisions of the Bill Lee Act.

order within the past three years for willful serious violations or for failing to abate serious violations.

- The taxpayer and the taxpayer's related entities and strategic partners have no overdue tax debts that have not been satisfied or otherwise resolved.

The taxpayer must apply to the Secretary of Commerce for the required eligibility determinations. The application must be made under oath. The determination is a question of fact and must be made whenever a taxpayer can demonstrate performance or provide a credible plan for performance. If the taxpayer does not perform as promised, the taxpayer does not forfeit any of the credits already taken, unless the assertions of the taxpayer can be proven to have been false when made.[5]

Credit Amount - The credit amount and conditions vary from year to year based on complicated formulas. The actual amount of the credit is computed in two steps. First, one must determine the lesser of the cap and an amount determined by multiplying the number of units produced at the facility by a dollar amount. In some cases, this amount would be adjusted downward based on how much the actual increased employment level is below certain targets. In other situations, no downward adjustment is made for reductions in increased employment level.

If the amount of the credit computed in the first step is less than the cap, then the amount can be brought up to the cap by using amounts in a make up account. The make up account includes amounts by which prior year formula calculations exceeded the applicable caps. These amounts must be used within seven years. This credit is the first one the State has enacted that allows a taxpayer to carry forward credit amounts that could not be used because they exceeded the caps. It is also the first time the State has allowed a taxpayer to meet a cap by using prior year excesses.

In 2005, the taxpayer may claim a credit equal to $10 million if the taxpayer has invested at least $25 million by the end of the taxable year to construct a computer manufacturing and distribution facility. The investment may be made either directly by the taxpayer or indirectly through related entities.

For taxable years 2006 - 2009, the maximum credit allowed is $10 million. The actual amount of the credit is determined by the increased employment level of the taxpayer at the facility and the number of consumer-ready computers and computer peripherals produced, assembled, or manufactured by the facility during that taxable year, hereinafter referred to as 'unit output of facility'. The formula is as follows:

Credit amount = (Employment level adjustment factor)(Production factor)(Unit output of facility)

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[5] One could argue that there is the potential for a court to find that allowing a credit for nothing more than a finding by the Secretary of Commerce violates the constitutional provision prohibiting the General Assembly from delegating the taxing authority because it potentially gives the executive branch the authority to pick and choose which taxpayers will receive credits. Under current law, when a taxpayer receives a tax benefit based on a determination by the Secretary regarding expected future activity, the tax benefits are subject to forfeiture if the taxpayer does not perform as expected. Because there is no forfeiture under the credit created in this act, if the taxpayer does not produce the expected jobs or make the expected investment, one could argue that the General Assembly has delegated its taxing authority to the Secretary.

The employment level adjustment factor is the lesser of 1 or the increased employment level for the year divided by the applicable target increased employment level. Assuming the taxpayer meets the increased employment levels stated in the act, the adjustment factor would be 1. If the taxpayer fails to meet the targeted increased employment levels, then the factor would be a percentage less than 1, thereby reducing the amount of credit available to the taxpayer for that taxable year. The target increased employment level and the production factor vary for tax years 2006-2009 as follows:

Year	Increased employment level	Production factor
2006	600	\$15
2007	1,000	\$6.25
2008	1,100	\$6.25
2009	1,500	\$6.25

For taxable years <u>2010-2014</u>, the maximum credit amount depends upon the increased employment level attained by the taxpayer at the facility for which the credit is claimed.

- If the taxpayer has EVER attained an increased employment level of at least 1,500 at the facility for which the credit is claimed, then the credit amount for taxable years 2010-2014 is the unit output of the facility multiplied by \$6.25 or \$15 million, whichever is less. The credit amount would be reduced if the taxpayer's increased employment level decreased by more than 40% from that of the previous year. The reduction would be a percentage reduction equal to the increased employment level for the taxable year divided by 1,500.

- If the taxpayer never attained an increased employment level of at least 1,500, then the maximum credit amount remains at \$10 million and the amount of the credit is reduced for any year the taxpayer does not reach an increased employment level of 1,500. The formula for determining the credit amount is:

  Credit = (Employment level adjustment factor)(Unit output of facility)(\$6.25)

  The employment level adjustment factor is the lesser of one and the number derived by dividing the taxpayer's increased employment level for the taxable year by 1,500.

For taxable years <u>2015-2019</u>, the maximum credit amount may be increased to \$20 million if the taxpayer has in ANY year attained an increased employment level of 2,500 at the facility for which the credit is claimed. The credit amount continues to vary depending upon the maximum increased employment level EVER attained and the current increased employment level.

- If the taxpayer has EVER attained an increased employment level of 2,500 AND the taxpayer's increased employment level for the current year is at least 1,500, then the credit amount is the unit output of the facility multiplied by \$6.25 or \$20 million, whichever is less.

- If the taxpayer has EVER attained an increased employment level of 2,500 BUT the taxpayer's increased employment level for the current year is less than 1,500, then the credit amount is the unit output of the facility multiplied by \$6.25 or \$15 million, whichever is less. The credit amount would be reduced if the taxpayer's increased employment level decreased by more than 40% from that of the previous year AND the increased employment level of the previous year was 1,500 or less or the increased employment level for the current year is 900 or less.

- If the taxpayer has EVER attained an increased employment level of 1,500, but has never attained an increased employment level of 2,500, then the credit amount is the unit output of the facility multiplied by $6.25 or $15 million, whichever is less. The credit amount would be reduced if the taxpayer's increased employment level decreased by more than 40% from that of the previous year AND the increased employment level of the previous year was 1,500 or less or the increased employment level for the current year is 900 or less.
- If the taxpayer has never attained an increased employment level of at least 1,500, then the maximum credit amount remains at $10 million and the amount of the credit is reduced for any year the taxpayer does not reach an increased employment level of 1,500.

Constitutional Concerns - The credit set out in Section 1 of the act would be vulnerable to attack under the reasoning of the *Cuno* decision because it evinces a clear preference for in-State economic activity at the expense of out-of-state development. On September 2, 2004, the Sixth Circuit Court of Appeals issued its decision in *Cuno v. DaimlerChrysler*, 386 F.3d 738, (2004, 6th Cir. (Ohio)). In that decision, the Court found that Ohio's investment tax credit violated the Commerce Clause of the United States Constitution because it (a) encouraged in-state economic development at the expense of out-of-state economic development and (b) allowed the taxpayer to reduce pre-existing income tax liability by investing in-state but not by investing out-of-state.

Although the Sixth Circuit's decision is not binding in North Carolina[6] and is subject to further review[7] a similar case could be brought in this jurisdiction. If a decision applicable in this jurisdiction followed the reasoning of the Sixth Circuit opinion, the credit set out in Section 1 of the act would be ruled unconstitutional. If that happened, it is uncertain what the remedy would be. Possible remedies could include ordering the State to provide retroactive credits to otherwise similarly situated taxpayers who had made similar investments in other states.

The credit could also be vulnerable to attack on equal protection grounds because the amount of the credit is based, in part, on the maximum increased employment level ever attained by the taxpayer and not just on the current increased employment level of the taxpayer. Under this proposal, two companies that have identical output and increased employment levels in the current year could be eligible for substantially different credits based on the increased employment level attained in an earlier year.

For example, consider two companies – CorpA and CorpB. In 2010, CorpA has an increased employment level of 1,500 and CorpB has an increased employment level of 1,200. In that year, CorpA is eligible for a maximum credit of $15 million and CorpB is eligible for a maximum credit of $8 million. Further assume that in 2011, CorpA reduces its increased employment level to 1,200 and CorpB maintains its increased employment level at 1,200.

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[6] The decision is binding only in the states that compose the Sixth Circuit: Kentucky, Michigan, Ohio, and Tennessee.

[7] The United States Supreme Court will hear this case during the 2005-2006 Term..

CorpA remains eligible for a maximum credit of $15 million while CorpB remains eligible for a maximum credit of $8 million. Under this example, in 2011, two corporations with identical output and increased employment levels would be eligible for vastly different credits. A court could find that there is no rational basis for awarding CorpA almost double the amount of credit just because it once had an increased employment level of 1,500. In fact, one could argue that the distinction is irrational because the company that has laid off employees is the one that qualifies for the larger credit.

This problem is exacerbated in certain situations. Once a taxpayer has attained an increased employment level of 1,500, it can reduce its labor force by up to 40% a year without a reduction in the maximum amount of credit for which it is eligible. Continuing the example cited above, CorpA could reduce its increased employment to 900 in 2011 and still be eligible for a maximum credit of $15 million. In that case, CorpA would have less of a positive impact (i.e. 900 new jobs as opposed to 1,200 new jobs) in 2011 than CorpB, but be eligible for a much larger credit.

<u>*Other Considerations*</u> – The credit, as enacted raises the following additional issues:

- The method for calculating the amount of a credit for which a taxpayer is eligible is extremely complicated. This may result in additional compliance and auditing burdens.

- There is no provision regarding expiration of a credit if the increased employment level is not maintained. Generally under prior law, when a taxpayer was allowed a credit for a certain activity, the credit expired if the activity was not maintained. For example, in order for a taxpayer to take full advantage of the credit for creating jobs under the Bill Lee Act, those jobs must be maintained for a number of years.

  The credit in this act is designed in a way that allows the taxpayer, under certain circumstances, to take the full benefit of a credit even if increased employment levels are not maintained. Once a taxpayer has attained an increased employment level of at least 1,500, the taxpayer may reduce its increased employment level by up to 40% each year without being subject to a reduction in the maximum amount of the credit for which it is eligible. For example, if a taxpayer has an increased employment level of 1,500 in 2010, the taxpayer would be eligible for a maximum credit of $15 million per year. In 2011, the taxpayer could reduce its increased employment level to 900 while maintaining eligibility for up to $15 million per year in tax credits. Then, in 2012, the taxpayer could reduce its increased employment level to 540 while still maintaining eligibility for a maximum credit of $15 million.

  Taken to the mathematical extreme, it is theoretically possible for a taxpayer to reduce its increased employment level by almost 99% over nine years while maintaining eligibility for the maximum amount of the credit. Continuing the example cited above, a taxpayer that had an increased employment level of 1,500 in 2010 that took the 40% reduction each year would have an increased employment level of just 16 by 2019 and would still be eligible for a maximum credit of $15 million.[8]

[8] The amount of the credit is also based on output at the facility. It is likely that a taxpayer that greatly decreased its employment level at a facility would also decrease output, so the taxpayer may not be able to take advantage of the maximum amount of the credit.

- There is no wage standard associated with this credit. The Bill Lee Act generally requires that jobs at the relevant facility satisfy a wage standard in order for the taxpayer to be eligible for a credit under that Act. A wage standard does not apply in tiers one and two or in development zones. Although there was no wage standard requirement for the alternative credit for cigarette exportation enacted in 2003, it was understood at the time that those jobs would easily satisfy the Bill Lee wage standard.

- The 25-year carryforward period for credits under this act is extremely long, although not unprecedented.

- This credit is the first one the State has enacted that would give one entity a credit for activity undertaken by another. North Carolina has struggled for years with companies using related entities as a tax avoidance mechanism. Companies create related Delaware holding companies and use accounting tricks to eliminate their North Carolina taxable income. Companies create complex chains of related companies to shift property into LLCs and avoid franchise tax. Shifting income and expenses between and among various related entities is the essence of tax avoidance. North Carolina is a separate entity filing state; therefore the Department of Revenue cannot view the entire web of inter-related entities to determine the real economic effect of the actions of related entities.

Bill Lee Incentive Enhancements

Section 2 of the act provides that a taxpayer who is otherwise eligible for one of the tax credits under the Bill Lee Act and who qualifies for the tax credit for major computer manufacturing facilities is eligible for the following major computer facility enhancements under the Bill Lee Act, regardless of the enterprise tier designation of the county in which it is located. The taxpayer may include employees of or investments made by related entities or strategic partners to meet its Bill Lee eligibility requirements. The Bill Lee Act expires for computer manufacturing facilities in 2009.

- Wage Standard. – The wage standard does not apply to the activities of the taxpayer at the major computer facility. Under prior law, the wage standard was inapplicable only in tiers one and two or in development zones.

- Credit for Creating Jobs. – The amount of the credit for creating jobs is increased by \$4,000 per job for jobs at the major computer facility. For jobs created at other facilities, the amount of the credit remains at \$500 per job in a tier five county; \$1000 in tier four; \$3,000 in tier three; \$4,000 in tier two; and \$12,500 in tier one.

- Credit for Investing in Machinery and Equipment. – The threshold investment a taxpayer must meet to qualify for the credit and the amount of credit the taxpayer is allowed under the Bill Lee Act is the same as allowed under current law for a tier one county: a threshold amount of zero and a credit amount equal to 7% of the eligible investment. Under current law, the threshold for a tier five county is \$2 million and the applicable credit percentage is 4%.

- Credit for Worker Training. – The maximum amount of the credit is \$1,000 per worker. This is the same credit amount allowed to other taxpayers for jobs in a tier one area. If the jobs are not in a tier one area, then other taxpayers are allowed a $500 credit for worker training..

- Credit for Substantial Investment in Other Property. – Under prior law, this 30% credit was available only for property located in a tier one or two area. The credit in the act is available to a taxpayer who qualifies as a major computer manufacturing facility regardless of the enterprise tier area in which the property is located.

Sales Tax Incentives

In 2003, the General Assembly provided that the owner of an eligible facility that invests at least $100,000,000 of private funds to acquire, construct, and equip a facility in North Carolina was allowed an annual refund of sales and use taxes paid by it on building materials, building supplies, fixtures, and equipment that become a part of the real property of the eligible facility. An eligible facility includes computer manufacturing. If the owner of an eligible facility does not make the required minimum investment within five years after the first refund is allowed, the facility loses its eligibility and the owner forfeits all refunds already received. Upon forfeiture, the owner is liable for tax equal to the amount of all past taxes refunded plus interest. The tax and interest are due 30 days after the date of the forfeiture.

Section 3 of the act makes several changes to the sales tax refund statute as it applies to computer manufacturing. These changes are effective January 1, 2005, and apply to sales made on or after that date:

- It provides that the investment may be made directly by the taxpayer or indirectly through a related entity.
- It clarifies that a 'computer facility' may include multiple buildings on a single campus.
- It provides that the term 'computer manufacturing' includes peripheral equipment if the manufacture or assembly of this peripheral equipment occurs at the facility or campus at which the taxpayer also manufactures or assembles electronic computers.

Section 4 of the act adds an exemption to the confidentiality of tax information statute so that the State may verify information received by a taxpayer claiming the credit under the act with a related entity or strategic partner.

Hurricane Recovery Act of 2005.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-1	**SB 7**	**Senator Nesbitt**

AN ACT TO ENACT THE HURRICANE RECOVERY ACT OF 2005, MAKING FINDINGS AS TO DAMAGE CAUSED BY THE HURRICANES THAT STRUCK NORTH CAROLINA IN 2004, CONCERNING ESTABLISHMENT OF THE DISASTER RELIEF RESERVE FUND, MAKING APPROPRIATIONS TO THE DISASTER RELIEF RESERVE FUND, DIRECTING THE

REESTABLISHMENT AND MODIFICATION OF HURRICANE FLOYD RECOVERY PROGRAMS, AUTHORIZING ESTABLISHMENT OF NEW PROGRAMS, EXPANSION OF EXISTING PROGRAMS, AND MODIFICATION OF EXISTING PROGRAMS TO IMPLEMENT THIS ACT, AUTHORIZING TRANSFER OF FUNDS TO FEDERAL AGENCIES AND LOCAL GOVERNMENTS, AUTHORIZING TIME-LIMITED POSITIONS TO IMPLEMENT THIS ACT, PROVIDING FOR SUBROGATION BY THE STATE OF CERTAIN INSURANCE CLAIMS, AUTHORIZING ADVISORY COUNCILS TO ADVISE STATE AGENCIES ON RECOVERY EFFORTS, PROVIDING FOR TAX EXEMPTION OF BENEFITS, DIRECTING THE MAPPING OF FLOOD PLAINS AND THE IDENTIFICATION OF POTENTIAL LANDSLIDE AREAS AND STREAM BANK EROSION, DIRECTING THE DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES TO STUDY THE CAUSES OF FLOODING IN CERTAIN AREAS AND DETERMINE MEASURES TO PREVENT OR MITIGATE FUTURE FLOODING, DIRECTING THE GOVERNOR TO MAINTAIN THE REDEVELOPMENT OFFICE IN WESTERN NORTH CAROLINA, APPROPRIATING FUNDS TO RESTORE AND REPAIR CERTAIN PUBLIC BUILDINGS IN HYDE COUNTY DAMAGED BY HURRICANE ISABEL AND ESTABLISHING REPORTING REQUIREMENTS.

OVERVIEW: This act provides disaster assistance to individuals, businesses, and public agencies that sustained damage from one or more of the six hurricanes that struck North Carolina during the late summer and early fall of 2004. The Governor has established the Disaster Relief Reserve Fund in the Office of State Budget and Management, and this act makes appropriations to this Fund. It also provides greater income tax relief for recipients of disbursements from the Disaster Relief Reserve Fund than current law allows.

FISCAL IMPACT: The act appropriates $247,541,447 to the Disaster Relief Reserve Fund. The State income tax deduction is expected to result in a one-time loss of General Fund revenues of $1,575,000.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The tax deduction became effective for taxable years beginning on or after January 1, 2004; the remainder of the act became effective when it became law, February 25, 2005.

ANALYSIS: North Carolina was struck by six hurricanes in 2004. Hurricanes Alex, Bonnie, Charlie, and Jeanne brought flooding and wind damage to the Eastern Region of the State. Hurricanes Frances and Ivan dumped heavy rains in the Western Region of the State resulting in landslides, flooding, and the death of at least 11 people. Forty-five counties in western North Carolina were included in federal disaster declarations as a result of

Hurricanes Frances and Ivan. Nineteen of those counties were designated by FEMA as eligible for individual assistance and public assistance. Another twenty-six counties were designated as eligible for individual assistance. The damage in the Eastern Region resulted in State disaster declarations.

This act is known as the 'Hurricane Recovery Act of 2005'. It sets forth detailed findings regarding the impacts of the many hurricanes on individuals, businesses, and local governments in the affected areas. One of the findings states that further deterioration of the economy, environment, public health and safety, and quality of life in the State is likely to occur unless significant additional State assistance is allocated to the areas affected.

The act establishes the following 47 counties as eligible to receive assistance under the Act:

- The 19 counties that were designated as eligible for federal individual assistance and public assistance: Alleghany, Ashe, Avery, Buncombe, Burke, Caldwell, Haywood, Henderson, Jackson, Macon, Madison, McDowell, Mitchell, Polk, Rutherford, Swain, Transylvania, Watauga, and Yancey.
- The 26 counties that were eligible for federal public assistance: Alamance, Alexander, Bladen, Cabarrus, Caswell, Catawba, Cleveland, Columbus, Cumberland, Davidson, Forsyth, Gaston, Graham, Guilford, Hoke, Iredell, Lincoln, Mecklenburg, Randolph, Robeson, Rockingham, Rutherford, Scotland, Stokes, Union and Wilkes.
- The two counties that were not included in a federal disaster declaration but were included in a State disaster declaration as a result of the damages sustained by one of the hurricanes that occurred in 2004: Hyde and Dare.

The act notes that the Governor has established the Disaster Relief Reserve Fund for the purpose of providing necessary and appropriate assistance and relief needed as a result of natural disasters. Funds in the Disaster Relief Reserve Fund may be used for a variety of purposes such as housing buyout and relocation assistance, loans, infrastructure repair, studies, and federal matches. The Governor must report periodically to the Appropriations Committees and to the Joint Legislative Commission on Governmental Operations on the use of the money in the Fund. The act appropriates $247,541,447 to the Fund. This amount comes from the following sources:

- $91 million from unexpended General Fund appropriations for fiscal year 2004-2005.
- $153,541,447 million from the Savings Reserve Account. Of this amount, $30,000,000 must be used to implement the recommendations of the study on flood prevention and mitigation.
- $3 million in reversions from the NC Community Development Initiative for Hurricane Floyd recovery programs. (These are unused Hurricane Floyd Recovery funds)

The act also provides a State income tax deduction equal to the amount paid to the taxpayer, either individual or business, during the taxable year from the Disaster Relief Recovery Fund. The deduction does not apply to amounts received as payments for goods and services provided by the taxpayer. Under current State and federal law, payments received to replace property lost in a federally declared disaster are exempt from tax. However, payments received to replace income are not exempt. Payments to farmers for crop losses would be an example of a taxable payment, as the crops are assumed to be converted into income. The General Assembly provided similar tax relief to Hurricane Floyd victims in 1999. The deduction is effective for taxable years beginning on or after January 1, 2004.

NASCAR Hall of Fame Financing.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-68	**SB 525**	**Senator Clodfelter**

AN ACT RELATING TO NASCAR HALL OF FAME FINANCING.

OVERVIEW: This act authorizes the Mecklenburg County Board of Commissioners to levy an additional 2% occupancy tax upon receiving written confirmation from NASCAR that it will locate the NASCAR Hall of Fame Museum facility in Charlotte. The net proceeds of the additional 2% occupancy tax can be used only for the acquisition, construction, repair, maintenance, and financing of the NASCAR Hall of Fame Museum facility and an adjacent NASCAR convention center ballroom facility. The additional 2% tax would bring the occupancy tax rate to 8% in Mecklenburg. No other county or city in North Carolina currently has an occupancy tax rate in excess of 6%.

FISCAL IMPACT: The act does not impact State revenues. The additional 2% occupancy tax rate will generate an additional $5.8 million in 2005-06 fiscal year for Mecklenburg County; the amount is projected to increase to $7 million by fiscal year 2009 - 2010.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act became effective when it became law, May 26, 2005.

ANALYSIS: NASCAR plans to locate a NASCAR Hall of Fame Museum in one of five cities. The City of Charlotte is one of the five locations being considered.[9] To finance the capital costs of building the facility, the City of Charlotte and Mecklenburg County requested, and the General Assembly enacted, authorization for Mecklenburg County to levy an additional 2% occupancy tax. Mecklenburg County currently has the authority to levy a 6% occupancy tax. Of the more than 74 counties and 65 cities authorized to levy a room occupancy tax, no locality has the authority to levy an occupancy tax in excess of 6%.[10]

In authorizing Mecklenburg County to levy an 8% occupancy tax, the General Assembly set strict parameters around the levy, use, and repeal of the tax. The act authorizes Mecklenburg County to levy an additional 2% room occupancy tax upon receiving written confirmation

[9] The other cities are Daytona Beach, FL; Atlanta, GA; Richmond, VA; and Kansas City, KS.

[10] In 1993, a House Finance Subcommittee on Occupancy Tax established uniform guidelines for the occupancy tax legislation it considered. As a general rule, the House Finance Committee continues to follow these guidelines. One of those guidelines is that the combined city and county tax rate cannot exceed 6%.

from NASCAR that it will locate the NASCAR Hall of Fame Museum facility in Charlotte. The proceeds of the additional 2% occupancy tax must be distributed to the City of Charlotte and used only for the acquisition, construction, repair, maintenance, and financing of a NASCAR Hall of Fame Museum facility and an ancillary and adjacent NASCAR convention center ballroom facility. By using the term 'proceeds' instead of the defined term 'net proceeds', the bill ensures that all of the proceeds of the additional 2% tax will be used for the stated purposes and that none of the proceeds will be used for administrative expenses associated with collecting and administering the additional 2% tax. Lastly, the act provides that the Mecklenburg County Board of Commissioners must repeal the tax effective the earlier of July 1, 2038, or July 1 following the date of final satisfaction of all debt instruments or obligations issued by the City of Charlotte (or a related special purpose entity) in connection with the financing or refinancing of the NASCAR Hall of Fame Museum facility.

Allow Payment of Tax by Offset.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-134	**SB 537**	**Senator Clodfelter**

AN ACT TO ALLOW THE PAYMENT OF TAXES IN LIMITED CIRCUMSTANCES BY OFFSET OF AN OBLIGATION OWED TO THE TAXPAYER BY THE TAXING UNIT.

OVERVIEW: This act provides that a taxing unit may, under limited circumstances, collect taxes through offset of an obligation owed to the taxpayer by the taxing unit.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when signed into law by the Governor on June 29, 2005.

ANALYSIS: G.S. 105-357 provides that taxes owed to local taxing authorities are payable in existing national currency. A taxing unit is specifically prohibited from accepting the following as payment of taxes: deeds to real property; notes of the taxpayer; bonds or notes of the taxing unit; or payments in kind.[11] Prior to the enactment of this act, G.S. 105-357 also specifically prohibited a taxing unit from permitting the payment of taxes by offset of any bill, claim, judgment, or other obligation owed to the taxpayer by the taxing unit. This act provides that the prohibition against payment of taxes by offset does not apply to an offset of an obligation that arose under a lease or another contract entered into before July 1 of the fiscal year for which the taxes are levied.

This change was intended to facilitate the collection of taxes when a taxpayer has declared bankruptcy. When a taxpayer declares bankruptcy, the bankruptcy laws generally operate as a stay for all actions to collect pre-petition debts.[12] However, a creditor's right of setoff under non-bankruptcy law is preserved when the right of setoff arose before the commencement

[11] G.S. 105-241 provides that taxes owed to the State are payable in national currency. However, the statute does not specifically prohibit the right of setoff.
[12] 11 U.S.C. § 362.

of the bankruptcy case.[13] To affect a setoff, a 'party in interest' must seek court approval from the automatic stay. The court will generally allow the setoff if the debt is a pre-petition debt and if the right of offset existed under applicable non-bankruptcy law. Prior to the enactment of this act, G.S. 105-357 prevented local taxing authorities from utilizing this form of collection in bankruptcy cases because, as applicable non-bankruptcy law, it forbid such an offset.

2005 Continuing Budget Authority/Revenue.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-144	**HB 1630**	**Representative Luebke**

AN ACT AUTHORIZING THE DIRECTOR OF THE BUDGET TO CONTINUE EXPENDITURES FOR THE OPERATION OF GOVERNMENT AT THE LEVEL IN EFFECT ON JUNE 30, 2005; EXTENDING THE FINAL MATURITY OF CERTAIN GLOBAL TRANSPARK DEBT FROM JULY 1, 2005, UNTIL JULY 31, 2005; EXTENDING THE SUNSET ON RETIRED TEACHERS RETURNING TO THE CLASSROOM UNTIL JULY 31, 2007; CONFORMING THE STATE ESTATE TAX TO THE FEDERAL ESTATE TAX SUNSET; AND EXTENDING THE SUNSET ON THE ADDITIONAL ONE-HALF CENT STATE SALES AND USE TAX FROM JULY 1, 2005, UNTIL THE 2005 APPROPRIATIONS ACT BECOMES LAW.

OVERVIEW: Part VIII of the act conforms the repeal of the North Carolina estate tax to the repeal of the federal estate tax. Part IX of the act extends the sunset of the additional one-half cent State sales and use tax until the date that the Current Operations and Capital Improvements Appropriations Act of 2005 (hereinafter 2005 Appropriations Act) becomes law, but in no event is the tax extended beyond December 31, 2005.[14]

The remaining parts of the act set out temporary year-end transitional provisions that were in effect until the passage of the 2005 Appropriations Act, extended the maturity date of certain debt of the Global Transpark Authority, and extended the sunset on retired teachers returning to the classroom.[15]

FISCAL IMPACT: The extension of the estate tax sunset is estimated to generate gains to the General Fund of $30.6 million in FY 2005-06 and $121.6 million in FY 2006-07. See the summary of S.L 2005—276 (2005 Appropriations Act) for the fiscal impact of the extension of the one-half cent state sales tax.

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[13] 11 U.S.C. § 553.
[14] The 2005 Appropriations Act became law on August 13, 2005, and extended the sunset on the additional one-half cent State sales and use tax to July 1, 2007. (See Section 33.1 of S.L. 2005-276).
[15] S.L. 2005-201 extended the maturity date of certain Global Transpark debt to August 31, 2005.

(For a more complete fiscal analysis, see *__Overview: Fiscal and Budgetary Actions, 2005 Session.__* *Available in the Legislative Library.)*

__**EFFECTIVE DATE:**__ Parts VIII and IX of the Act became effective when signed into law by the Governor on June 30, 2005.

__**ANALYSIS:**__ Part VIII of the act conforms the repeal of the State estate tax to the repeal of the federal estate tax, which is scheduled to become effective for deaths occurring on or after January 1, 2010. The State continues to conform to the increasing federal exemption amounts.[16] The amount of the State estate tax remains at the amount of the State death tax credit allowed under the Internal Revenue Code in 2001. The Governor and the Senate, in Senate Bill 622, also recommended continuing the State estate tax.

North Carolina repealed its inheritance tax in 1998, effective for deaths occurring on or after January 1, 1999. It replaced the inheritance tax with an estate tax that was equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of state estate tax was known as a "pick-up" tax because it picked up for the state the amount of federal estate tax that would otherwise be paid to the federal government. In 2001, Congress increased the exclusion amount for the federal estate tax and phased out the state death tax credit over four years by reducing it 25% in 2002, 50% in 2003, and 75% in 2004%, and by repealing it entirely in 2005.

In 2002, the General Assembly enacted legislation not to conform to the phase-out of the state death tax credit. In other words, North Carolina began tying the amount of the State estate tax owed to the federal credit as it existed in 2001 rather than as it currently exists. The 2002 legislation was set to sunset for estates of decedents dying on or after January 1, 2004. S.L. 2003-2004 extended the sunset to July 1, 2005, meaning that the estate tax would continue to be based on the federal credit as it existed in 2001. This act removes the sunset. The result of the removal of the sunset is that so long as there is a federal estate tax, there will be a North Carolina estate tax. The amount of the State estate tax will be equal to the amount of the federal state death tax credit as it existed in 2001.

Part IX of the act extends the sunset on the additional one-half percent State sales and use tax rate to the date that the 2005 Appropriatons Act became law. The General Assembly increased the State sales and use tax rate in S.L. 2001-424 from 4% to 4.5%. This increase was to sunset July 1, 2003. S.L. 2003-284 extended the sunset for two years to July 1, 2005. The 2005 Appropriations Act extends the additional one-half per cent rate to July 1, 2007.

Before 2001, the State sales and use tax rate had last been increased in 1991 from 3% to 4%. The Governor's 2005 budget (House Bill 719) recommended removal of the sunset on the ½% additional State sales and use tax, and the Senate passed his recommendation in Senate Bill 622.

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[16] North Carolina conforms to the following federal exemption amounts: 100% exemption for property passing to a surviving spouse; $1.5 million exemption for other estates. Under current federal law, this exemption amount rises to $2 million in 2006, $3.5 million by 2009, and the tax is fully repealed in 2010.

Public Finance Changes.

Session Law	Bill #	Sponsor
S.L. 2005-238	**HB 1117**	**Representative Ross**

AN ACT TO MAKE CHANGES TO STATE AND LOCAL GOVERNMENT FINANCE LAWS AND TO AUTHORIZE PUBLIC HOSPITAL AUTHORITIES TO GRANT MORTGAGES TO FINANCE OR REFINANCE HOSPITAL FACILITIES AND EQUIPMENT.

OVERVIEW: This act makes various amendments to statutes dealing with public finance. The act contains a severability clause so that if any provision of the act is found invalid, the invalidity will not affect other provisions of the act.

FISCAL IMPACT: No impact.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The act became effective August 1, 2005.

ANALYSIS: This act makes various changes to State and local government finance laws.

Project Development Financing. – In 2003, the General Assembly passed an act authorizing the voters of the State to vote in the November 2004 statewide general election on an amendment to the North Carolina Constitution that would allow local governments to finance development within defined districts by issuing tax increment financing bonds without a local referendum. The ballot measure passed. This development tool, known as 'project development financing', allows local governments to set aside the additional property taxes that are generated by a new investment to pay for public facilities that support that new investment. Under current law, the total land area of the defined district, known as the 'development financing district', may not exceed 5% of the total land area of the unit creating the district. The district also must be comprised of property that is one or more of the following:

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

The act provides that land in a district created by a county that subsequently becomes part of a municipality does not count against the five-percent (5%) limit for the municipality unless the municipality has entered into an agreement with the county under which the city taxes on the incremental valuation of the property in the district will secure the bonds issued by the county.[17]

[17] Sections 1, 5, and 12 of the act.

The act makes one other change to the project development financing statutes. Under prior law, units of local government could issue project development financing debt instruments, and agree to repay the debt with any available revenues of the unit, provided the agreement did not constitute a pledge of the unit's taxing power. The act expands the sources of revenue that may be pledged as security for the bond to include revenues to be raised from any special assessment, provided it did not constitute a pledge of the unit's taxing power, and the encumbrance of any real or personal property being financed or improved by the project. Any property so encumbered could be sold in accordance with the encumbering document and would not fall under any disposition of governmental property statutes. The act also allows cities and towns to pledge local sales tax revenues. Those revenues do not constitute a pledge of the taxing power of a city or town because local sales tax is a county tax that is shared with the municipalities, not a tax levied by a city or town.[18]

Revenue Bonds. – The State and units of local government are authorized to issue revenue bonds, but prior law specifically prohibited them from encumbering the related real property. This act allows the State and units of local government, including hospital facilities, to pledge, mortgage, or grant a security interest in real and personal property, whether owned or leased, comprising the utility or public enterprise project affected by the bond issuance. Any property so encumbered could be sold in accordance with the encumbering document and would not fall under any disposition of governmental property statutes. The act authorizes the same encumbrance of property in connection with the issuance of revenue bonds made through the Medical Care Commission that could occur through the Revenue Bond Act. The act also makes a similar change in the NC Clean Water Revolving Loan and Grant Act by permitting an applicant for clean water revolving grants and loans to grant a mortgage on the assets being financed.[19] Local government units and certain non-profit water corporations may apply for clean water revolving grants and loans.

General Changes. – The act makes the following general changes to the State and local finance laws:

- Local governments are required to appoint a finance officer to carry out certain statutorily required duties.[20] Under prior law, the finance officer was required to have a performance bond of at least $10,000 and no more than $250,000, payable to the local government. The act increased the minimum bond amount to $50,000 and removed the cap.[21]

- Under prior law, the public notification and hearing requirements for refunding bonds were the same as for the original issuance. The act provides that if refunding bonds do not extend the maturity of, or increase the aggregate debt service on, the debt being refunded, then a new public hearing is not required, the bond order may be introduced and adopted in one day, and various restrictions about installments, issues, series, and redemption do not apply.[22]

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[18] Section 6 of the act.
[19] Sections 4, 11, 13, and 14 of the act.
[20] G.S. 159-24 and G.S. 159-25.
[21] Section 2 of the act.
[22] Section 3 of the act.

- The act removes the requirement that all bonds of a particular maturity must bear interest at the same rate and clarifies that the interest rate restrictions do not apply to private negotiated sales.[23]
- The act eliminates the 2% deposit on the bids for general obligation bonds and in its place permits the Local Government Commission to set an appropriate bid deposit or to determine no bid deposit is required.[24]
- Bonds sold at public sale must be awarded to the bidder offering to purchase the bonds at the lowest interest cost. The act replaces the current statutory language used to determine the lowest interest cost for bond bid purposes with Local Government Commission authority to establish the appropriate calculation method in the notice of sale.[25]
- The act replaces the antiquated system for destroying cancelled bonds. It permits cancelled bonds to be destroyed by being marked cancelled in the manner determined by the finance officer with an entry of the destruction or cancellation entered in the government's official records. Under the prior law, the cancelled debt instrument had to be burned or shredded and the appropriate entry made in a 'substantially bound book'.[26]
- Lastly, the act expands the purposes for which the North Carolina Capital Facilities Financing Agency and local industrial development authorities may issue bonds to include museums and orphanages and similar housing facilities for children or disadvantaged or disabled persons.[27]

Extend JDIG and Bill Lee Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-241	**HB 1004**	**Rep. Gibson, Grady**

AN ACT TO EXTEND THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT AND THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; TO ALTER THE MANNER IN WHICH ENTERPRISE TIERS ARE DESIGNATED; TO AMEND THE HEALTH INSURANCE REQUIREMENTS FOR THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM; AND TO CREATE AN ECONOMIC DEVELOPMENT OVERSIGHT

[23] Section 7 of the act.
[24] Section 7 of the act.
[25] Section 8 of the act.
[26] Section 9 of the act.
[27] Section 10 of the act.

COMMITTEE TO PERFORM A COMPREHENSIVE STUDY OF THE ECONOMIC DEVELOPMENT INCENTIVES.

OVERVIEW: This act makes the following changes to the William S. Lee Quality Jobs and Business Expansion Act (hereinafter the Bill Lee Act) and the Job Development Investment Grant Program (hereinafter the JDIG Program):

- Extends the sunset for the Bill Lee Act and the JDIG Program until January 1, 2008. For certain projects located in development zones, the sunset of the Bill Lee Act is extended until January 1, 2010.
- Amends and adds exceptions to the tier designation formula under the Bill Lee Act as follows:
  - Adds an exception to designate a county as a tier one area if the county's rate of unemployment was one of the ten highest in the State for the most recent 12-month period preceding the designation.
  - Amends the exception for certain small counties that have a population of less than 12,000 and that meet a certain poverty level, by requiring that the counties only meet the population requirement to be designated a tier one area.
- Amends the JDIG Program so that an eligible business no longer is required to provide health insurance for **all** full-time employees. The eligible business must provide health insurance only to a full-time employee who earns less than $150,000 in taxable compensation annually or three and one-half times the annualized average wage for all private insured employers in the State employing between 250 and 1,000 people.
- Creates an Economic Development Oversight Committee

FISCAL IMPACT: Changes to the Bill Lee Act are estimated to reduce General Fund revenues by $2.03 million in FY 2006-07, $7.22 million in FY 2007-08, $5.47 million in FY 2008-09, and $5.64 million in FY 2009-10. The extension of the JDIG sunset is estimated to reduce General Fund revenues by $4.50 million in FY 2006-07, $9 million in FY 2007-08, $9 million in FY 2008-09, and $6 million in FY 2009-10.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act became effective when signed into law by the Governor on July 29, 2005. The sections of the act amending and adding exceptions to the tier designation formula of the Bill Lee Act apply to designations made on or after July 29, 2005.

ANALYSIS:

Extension of Sunsets for Bill Lee Act and JDIG Program

This act extends the sunsets on both the Bill Lee Act and the JDIG Program generally from January 1, 2006 to January 1, 2008.[28] In addition, the act extends the Bill Lee Act until

[28] There are several exceptions to the 2006 sunset date: Interstate air couriers are eligible to claim the credits for business activity that occurs on or before January 1, 2010, provided that the interstate air courier entered

January 1, 2010, for projects located in development zones if all of the following conditions[29] are met:

- Before January 1, 2006, the taxpayer must sign a letter of commitment with the Department of Commerce describing the proposed new or expanding project.
- Before January 1, 2006, the Secretary of Commerce must make a written determination that the taxpayer is expected to place in service at least $10 million of new machinery and equipment in a development zone over a three-year period and that the taxpayer will create at least 300 new jobs at the location over a three-year period.
- Before January 1, 2006, the taxpayer must place in service at least $4 million of real property and machinery and equipment in service at the location and must create at least 20 new jobs.

In 1998, the General Assembly amended the Bill Lee Act to provide additional incentives for businesses that locate or expand in development zones, which are economically distressed areas located within cities. In order to be designated as a development zone by the Department of Commerce, the area must satisfy all of the following conditions: (1) every census tract or block group in the zone is located at least partially in a city with a population of at least 5,000, (2) the zone has a population of at least 1,000, (3) more than 20% of the population of the zone is below the poverty level, (4) every census tract and census block group in the zone has more than 10% of its population below the poverty level, or is immediately adjacent to a tract or group that has more than 20% of its population below the poverty level, and (5) no census tract or block group in the zone is located in another development zone. Designation as a development zone is effective for two years.

Location in a development zone leads to enhanced tax incentives. For example, if a business locates in a development zone, its maximum worker training credit is $1,000 rather than $500, it receives an additional $4,000 per job on its jobs tax credit, and the credit for investing in machinery and equipment is calculated as if the zone were a tier one county. Finally, a business located in a development zone does not have to meet a wage standard to be eligible for the credits.

Exceptions to Tier Formula in Bill Lee Act[30]

into a real estate lease on or before January 1, 2006, with an airport authority that provides for the lease of at least 100 acres of land for a term of at least 15 years. Taxpayers that qualify as "eligible major industries" before January 1, 2006, are also allowed to claim credits for business activity that occurs on or before January 1, 2010. A taxpayer is an eligible major industry if it will invest at least $100 million in acquiring, constructing, and equipping a facility and it is engaged in bioprocessing, the manufacture or distribution of pharmaceuticals or medicines, aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, or semiconductor manufacturing. Also the credit for research and development under the Bill Lee Act would still expire effective January 1, 2006. During the 2004 Regular Session, the research and development credit under the Bill Lee Act was replaced with a stand-alone credit for research and development under Article 3F of Chapter 105. (See Part 32D of S.L. 2004-124) This stand-alone credit sunsets January 1, 2009.

[29] Only two projects qualified for this extension at the time this act was enacted: The Cheesecake Factory in Nash County and the Dole plant in Gaston County.

[30] S.L. 2005-406 also amends the tier designation formula by allowing certain industrial parks located in higher-tiered counties to be treated as if they were located in an enterprise tier one area if the parks meet conditions related to government ownership, size, population of the counties, and Medicaid eligibility within the counties.

Under the Bill Lee Act, counties are divided into five enterprise tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. 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 of Commerce must rank all 100 counties based on the following factors: the rank of the county in a ranking of counties by average rate of unemployment over the preceding 12 months from lowest to highest, the rank of the county in a ranking of counties by average per capita income over the preceding 12 months from highest to lowest, and the rank of the county in a ranking of counties by percentage growth in population over the preceding 12 months from highest to lowest. Each of these factors is given equal weight. The Secretary of Commerce is required to use the latest data available in making these calculations. Counties with one of the 10 highest rankings are designated enterprise tier one, the next 15 counties are enterprise tier two, the next 25 counties are enterprise tier three, the next 25 counties are enterprise tier four, and the remaining counties are enterprise tier five.

There are several exceptions to the tier formula. Once exception provides that any county that has a population of less than 12,000 and more than 16% of its population living below the federal poverty level is automatically a tier one county. This act eliminates the requirement related to the percent living below the poverty level. If this provision had been in effect for the 2005 designations, two counties would have been affected: Camden and Clay Counties would have been designated as enterprise tier one areas rather than enterprise tier three areas.

This act also creates a new exception for counties with particularly high rates of unemployment. Any county whose rate of unemployment was one of the ten highest in the State for the most recent 12-month period preceding the designation is automatically designated an enterprise tier one area. If this new exception had been in effect for the 2005 designation, five counties would have been affected: Anson, Cleveland, Rockingham, and Rutherford Counties would have fallen from tier two to tier one; Wilson County would have fallen from tier three to tier one

Health Insurance Requirement for JDIG Program

In 2002, the General Assembly created a new economic development tool for new and expanding businesses in North Carolina, the Job Development Investment Grant (JDIG) Program. The JDIG Program is used to attract businesses to the State by allowing a five-member committee to award grants to businesses. The grants may be awarded over as many as 12 years and the amounts of the grants are based on income tax withholdings from new jobs created by the businesses. The committee may enter into no more than 25 agreements per calendar year and may commit no more than $15 million in any fiscal year under all agreements entered into during a single calendar year. In order to be eligible for a grant under the JDIG Program, a business must provide health insurance for all full-time jobs associated with the project. The test is the same as under the Bill Lee Act – the business must, for all full-time employees of the project, pay at least 50% of the premiums for health insurance that meets at least the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee.

This act eliminates the requirement that the business provide health insurance for any individual whose taxable compensation from the business exceeds the greater of $150,000 on an annualized basis or 3.5 times the average wage for all private insured employers in the State employing between 250 and 1,000 people.

Creation of Economic Development Oversight Committee.

This act creates an Economic Development Oversight Committee.[31] This standing committee consists of twelve members: six appointed by the Speaker of the House of Representatives and six appointed by the President Pro Tempore of the Senate. The act directs the Committee to study the budgets, programs, and policies of various State, regional, and local entities involved with economic development; to analyze legislation from other states regarding economic development; and to analyze proposals of the Economic Development Board. Before the 2006 Regular Session, the Committee must complete a comprehensive study of the Bill Lee Act and JDIG Program. The Committee is also required to hold at least one joint meeting with the Revenue Laws Study Committee before issuing a report on the comprehensive study. The act states that it is the intent of the General Assembly to replace the Bill Lee Act and to revamp the JDIG Program based on the recommendations of the Committee.

2005 Appropriations Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-276	**SB 622**	**Senator Garrou**

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

OVERVIEW, EFFECTIVE DATES, AND FISCAL IMPACT:

Part	Description and Effective Dates	Fiscal Impact
7	**LEA Sales Tax Refund Reporting & Redirect Refundable Sales to State Public School Fund**	
	Section 7.27 authorizes the Department of Revenue to release sales tax refund data for individual LEAs.	No impact.
	Section 7.51 redirects sales and use tax refunds payable to LEAs to the State Public School Fund.	$33,300,000 recurring General Fund Revenue, beginning with the 2006-07 fiscal year.
8	**Extend the Sunset on Training & Reemployment Contributions made by Employers**	

[31] House Bill 1365, introduced by Rep. Daughtridge, also established an Economic Development Oversight Committee. This bill was in the House Rules Committee at the end of the Session.

	Section 8.8 extends for an additional five years the expiration of a tax, known as a "training and reemployment contribution" paid by employers in lieu of part of the unemployment taxes they would otherwise owe.	No impact.
11	**Increase Funds for North Carolina Grape Growers Council** Section 11.4 expands the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council by raising the annual cap from $350,000 to $500,000, effective October 1, 2005.	
22	**Department of Revenue Debt Fee for Taxpayer Locater Services and Collection and Property Tax Commission Per Diem** Section 22.1 adds three more purposes to the list of purposes for which the collection assistance fee may be used. Section 22.5 authorizes the Property Tax Commission to set the salary for its members, effective September 1, 2005.	
33	**Sales Tax Changes** This part makes the following changes to the State sales and use tax laws: • Section 33.1 extends the one-half cent State sales tax to July 1, 2007, effective August 13, 2005. • Section 33.11 taxes railway cars and locomotives at the general rate (was 3% State rate with cap of $1,500 per item), effective January 1, 2006. Section 33.12 provides interstate carriers a refund of a portion of the taxes paid.	FY 2005-06 $417.1 million gain FY 2006-07 $462.7 million gain FY 2007-08 $31.6 million gain Minimal fiscal impact expected

	• Section 33.4 taxes telecommunications at the combined general rate (was 6%), effective October 1, 2005. • Section 33.6 includes voicemail as part of the gross receipts of telecommunications service, effective October 1, 2005. • Section 33.4 taxes direct-to-home satellite service at combined general rate (was 5%), effective October 1, 2005.	FY 2005-06 $32.1 million gain. The gain is estimated at $51.7 million for a full fiscal year. Minimal fiscal impact. FY 2005-06 $6.5 million gain. The gain is estimated at $10.5 million for a full fiscal year.
	• Sections 33.4 and 33.14 tax cable service at combined general rate, and allow a cable service provider a credit for the local franchise taxes paid on cable service (was no sales tax), effective January 1, 2006. • Section 33.4 taxes satellite digital audio radio service at general rate (was no sales tax), effective January 1, 2006. • Section 33.4 taxes spirituous liquor at combined general rate (was 6%), effective October 1, 2005. • Section 33.10 taxes candy at general rate (was exempt), effective October 1, 2005.[32] • Section 33.4 taxes mobile classrooms and mobile offices at the general rate (was taxed at 3% State rate with cap of $1,500 per item), effective January 1, 2006. • Section 33.9 exempts the following	FY 2005-06 $10.9 million gain FY 2006-07 $26.1 million gain No fiscal information available, but a revenue gain is expected in future years. FY 2005-06 $2.9 million gain FY 2005-06 $9.8 million gain FY 2006-07 $15.8 million gain FY 2005-06 $0.1 million gain FY 2006-07 $0.3 million gain The exemption of items taxed at 1%

[32] Prior to 2003, candy was subject to State and local sales tax unless it was purchased for home consumption. S.L. 2003-284 exempted candy from sales tax. The taxation of candy brings it in line with the taxation of soft drinks.

		items currently taxed at special 1% State rate, effective January 1, 2006: o Horses and mules sold to farmers o Animal semen o Fuel, other than electricity, sold to farmers for farm purposes, to manufacturers, and to laundries and dry cleaners o Wrapping paper, cartons, and supplies sold to freezer locker plants	is expected to reduce the General Fund by $0.95 million in FY 2005-06 and thereafter by $2.0 million annually.
		• Section 33.9 exempts the following items currently taxed at the special State rate of 1%, with an $80 cap per item, effective January 1, 2006: o Sales to farmers of machinery, attachments and repair parts for the machinery, and lubricants applied to the machinery. o Sales to farmers of containers for use in planting, harvesting, marketing, packaging, or transporting farm products. o Bulk tobacco barns or racks, parts, and accessories attached to the barns. o Grain, feed, or soybean storage facilities.	The exemption of sales to farmers of machinery and containers and of sales of storage facilities and tobacco barns is estimated to reduce the General Fund by $1.5 million for FY 2005-06 and thereafter, by $3.1 million annually.

		o Sales to laundries and dry cleaners of machinery, parts, and accessories attached to the machinery. o Sales to an interstate passenger air carrier of aircraft simulators for flight crew training. o Sales to an interstate air courier of materials handling equipment and racking systems used at an airport or in a warehouse or distribution facility. o Central office equipment, switchboard equipment, private branch exchange equipment, and terminal equipment sold to telephone companies. o Towers and broadcasting equipment sold to a radio or	The exemption of sales of equipment to laundries, telephone companies, radio and television companies, and air couriers is estimated to reduce the General Fund by $0.9 million for FY 2005-06 and thereafter, by $2.0 million annually.

	television company licensed by the FCC; and broadcasting equipment (excluding cable) sold to a cable service provider. • Section 33.9 exempts sales of potting soil to farmers, effective January 1, 2006.	 Minimal fiscal impact
	• Section 33.9 exempts funeral services, but taxes tangible property such as caskets and monuments at the general rate, effective January 1, 2006. Current law exempts funeral expenses, including coffins and caskets, not to exceed $1,500. • Sections 33.8 and 33.24 make the use tax applicable to taxable services sourced to the State, effective October 1, 2005, and extend the sunset on the use tax line item on the individual income tax return from January 1, 2005 to January 1, 2010. • Section 33.3 adds new definitions to the sales tax laws in order to conform to the Streamlined Sales and Use Tax Agreement, effective October 1, 2005. <u>Revenue Laws Study Committee</u> Section 33.32 directs the Revenue Laws Study Committee to study the following issues and make a final report to the 2007 General Assembly: o Equity of taxation on video, cable, satellite, and data service providers. o Impact of taxing maintenance agreements. (It is the intent of the General Assembly to apply the sales and use tax to maintenance	FY 2005-06 $1.7 million gain FY 2006-07 $2.7 million gain

	agreements beginning July 1, 2006). Section 33.33 reenacts and limits S.L. 2004-123 so that it applies to Dare County only. The 2004 legislation authorized counties to levy an additional 1% sales and use tax for beach nourishment. The legislation, as the title indicates, was meant to apply to Dare County only.	
34	**Tobacco Tax Rate Changes** Effective September 1, 2005, increased the tax on cigarettes from 5 cents a pack to 30 cents a pack. Effective July 1, 2006, increases the tax on cigarettes to 35 cents a pack. Effective September 1, 2005, increased the tax on other tobacco products from 2% to 3%. Effective August 13, 2005, authorized a tobacco product manufacturer that elects to place funds into a qualified escrow fund in lieu of participating in the Master Settlement Agreement to assign its interest in the funds to the benefit of the State.	 FY 2005-06 $117.2 million gain FY 2006-07 $187.3 million gain FY 2007-08 $184.0 million gain FY 2008-09 $179.1 million gain FY 2009-10 $173.7 million gain FY 2005-06 $1.6 million gain FY 2006-07 $2.1 million gain FY 2007-08 $2.2 million gain FY 2008-09 $2.3 million gain FY 2009-10 $2.4 million gain
35	**IRC Update** Effective August 13, 2005, changed the State tax law reference to the Internal Revenue Code from May 1, 2004, to January 1, 2005. However, any amendments to the Internal Revenue Code enacted after May 1, 2004, that would have increased North Carolina taxable income for the 2004 taxable year are effective for 2005 taxable year.	The partial conformance to the Code results in a loss to the General Fund of $8 million for FY 2005-06 and $10.7 million for FY 2006-07.
36	**Individual Income Tax Changes** Extends the 8.25% upper-income individual income tax rate for two more taxable years:	FY 2005-06 $39.8 million gain FY 2006-07 $89.7 million gain FY 2007-08 $50.18 million gain

	2006 and 2007.	
38	**Corporate, Excise, and Insurance Tax Changes** Equalize Gross Premiums Tax Effective for taxable years beginning on or after January 1, 2007, taxes health maintenance organizations (HMOs) at the general gross premiums tax rate of 1.9% and repeals the special 1% rate for HMOs.	 FY 2005-06 no impact FY 2006-07 $13.4 million gain FY 2007-08 $3.94 million gain FY 2008-09 $13.4 million gain FY 2009-10 $13.4 million gain
39	**Tax Incentives/Film Industry Jobs Incentives** Film Industry Jobs Incentives Effective for taxable years beginning on or after January 1, 2005, provides a refundable income tax credit equal to 15% of the production expenses for film and television production companies that spend at least $250,000 in North Carolina in connection with certain productions.	 FY 2005-06 $3.5 million loss FY 2006-07 $3.5 million loss FY 2007-08 $3.5 million loss FY 2008-09 $3.5 million loss FY 2009-10 $3.5 million loss

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

ANALYSIS: This act is known as the 'Current Operations and Capital Improvements Appropriations Act of 2005.' The act contains several tax provisions that are summarized below.

Part 7: Public Schools

Part VII of the act contains two provisions related to the sales and use tax refund allowed to local school administrative units. LEAs are among the list of entities that may apply to the Secretary of Revenue for an annual refund of State and local sales and use taxes paid by it on direct purchases of tangible personal property and services, other than electricity and telecommunications service. A request must be in writing and is due within six months after the end of the LEA's fiscal year.

The first provision can be found in Section 7.27. It allows the Department of Revenue to release sales tax refund information on a per LEA basis and it makes a corresponding change in the tax secrecy statute. This information will be useful in providing complete budget oversight. Since the refund is received outside of the appropriations and budgetary process, the LEA could spend the money in whatever manner it chose. The act requires the Department to make an annual report to the Department of Public Instruction and to the Fiscal Research Division of the General Assembly by March 1 of the amount of refunds claimed by taxpayer. The act directs the Department to also provide this information for the past three fiscal years: 2002-03, 2003-04, and 2004-05.

The second provision can be found in Section 7.51. It redirects estimated State sales tax revenues refundable to LEAs to the State Public School Fund for allotment through State position, dollar, and categorical allotments. The effect of this provision is to funnel all State monies for public education through the budgetary process by eliminating the State monies going directly to LEAs through the refund process.

The provision accomplishes this redirection in three steps:

- It repeals the ability of individual LEAs to obtain an annual refund of the State and local sales and use tax monies paid, effective July 1, 2005, and applicable to sales made on or after that date.[33] LEAs have had the ability to request an annual refund of State and local sales and use taxes paid since July 1, 1998.[34] The provision also repeals the ability of school board cooperatives to obtain a refund; they have had the ability to request annual refunds since July 1, 2003.[35] The LEAs will be able to obtain a refund for sales and use taxes paid by them during the fiscal year 2004-05. The request for the refund must be made on or before December 31, 2005, and the amount will be refunded during fiscal year 2005-06.

- For fiscal year 2006-07, the provision directs the Secretary of Revenue to transfer quarterly a calculated amount from the State sales and use tax net collections to the State Public School Fund. The quarterly amount will be equal to one-fourth of the amount refunded to LEAs and school board cooperatives[36] during the 2005-06 fiscal year plus or minus the percentage of that amount by which the total collection of State sales and use tax increased or decreased during the preceding fiscal year. The Fiscal Research Division estimates that the total amount of this annual earmarking will be $33,000,000.[37]

- For subsequent fiscal years, the provision directs the Secretary to transfer quarterly an amount equal to one-fourth of the amount refunded to LEAs and school board cooperatives during the preceding fiscal year plus or minus the percentage of that amount by which the total collection of State sales and use taxes increased or decreased during the preceding fiscal year.

Part 8: Community Colleges

In 1999, the General Assembly temporarily reduced unemployment insurance taxes for most employers by 20% and levied a corresponding contribution to be used for enhanced reemployment services and worker training programs, effective January 1, 2000.[38] While the unemployment insurance taxes fund the unemployment insurance fund, the training and reemployment contribution is credited to a special account in the State Treasury to be appropriated annually by the General Assembly to the Department of Community Colleges for various worker-training programs. Thus, the training and reemployment contribution

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[33] The intent of the legislation, as reflected by the Committee Report, was to repeal the ability of school boards to obtain a refund of <u>State</u> sales and use taxes paid, not State <u>and</u> local. It is anticipated that a provision will be introduced in the 2006 legislative session to reinstate the refund of local sales and use taxes.
[34] S.L. 1998-212.
[35] S.L. 2003-431.
[36] S.L. 2003-345 corrected a statutory reference made in this provision of the act.
[37] This dollar amount reflects the amount of State sales and use taxes paid by LEAs, not the local sales and use taxes paid by them.
[38] S.L. 1999-321.

program has the effect of redirecting payments from the unemployment insurance fund to appropriations for State worker training programs The training and reemployment contribution program was originally set to expire in 2002. S.L. 2001-424 extended the expiration date to 2006. Section 8.8 of this act extends the sunset date to 2011.

The law, as written in 1999, automatically suspends the training and reemployment contribution any time the unemployment insurance fund falls to $900 million or less or any time the State unemployment rate rises above 4.3%.[39] The training and reemployment contribution was suspended shortly after it was enacted because the unemployment insurance fund balance fell below $900 million. The unemployment insurance fund currently has a balance of roughly $20 million and the State unemployment rate is 5.1%.

Part 11: Department of Agriculture and Consumer Services

The first $350,000 of the net proceeds of the excise tax on fortified and unfortified wine is credited to the Department of Agriculture and Consumer Services.[40] The funds credited to the Department from this tax must be allocated to the North Carolina Grape Growers Council and used to promote the North Carolina grape and wine industry and to contract for research and development services to improve viticultural and enological practices in North Carolina. If any of the earmarked funds are not expended during the fiscal year, they do not revert to the General Fund but remain available to the Grape Growers Council.

Section 11.4 of the act expands the quarterly distribution of a portion of the excise tax on wine to the North Carolina Grape Growers Council by raising the annual cap from $350,000 to $500,000. Prior to 2001, the Council received 94% of the net tax proceeds from the excise tax on unfortified wine and 95% of the tax collected on fortified wine, up to $175,000 a year. In 2001, the General Assembly allocated 100% of the net tax revenues from unfortified and fortified wine to the Council and increased the cap from $175,000 to $350,000 in 2001.[41] The amount distributed to the Council reached the $350,000 cap in fiscal year 2002-03. The net proceeds from the tax in fiscal year 2004-05, and the amount the Council would have received but for the cap, totaled $473,343.

Part 22: Department of Revenue

In 2001, the General Assembly established a system under which the cost of collecting overdue tax debts is to be borne by the delinquent taxpayers, not by the taxpayers who pay their taxes on time. The collection assistance fee is 20% of the overdue tax debt and is a receipt of the Department.[42] The proceeds of the fee are credited to a special, non-reverting account to be used only for collecting overdue tax debts. The Department of Revenue may apply the fee proceeds to pay contractors for collecting tax debts and to pay the fee charged by the federal government for collecting tax debts by offset. The remaining proceeds of the fee may be spent for collecting overdue tax debts only pursuant to appropriation by the General Assembly. In 2004, the General Assembly

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[39] G.S. 96-6.1.

[40] S.L. 2005-380 transferred the North Carolina Grape Growers Council from the Department of Agriculture and Consumer Services to the Department of Commerce.

[41] S.L. 2001-475.

[42] Section 22.6 of S.L. 2005-276 amended the law to provide that the amount of the collection assistance fee would be the actual cost of collection, not to exceed 20% of the amount of the overdue tax debt. However, section 37 of S.L. 2005-345 subsequently repealed this section, leaving the amount of the collection assistance fee at 20% of the amount of the overdue tax debt.

enacted legislation stating that the proceeds of the fee could not be used for any purpose that is not directly and primarily related to collecting overdue tax debts. In addition to the two expenditures specifically authorized in 2001, the General Assembly added 'taxpayer locater services' to the list of purposes directly and primarily related to collecting overdue tax debts.

Section 22.1 of this act adds three more purposes to which the fee proceeds may be applied:

- Postage or other delivery charges for correspondence relating to collecting overdue tax debts.
- Operating expenses for Project Collection Tax and the Taxpayer Assistance Call Center.
- Expenses of the Examination and Collection Division relating to collecting overdue tax debts.

The provision also requires the Department to account for all expenditures using accounting procedures that clearly distinguish costs allocable to collecting overdue tax debts from costs allocable to other purposes and it must demonstrate that none of the fee proceeds are used for any purpose other than collecting overdue tax debts. This section became effective July 1, 2005.

Section 22.5 authorizes the Property Tax Commission to set the salary for its members, effective September 1, 2005. Under prior law, the Commission members were compensated $200 a day for their work on the Commission.[43] In the fourth edition of Senate Bill 622, this provision changed the salary of the Commission members from $200 a day to $400 a day and it also set the salary for the chair of the Commission at $450 a day. Although the final budget act did not set the salaries at this amount, S.L. 2005-345, 'Modify 2005 Budget Appropriations Act', amended this act to appropriate additional funds to the Department of Revenue to be used to pay the increased salaries of the Commission members at that amount.

The Property Tax Commission is the five-member State board of equalization and review that hears and decides taxpayers' administrative appeals from decisions concerning the listing, appraisal, or assessment of property made by county boards of equalization and review and boards of county commissioners. It consists of five members, three of whom are appointed by the Governor, one of whom is appointed by the General Assembly upon the recommendation of the Speaker of the House of Representatives, and one of whom is appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate. The members serve staggered, four-year terms.

The expenses of the Property Tax Commission do not come from the General Fund but are paid by local governments. The Department of Revenue collects local sales taxes on behalf of local governments and distributes the proceeds quarterly. In making these distributions, the Department is required under G.S. 105-501 to deduct the State's costs relating to local

[43] S.L. 2000-67 provided that members of the Commission would receive travel, subsistence, and salary while being trained and clarified those members should receive salary and reimbursement while deciding, as well as hearing, cases.

property tax administration, the Property Tax Commission, the School of Government's property tax training program, and the Local Government Commission.

Part 33: Sales Tax Changes

Part 33 makes a number of changes to the sales tax laws that are necessary to conform to the Streamlined Sales and Use Tax Agreement. The Streamlined Sales Tax Project is an effort by states, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The Project began in March 2000, and has the goal of achieving sufficient simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in participating states. In November 2002, the implementing states approved the Streamlined Sales and Use Tax Agreement. The Agreement contains the uniformity and simplification provisions developed by the Project. On July 1, 2005, eleven states, including North Carolina, were determined to be in substantial compliance with terms of the Agreement. The Agreement becomes effective when at least 10 states representing 20% of the population of all states with a sales tax are in compliance with the provisions of the Agreement. As of October 2005, these requirements were met and the Agreement became effective.

Over the past several years, the Revenue Laws Study Committee has recommended, and the General Assembly has enacted, changes to North Carolina sales tax laws to bring it into compliance with the Agreement. As set out in the OVERVIEW, the act makes the following changes to the sales and use tax laws:

- Section 33.3 defines a number of terms. "Combined general rate" is defined as the State's general rate of tax plus the sum of the rates of the local sales and use taxes. The act defines "Streamlined Agreement" and conforms the definition of "food" to the Agreement by removing "alcoholic beverage" from the definition of food. The act also defines the terms "cable service" and "satellite digital audio radio service".
- Amends the sales tax holiday statute to include definitions for "computer supplies" and "school supplies". A State has the option of allowing a sales tax holiday, but the items included in the holiday must be defined terms under the Agreement. The act includes computer supplies in the sales tax holiday. Computer supplies include computer storage media, printers, printer supplies, hand-held electronic schedulers, and personal digital assistants. Prior to August 2004, the State's sales tax holiday included most of these items. The General Assembly changed the law in 2003 to except these items from the holiday in 2004, in conformity with the Streamlined Agreement. Section 33.11, based upon amendments to the Agreement in November 2004, expands the sales tax holiday to include these items once again so long as the sales price does not exceed $250.
- Sections 33.4 and 33.9 amend the taxation of a number of items as set out in the OVERVIEW by either exempting the item from the sales tax or taxing the item at the combined general rate. These changes satisfy the requirement of the Streamlined Agreement that states must have one tax rate with no caps or thresholds.
- Sections 33.20 and 33.21 expand Article 5F of Chapter 105 to provide that the privilege tax will apply to manufacturing fuel and certain machinery and equipment, effective January 1, 2006. The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Agreement that states must simplify their sales

tax rates. The 2001 legislation, which becomes effective January 1, 2006, repealed the 1% sales tax rate and $80 cap imposed on mill machinery and replaced it with a privilege tax having the same rate. Sections 33.20 and 33.21 of the act continue the sales tax rate simplification requirement by imposing a 1% privilege tax on a manufacturing industry or plant that purchases fuel, other than electricity or piped natural gas, to operate the industry or plant. The act also imposes a 1% privilege tax with a cap of $80 per article on a major recycling facility that purchases certain personal property used at the facility. The privilege tax becomes effective January 1, 2006, and replaces the current sales tax imposed on these taxpayers. There will be no fiscal impact because the privilege tax rates will be the same as the current sales and use tax rates. The change from a sales tax to a privilege tax means that retailers are not responsible for collecting and remitting the tax.

- Section 33.13 clarifies the effective dates for sales tax rate increases and decreases on services, effective October 1, 2005. For a rate increase, the new rate applies to the billing period that starts on or after the effective date. For a rate decrease, the new rate applies to bills rendered on or after the effective date. For prepayments of telecommunications and direct-to-home satellite services, the billing period starts on or after November 1, 2005. For prepayments of satellite digital audio radio services, the first billing period starts on or after February 1, 2006.

- Section 33.15 conforms the statutory language in G.S. 105-164.28 to the information actually requested on a certificate of resale, effective October 1, 2005.

- Section 33.17 provides an amnesty provision as required by the Streamlined Sales Tax Agreement for sellers who register with the State within 12 months after the State becomes a member of the Agreement, effective October 1, 2005.

- Section 33.18 clarifies that a seller who relies on the Secretary of Revenue for information concerning the boundaries of taxing jurisdictions and the tax rates applicable to those jurisdictions is not liable for any underpayments of tax attributable to erroneous information provided by the Secretary, effective October 1, 2005.

- Sections 33.8 and 33.24 provide that the use tax applies to taxable services sourced to the State, effective October 1, 2005, and extend the sunset on the use tax line item on the individual income tax return from January 1, 2005 to January 1, 2010. The use tax is owed by the consumer, and unlike sales tax, the consumer must remit it to the State. To simplify use tax collection, the General Assembly established an annual filing period in 1997 for the payment of use taxes owed by consumers on mail order and other out-of-state purchases. In 1999, it simplified use tax collection by providing that the use tax will be paid on taxpayers' income tax returns. In 2000, the General Assembly sunset this provision in anticipation that use tax collection would be handled by retailers by 2003, as a result of the Streamlined Sales Tax Agreement. The 2003 sunset was overly optimistic. The General Assembly extended the sunset to 2005 in S.L. 2003-284. The act extends it for five more years.

Part 34: Tobacco Tax Changes

Part 34 makes the following three changes to the tobacco tax:

- Effective September 1, 2005, it increased the tax on cigarettes from five cents a pack to 30 cents a pack. Effective July 1, 2006, it increases the tax on cigarettes an additional five cents to 35 cents a pack. The General Assembly last increased the cigarette tax in 1991 from two cents a pack to five cents a pack. The Governor, in his 2005 budget, recommended increasing the tax on cigarettes from five cents a pack to 40 cents a pack from the period between September 1, 2005, and June 30, 2006, and then to 50 cents a pack.
- Effective August 13, 2005, it increased the tax on other tobacco products, such as cigars and snuff, from 2% of the cost price of the product to 3%. The General Assembly first imposed a tax on other tobacco products in 1991 at the rate of 2%. The Governor, in his 2005 budget, recommended increasing the tax from 2% to 15% for the period between September 1, 2005 and June 30, 2006, and then to 18%.
- Effective August 13, 2005, it authorized a tobacco product manufacturer that elected to place funds into a qualified escrow fund in lieu of participating in the Master Settlement Agreement, to assign its interest in the funds to the benefit of the State. Under G.S. 66-291, a tobacco product manufacturer that places funds in escrow is allowed to receive the interest or other appreciation on such funds as earned. This act would allow the manufacturer to assign its interest in the funds, including any earning and appreciation in the escrow account, to the benefit of the State. The assignment is irrevocable and must be in writing. The benefit of this legislation is that a nonparticipating manufacturer that makes an assignment can claim an income tax deduction. The act provides that this legislative authorization is repealed and any assignment of the funds is void if (1) a court finds the new legislation invalid or unenforceable, or (2) a court finds that the new legislation would subject participating manufacturers under the Master Settlement Agreement to a nonparticipating manufacturer adjustment under the Agreement.

Part 35: IRC Update

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.[44] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[45] 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.

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[44] 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.

[45] 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."

Part 35 of this act changed the reference date from May 1, 2004 to January 1, 2005. Changing the reference date to January 1, 2005, incorporates federal changes made in the Working Families Tax Relief Act of 2004 (P.L. 108-311) and the American Jobs Creation Act of 2004 (P.L. 108-357). In addition, in early 2005 Congress enacted an act to enhance the tax benefit for certain charitable contributions made in January 2005 for tsunami relief (P.L. 109-1). That act did not amend the Code, but rather used uncodified language to bring about that result. The 2005 Appropriations Act conforms to that legislation as well. A detailed summary of these federal tax law changes is set out below:

Working Families Tax Relief Act (WFTRA) of 2004 (P.L. 108-311)

The Working Families Tax Relief Act of 2004 was signed into law by President Bush on October 4, 2004. Despite its title, the act provides tax benefits for businesses as well as individuals and families. The following features of the act are important for State tax purposes:

- *Creation of a more uniform definition of "child" throughout the Code starting with the 2005 taxable year*. At the federal level, the definition of "child" is important in five areas: the dependency exemption, the child credit, the earned income credit, the dependent care credit, and head of household filing status. The WFTRA creates a more uniform definition of "child" that applies to each of these areas. Under the new definition, a child is a qualifying child if the child satisfies three separate conditions. First, the child must have the same principal place of abode as the taxpayer for more than one half the tax year (residency test). Temporary absences due to special circumstances are not included. Second, the child must be the child, stepchild, sibling, stepsibling, or a descendant of any of these relations of the taxpayer (relationship test). Third, the child must satisfy an age condition to be deemed a qualifying child. In general, a child must be under age 19, or under age 24 if a full-time student, to be a qualifying child. However, lower age limits were retained for the dependent care credit (under 13 years of age unless disabled) and the child tax credit (under 17 years of age). For State tax purposes, the changes are important in so far as they relate to the dependency exemption, the child tax credit, and head of household filing status. The new definition of qualifying child for the dependency exemption may result in a change of status of some children – where the new law has a residency test, the old law had a support test (the taxpayer claiming the child as a dependent had to provide at least 50% of the child's support). For the federal child tax credit, some taxpayers may become eligible to claim the credit due to the elimination of some restrictions related to foster children. This is important because eligibility for the State child tax credit is dependent on the taxpayer's eligibility for the federal credit. In general, the uniform definition should not affect head of household filing status.

- *Extension of the above-the-line deduction for educators*. Under previous law, an eligible educator was allowed an above-the-line deduction of up to $250 for amounts paid by the teacher for books or supplies used in the classroom. This provision was set to expire with the 2003 taxable year. The WFTRA extended this provision for the 2004 and 2005 taxable years.

- *Extension of elective expensing of qualified environmental remediation expenditures*. Under previous law, a taxpayer could elect to treat qualified environmental remediation expenditures that would normally be charged to a capital account and depreciated over time as deductible in the current year. To be deductible currently, the expenditure must be paid or incurred with the abatement or control of hazardous substances at a qualified contaminated site. This provision would have expired with the 2003 tax year. The WFTRA extended this provision for the 2004 and 2005 taxable years.

- *Extension of enhanced deduction for qualified computer contributions*. Under previous law, corporations were allowed an enhanced charitable contribution deduction for contributions of computer technology or equipment to schools or public libraries that would use the computer equipment for educational purposes. This provision would have expired with the 2003 tax year. The WFTRA extended this provision for the 2004 and 2005 taxable years.

- *Elimination of the phase down of the deduction for qualified clean fuel property*. Under previous law, a taxpayer was allowed a specified deduction for clean fuel vehicles or refueling property placed into service before January 1, 2007. The amount of that deduction was to be reduced by 25% in 2004, 50% in 2005, and 75% in 2006, and was to be completely phased out in 2007. The WFTRA eliminated the phase down in the 2004 and 2005 taxable years. Without further action, the phase down will resume at 75% in 2006.

- *Extension of Archer Medical Savings Accounts (MSAs*). Archer MSAs were designed to give small employers, their employees, and self-employed individuals a way of creating tax-deferred savings to offset qualifying medical expenses. The program was designed to be limited in scope: no new Archer MSAs could be set up after a certain threshold had been met or after the end of 2003. The WFTRA extends the period in which new Archer MSAs may be created until the end of 2005.

American Jobs Creation Act (AJCA) of 2004 (P.L. 108-357)

The American Jobs Creation Act of 2004 was signed into law by President Bush on October 22, 2004. The bill makes many substantial changes in many different areas of tax law. The act conforms to all but the following three federal tax law changes:

- It does not create a tonnage tax in lieu of an income tax on qualifying shipping activities.

- It does not create a deduction for income attributable to domestic production activities.

- It does not allow a deduction of state and local sales taxes in lieu of a deduction for state income taxes for the 2004 taxable year. The act conforms to this change for the 2005 taxable year, but requires an add back of the amount of sales taxes deducted.

The act does conform to the following changes for State tax purposes listed below:

- *Repeal of the exclusion for extraterritorial income (ETI).* Under previous law, U.S. exporters were eligible for an exclusion from gross income for qualifying extraterritorial income. In 2000, the World Trade Organization declared this exclusion an illegal trade subsidy. Congress did not take action regarding this finding until the European Union (EU) began placing sanctions on U.S. exports. At the time Congress acted, those sanctions were at 12% and were rising by one percentage point per month. This exclusion will be phased out over several years. The ETI exclusion will be reduced by 20% in 2005 and by 40% in 2006. The ETI exclusion will be eliminated altogether beginning in 2007. Based on Congress's enactment of this law, the EU has indicated it will drop sanctions on U.S. imports beginning January 1, 2005.

In part to replace the ETI exclusion, Congress created a new deduction for domestic production activities.[46] "Domestic production activities" is defined fairly broadly and includes the following:

- sale, lease, or license of property manufactured or produced by the taxpayer in significant part in the United States,
- sale, lease, or license of United States produced motion pictures and video tapes,
- sale of electricity, natural gas, or potable water within the United States,
- construction activities performed in the United States, and
- engineering or architectural services performed in the United States for construction projects occurring in the United States.

For taxable years beginning in 2009, the amount of the deduction is equal to nine percent (9%) of the lesser of the domestic production activities income of the taxpayer or taxable income without regard to the deduction. This deduction will be phased in over several years beginning in 2005. For the 2005 and 2006 taxable years the deduction will be limited to three percent (3%). This amount will grow to six percent (6%) for the 2007 and 2008 taxable years.

- *Extension of 179 expensing limit increase/revisions regarding SUVs.* Section 179 of the Code allows a taxpayer to treat the cost of certain property as an expense which is not chargeable to a capital account. This allows the taxpayer to take a deduction for the property in the year in which it is placed into service rather than depreciating the property over a number of years. In 2003, Congress increased the amount that could be expensed under Section 179 of the Code from $25,000 to $100,000.[47] The federal change was originally set to expire after the 2005 taxable year. The AJCA extends this provision through the 2007 taxable year.

  One frequent complaint about the federal provision was that it allowed expensing of costs associated with the purchase of a sports utility vehicle (SUV) by a small business. General rules relating to the depreciation of motor vehicles did not apply to many large SUVs because those rules applied only to vehicles weighing 6,000 pounds or less. The effect of this provision was to allow an immediate write-off for the purchase price of a large SUV, but to require more gradual depreciation for the purchase of most other passenger vehicles. Taxpayers thus had a greater incentive to purchase a large SUV. The AJCA limits the amount of the purchase price that may be expensed under Section 179 with respect to a vehicle weighing less than 14,000

[46] As previously noted, the act does not create a deduction for income attributable to domestic production activities.
[47] The General Assembly conformed to this federal change as part of the 2003 Budget Act (S.L. 2003-284).

pounds to $25,000[48] The federal legislation made this change effective when it became law, October 22, 2004.

- *Establishment of 15-year straight line cost recovery for qualified leasehold improvements and qualified restaurant property.*. The AJCA provides for 15-year straight-line depreciation for qualified leasehold improvements to nonresidential real property placed into service after the date of enactment (October 22, 2004) and prior to January 1, 2006. A qualified leasehold improvement is an improvement made to the interior of a building by either the lessor or lessee and placed in service more than three years after the building is placed in service. Under prior law, a qualified leasehold improvement was depreciated using straight-line depreciation over a 39-year period – the same period as for depreciation of nonresidential property in general.

  A similar depreciation schedule is put into place for qualified restaurant property placed into service after the date of enactment (October 22, 2004) and prior to January 1, 2006. In order to qualify as "qualified restaurant property", the property must be a building improvement placed in service more than three years after the building is placed in service and the restaurant must use more than half of the square footage of the building.

  If the leasehold improvement or restaurant property contains tangible personal property that may be segregated from the cost of other improvements and that tangible personal property has a shorter depreciation period, then the taxpayer may depreciate that property separately using the shorter period.

- *Modification of deduction for charitable contribution of used motor vehicles.* The AJCA limits the amount of the deduction for contributions of motor vehicles to charity. Vehicle donation programs have become popular in recent years. Generally, the taxpayer who has donated the motor vehicle has claimed a deduction for the full "blue book" value of the vehicle. The new law will limit the amount of the deduction based on how the donee organization uses the vehicle. If the charitable organization sells the vehicle without using it in any significant way, the amount of the deduction cannot exceed the gross proceeds of the sale. If the charity retains the vehicle for its own use, the taxpayer must receive an acknowledgment from the charity as to the value of the vehicle. The deduction may not exceed the acknowledged value of the vehicle to the charity. These changes become effective with the 2005 taxable year.

- *Establishment of an above-the-line deduction for certain attorney fees and court costs.* The AJCA allows an individual taxpayer an above-the-line deduction (i.e. from gross income) for attorney fees and court costs associated with certain civil rights actions, claims against the government, and Medicare fraud claims. Under previous law, these costs were deductible only as an itemized deduction, meaning that they were deductible only if the taxpayer itemized deductions and only to the extent aggregate itemized deductions exceeded 2% of the taxpayer's adjusted gross income. This provision became effective when the legislation became law, October 22, 2004.

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[48] There are some exceptions to this rule for certain vehicles. These exceptions were put in place to ensure that the legislation would apply only to SUVs and not other types of heavy motor vehicles (such as delivery trucks) that have a weight greater than 6,000 pounds but less than 14,000 pounds.

- *Modification of deduction for automobile expenses of United States Postal Service employees.* The AJCA allows United States Postal Service employees who deliver and collect mail on rural routes and receive qualified reimbursements of automobile expenses involving these duties to deduct their actual automobile expenses that exceed the reimbursement amount. This is an itemized deduction and therefore may be claimed only to the extent aggregate deductions exceed 2% of the taxpayer's adjusted gross income. Under previous law, the deduction could not exceed the amount of the qualified reimbursements, regardless of actual expenditures. As under previous law, reimbursements in excess of the amount of actual expenditures do not have to be included in gross income.

- *Exclusion of National Health Service Corps Loan Program repayments from gross income and from employment taxes.* The National Health Service Corps is an agency housed within the U.S. Department of Health and Human Services and has as its mission improving the health of the nation's underserved populations. Under the National Health Service Corps Loan Repayment Program, participants in the program may receive up to $25,000 per year for two years to pay off qualified educational loans. The loan repayment is in addition to any salary the participant receives from the employing community site. Under previous law, the amount of loan repayment was included in taxable income and was also subject to employment taxes (i.e. FICA). Under the AJCA, these loan repayments are to be excluded from both gross income and from employment taxes. This provision became effective with the 2004 taxable year.

- *Creation of a deduction for start-up costs and amendments to the expensing schedule for such costs.* Under the AJCA, a taxpayer may take a deduction of up to $5,000 for start-up and organization expenses of the taxpayer's trade or business. However, the amount of the deduction is reduced by the amount by which those expenses exceed $50,000. Any expenses in excess of $5,000 must be amortized over a 15-year period. Under previous law, no current expensing was allowed, the full amount of the start-up and organizational expenses would be amortized over 5 years. This provision is effective for expenses that occur on or after the date the legislation became effective, October 22, 2004.

- *Modification regarding the treatment of gain on the sale of a principal residence when the residence was acquired in a like-kind exchange.* Under current law, a taxpayer is allowed to exclude up to $250,000 of gain from the sale of a residence ($500,000 if a married couple filing jointly) if the taxpayer owned and used the residence as a principal residence for at least two of the last five years. The AJCA makes a change to this provision when the home was acquired as part of a like-kind exchange.[49] Under the AJCA, a residence received in a like-kind exchange must be owned by the taxpayer for at least five years and must be used as a principal residence of the taxpayer for at least two of the last five years in order to qualify for the exclusion from gross income of the gain on the sale of the residence. This provision became effective for residences sold on or after the date the legislation was enacted, October 22, 2004.

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49 A like-kind exchange is an exchange of property held for productive use in a trade or business or for investment for similar property. Unless cash is received as part of the trade, the exchange is not a taxable event.

As previously noted, the act does not conform to three aspects of the federal tax law changes in the AJCA:

- It does not create a tonnage tax in lieu of an income tax on qualifying shipping activities. – The AJCA provides that a corporation can elect to be subject to a tonnage tax rather than an income tax on its qualified shipping activities. The tonnage tax is based on the taxpayer's "notional shipping income." Notional shipping income is determined by reference to a monetary rate per ton shipped. The rate is 40 cents per 100 tons per day for the first 25,000 tons shipped per vessel and 20 cents per 100 tons per day for the amount shipped in excess of 25,000 tons per vessel. Once notional shipping income has been determined, tax is computed on that amount at the rate of 35%. In exchange for electing to be subject to the tonnage tax, the taxpayer may exclude from its gross income any amount resulting from its qualifying shipping activities. Conforming to this exclusion would result in income from shipping activities being excluded from taxation in North Carolina. In effect, it would result in a loss of tax revenues at the State level without a corresponding loss at the federal level. In order to maintain this revenue source, this act requires the taxpayer to add back the amounts deducted from gross income because of this new provision.

- It does not create a deduction for income attributable to domestic production activities. The AJCA phases out the exclusion for extraterritorial income: 20% in 2005, 40% in 2006; eliminated in 2007. Congress created a new deduction for domestic production activities to replace the ETI. "Domestic production activities" is defined fairly broadly. For taxable years beginning in 2009, the amount of the deduction is equal to 9% of the lesser of the domestic production activities income of the taxpayer or taxable income without regard to the deduction. This deduction will be phased in over several years beginning in 2005. For the 2005 and 2006 taxable years the deduction will be limited to 3%: this amount will grow to 6% for the 2007 and 2008 taxable years. In order to maintain this revenue source, this act requires the taxpayer to add back the amounts deducted from gross income because of this new provision.

- It does not allow a deduction of state and local sales taxes in lieu of a deduction for state income taxes for the 2004 taxable year. The act does conform to this change for the 2005 taxable year, but requires an add back of the amount of sales taxes deducted. The AJCA allows taxpayers to deduct state and local sales taxes in lieu of deducting state and local income taxes. This provision became effective with the 2004 taxable year and is set to expire for taxes beginning in 2006 and thereafter. Taxpayers that elect to deduct state and local sales taxes instead of state and local income taxes will have two options for determining the deductible amount: a) they may accumulate receipts for the actual amount of sales and use tax paid, or b) they may refer to tables prepared by the Secretary of the Treasury which estimate the amount of taxes paid based on average consumption and other factors.

  This federal provision is of particular benefit to taxpayers who reside in states that do not impose a personal income tax. For most North Carolina taxpayers, the greater benefit would come from deducting state income taxes rather than from deducting state and local sales taxes. Some exceptions to this general statement would include the following:

- Nonresidents or part-year residents who reside in a state that does not impose an income tax and who have relatively low income tax liability in North Carolina or other states.
- Taxpayers who may have a low tax liability due to eligibility for a significant amount of tax credits.
- North Carolina residents for whom a large portion of income is not subject to taxation. This class of taxpayers would include many government retirees whose government pensions are not subject to State income tax under the decisions in *Bailey* and the related cases and whose Social Security payments are not subject to State income tax under G.S. 105-134.6.

North Carolina law currently requires taxpayers to add back the amount of the deduction allowed under the Code for state, local, and foreign income taxes. In order to treat the deduction for state and local sales taxes equivalent to the deduction for state, local, and foreign income taxes, the General Assembly would have to have required the add back of the deduction for state and local sales taxes if it had decided to conform to the federal change. This conformance would have been problematic, however, given that the federal legislation is effective for the 2004 taxable year and the General Assembly could not conform to the federal legislation and require the add back unless it acted before the end of the year. Although the practical effect of conforming to the change and requiring the add back is the same as not conforming to the change at all, a court could find that requiring an add back would in effect be a retroactive tax increase. Therefore, the act does not conform to the change allowing a deduction of state and local sales taxes in the 2004 taxable year, but does conform to that change and require an add back for the 2005 taxable year.

An Act to accelerate the income tax benefits for charitable cash contributions for the relief of victims of the Indian Ocean tsunami (P.L. 109-1).

On December 26, 2004, a large earthquake centered in the Indian Ocean unleashed a catastrophic tsunami that resulted in widespread devastation in 11 countries in South Asia, Southeast Asia, and Africa. The disaster is estimated to have caused billions of dollars in damages and produced a death toll in excess of 270,000.

On January 6, 2005, the first act of the 109th Congress was to approve accelerated tax benefits for charitable cash contributions for the relief of victims of the Indian Ocean tsunami. President Bush signed the act into law the following day. The act allows a taxpayer to treat a cash contribution for tsunami relief efforts made in January 2005, as if it were made on December 31, 2004. Thus, the taxpayer would be able to take a deduction in the 2004 taxable year rather than the 2005 taxable year. In order to qualify for the accelerated benefit, the contribution must be cash. Donations of property or cash substitutes, such as marketable securities, are not eligible for the accelerated benefits. In addition, the contribution must be specifically designated to be for tsunami relief. A contribution that is made to a charitable organization that is assisting in relief efforts but that is not specifically designated to relief efforts is not eligible for the accelerated benefits. For example, a donation to the Red Cross would be eligible for the accelerated benefit only if the donation were specifically designated for tsunami relief efforts; a general donation to the Red Cross would not be eligible for the accelerated benefit.

Part 36: Individual Income Tax Changes

Part 36 of the act extends the 8.25% upper-income individual income tax rate for tax years 2006 and 2007. The Governor's budget recommended a phase down of the upper income tax rate to 8% in 2006, and the elimination of the bracket in 2007.

In 2001, the General Assembly added a new tax bracket that imposed an additional one-half percent income tax (a total rate of 8.25%) on certain North Carolina taxable income for three years. The change was estimated to affect approximately 2% of North Carolina taxpayers. In 2003, the General Assembly extended the tax rate for two more years. This act retains the upper bracket for two additional years.

Under prior North Carolina law, tax was imposed at the following rates on individuals' North Carolina taxable income:

Tax Rate	Married filing jointly	Heads of household	Single filers	Married filing separately
6.0%	Up to $21,250	Up to $17,000	Up to $12,750	Up to $10,625
7.0%	Over $21,250 and up to $100,000	Over $17,000 and up to $80,000	Over $12,750 and up to $60,000	Over $10,625 and up to $50,000
7.75%	Over $100,000	Over $80,000	Over $60,000	Over $50,000

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

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

This part of the act was later amended in section 46 of S.L. 2005-345 (Modify 2005 Appropriations Act) to increase from $1 to $3 the amount that an individual income taxpayer may designate on the taxpayer's return to be allocated to the North Carolina Political Parties Financing Fund. The amount is for use by the political party designated by the taxpayer.

Part 38: Corporate, Excise, and Insurance Tax Changes[50]

This part equalizes the gross premiums tax on insurance companies by taxing health maintenance organizations (HMOs) at the same rate as other insurers. HMOs are currently

[50] The Senate version of Senate Bill 622 would have reduced the corporate income tax rate from 6.9% to 6.4% and repealed the earmarking of a percentage of the corporate income tax collections to the Public School Building Capital Fund. The House version would have equalized the privilege tax on entertainment by taxing all forms of entertainment at a rate equal to the combined State and local sales tax rate, and would have provided an income tax credit to a small business that provides health insurance to its full-time employees.

taxed at 1%. This part repeals the special 1% rate for HMOs and taxes HMOs at 1.9%, effective for taxable years beginning on or after January 1, 2007. Prior to 2001, HMOs did not pay a gross premiums tax.[51]

In 2001, the General Assembly enacted legislation subjecting all insurance carriers to the gross premiums tax in lieu of the State's corporate income and franchise tax. However, the rate continued to vary depending upon the type of insurer. The 2001 legislation taxed HMOs and Article 65 corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, at the rate of 1%. Effective January 1, 2004, the General Assembly increased the gross premiums tax on Article 65 corporations from 1% to 1.9%. This act increases the rate on HMOs to 1.9%, effective for taxable years beginning January 1, 2007. For the 2007 tax year only, HMOs are directed to make the following estimated payments of the tax: 50% on April 15 and 50% on June 15, with true-up the following March 15. For subsequent tax years, the general law on installment payments of gross premiums tax applies. This change accelerates the timing of the tax payment to move the revenue gain to an earlier fiscal year.

Part 39: Tax Incentives/Film Industry Jobs Incentives

This part replaces the current film industry development grant program[52] with a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production. However, the amount of the credit with respect to a feature film production is capped at $7.5 million. The credit is effective for taxable years beginning on or after January 1, 2005, and applies to qualifying expenses occurring on or after July 1, 2005. The credit expires for qualifying expenses occurring on or after January 1, 2010. The incentive is targeted at feature films, episodic television series, and commercial advertising. The Governor's budget exempted from sales and use tax, sales to a production company of film or video production equipment.

Under G.S. 105-164.3, a production company is defined as a person engaged in the business of making original motion picture, television, or radio images for theatrical, commercial, advertising, or educational purposes. However, for the purposes of the new credit, the production may not be any of the following: political advertising, television production of a news program or live [53] sporting event, a radio production, or a production containing obscene material.[54] In the case of an episodic television series, an entire season of episodes is considered one production.

In order to obtain the credit, the taxpayer must have qualifying expenses in excess of $250,000 with respect to a production and provide on its return a detailed accounting of

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[51] Prior to 2001, HMOs were subject to corporate income and franchise taxes. Companies that pay a gross premiums tax are exempt from State corporate income and franchise taxes.

[52] Section 39.1(d) of this part repeals G.S. 143B-434.4, which creates the Film Industry Development Account. The General Assembly has not appropriated money to this account for the past couple of years.

[53] Section 47 of S.L. 2005-345 amended this part to clarify that the sporting event ineligible for the credit is a "live" sporting event and to define the term "live sporting event".

[54] G.S. 14-190.1 defines "obscene" material as material that meets all of the following conditions: the material depicts or describes in a patently offensive way sexual conduct; the average person applying contemporary community standards relating to the depiction or description of sexual matters would find that the material taken as a whole appeals to the prurient interest in sex; the material lacks serious literary, artistic, political, or scientific value; and the material as used is not protected or privileged under the Constitution of the United State or the Constitution of North Carolina.

qualifying expenses. Qualifying expenses are the total amount spent in North Carolina for the following:

- Goods and services purchased by a production company in connection with a production. For goods with a purchase price of $25,000 or more, the amount included in qualifying expenses is the purchase price less the fair market value of the goods at the time the production is completed.
- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. Any amounts paid to an individual who receives in excess of $1 million with respect to a single production cannot be included in a qualifying expense.

The taxpayer must maintain and make available for inspection any information or records required by the Secretary of Revenue or the regional film commissions. The taxpayer has the burden of proving eligibility for the credit and the amount of the credit. The Secretary of Revenue may consult with the North Carolina Film Office of the Department of Commerce and the regional film commissions in order to determine the amount of qualifying expenses.

The credit may be claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit; therefore, it does not distribute the credit among its owners. The taxpayer may not claim the credit for qualifying expenses for which it claimed a deduction under the Internal Revenue Code.

The Department of Revenue must publish by May 1 of each year the following information, itemized by taxpayer for the 12-month period ending the preceding December 31:

- The location of the sites used in a production for which a credit was claimed.
- The qualifying expenses for which a credit was claimed, classified by whether the expenses were for goods, services, or compensation.
- The number of people employed in the State with respect to the credits claimed.
- The total cost to the General Fund of the credits claimed.

Finally, this part amends the tax secrecy statutes to allow the exchange of information concerning the credit with the North Carolina Film Office of the Department of Commerce and the regional film commissions.

Present-Use Value Buyout Credits.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-293	**HB 705**	**Representative Hill**

OVERVIEW: This act allows payments received under the tobacco quota buyout program to be counted towards the $1,000 income requirement which must be met before agricultural land can be assessed at present-use value for property tax purposes.

FISCAL IMPACT: The Department of Revenue does not expect that this act will result in any significant amount of additional acreage being assessed at present-use value.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

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

ANALYSIS: Agricultural land, horticultural land and forestland have been designated as a special class of property and are appraised and assessed at present-use value, instead of market value, for property tax purposes if the land meets certain statutory requirements. Agricultural land must be part of a farm unit, under a sound management program, individually owned, consist of one or more tracts (one of which must consist of at least 10 acres that are in actual production) and for the three years preceding January 1 of the year for which the present-use value benefit is claimed, have produced an average gross income of at least $1,000. Counted income includes the following:

- Income from the sale of agricultural products produced from the land, and
- Payments received under a governmental soil conservation or land retirement program

This act allows payments received under the Fair and Equitable Tobacco Reform Act of 2004 to be included as income when determining the present-use value eligibility of agricultural land. The agricultural land must continue to meet the ownership and actual production requirements.

Congress passed the Fair and Equitable Tobacco Reform Act of 2004 in October, 2004. That act repeals the federal tobacco price support and quota programs, provides compensation payments to tobacco quota owners and growers, and provides an assessment mechanism for tobacco manufacturers and importers to pay for the buyout. An eligible quota owner is the owner of a farm on the date the federal legislation was enacted, October 22, 2004, for which a basic tobacco quota/allotment was established for the 2004 marketing year. An eligible quota grower is an owner, operator, landlord, tenant or sharecropper who shared in the risk of producing tobacco in the 2002, 2003, or 2004 marketing year. Quota owners will be paid $7 per pound for the basic quota they owned in 2002. Growers will be paid $3 per pound for their 2002 effective quota.[55] These payments will be distributed equally over 10 years, beginning with the 2005 fiscal year and ending in 2014. The initial payment was made by the beginning of October 2005. The buyout is funded by quarterly assessments on tobacco manufacturers and importers. Because the buyout is funded by manufacturer and importer assessments, future Phase II payments will be terminated. For federal tax purposes, quota owner payments are treated as capital gains and grower payments are expected to be treated as ordinary income. As of October 2005, the I. R. S. had not ruled on the tax status of these payments.

Property Tax Paid With Vehicle Registration.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-294	**HB 1779**	**Rep. Folwell, Insko, Justice, Walker**

AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM.

OVERVIEW: This act creates a combined system for motor vehicle registration renewal and property tax collection. Currently, the two systems, though interrelated, are run separately and administered by different entities.

FISCAL IMPACT: The NC Association of Tax Assessors estimates that this act will result in collection of approximately $72 million annually in additional motor vehicle property taxes that currently go uncollected. Counties will also likely experience savings from the elimination of resources devoted to collection of property taxes on motor vehicles, including staff time and mailings for delinquent notices. An administrative fee equal to the cost of preparing and mailing notices will be retained by the Department of Revenue. A second fee for the cost of collection of taxes and fees will be retained by the Division of Motor Vehicles and tag agents. The bill will require significant changes in DMV operations and significant costs for changing DMV computer systems. The full extent of these changes and costs is not currently known.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Different portions of the act have different effective dates as specified in the analysis. Most of the act becomes effective on the earlier of January 1, 2009, or the date when the Department of Revenue and the Division of Motor Vehicles have certified that an integrated computer system is in operation. The act became law when signed by the Governor on August 22, 2005.

ANALYSIS: Since 1993, all motor vehicles, except public service company vehicles appraised by the Department of Revenue and manufactured homes, are classified for listing, assessment, and taxation separately from other classes of property. The classified motor

[55] The payment is $2 per pound if the grower participated in two of the three marketing years, and $1 per pound if the grower participated in only one of the three marketing years.

vehicles consist of two groups; those that are registered with the Department of Transportation's Division of Motor Vehicles (DMV) and those that are not registered with the DMV.[56]

The county in which the motor vehicle is registered assesses the vehicle for property taxes on a revolving, year-round basis. To accomplish this, DMV gives each county a monthly list of all the motor vehicles in the county for which the registration was renewed or obtained two months earlier. The county then lists and appraises each vehicle and sends the owner of the vehicle a bill for the county, municipal, and special district property taxes due. The result is that a motor vehicle owner receives a tax bill for the vehicle approximately three months after the vehicle is registered or the registration is renewed. Each month, the county tax collector collects taxes on approximately one-twelfth of the motor vehicles having a tax situs in the county. If the taxes on the registered motor vehicle are not paid within one month after they become due, then the motor vehicle owner is liable for interest at the rate of 2% a month for the first month following the date the taxes were due and ¾ % for each month thereafter. In addition, if the taxes are not paid, the county includes the motor vehicle on a list that is sent to the DMV. The DMV then refuses to renew the vehicle's registration the following year unless the taxpayer obtains a receipt showing that the previous year's taxes have been paid.[57] Unpaid taxes may also be collected by levying on the motor vehicle or other personal property of the owner, but the unpaid taxes do not become a lien on the owner's real property.

The DMV requires motor vehicles to be registered annually. Under G.S. 20-66, the registration of a vehicle that is renewed by means of a registration renewal sticker expires at midnight on the last day of the month designated on the sticker. It is lawful, however, to operate the vehicle on a highway until midnight on the fifteenth day of the month following the month in which the sticker expired. The DMV varies the expiration dates of registration renewal stickers for a type of vehicle so that an approximately equal number expires at the end of each month, quarter, or other period consisting of one or more months. The $28 fee[58] is paid to the DMV and credited to the Highway Fund.

This act combines the motor vehicle registration and property tax billing and collection into a combined process. The goals of the combined process are to reduce the number of taxpayer interactions with government, save money, increase the overall efficiency of both functions, and improve the property tax collection rate on motor vehicles.

Beginning January 1, 2006, the interest rate on unpaid taxes on classified motor vehicles will increase from 2% for the first month to 5% for the first month following the date the taxes were due. Instead of going to the taxing unit that is the situs of the motor vehicle, 60% of the interest collected on unpaid taxes on registered vehicles will be transferred on a monthly basis to a special account created within the Treasurer's Office. The North Carolina Association of County Commissioners will direct the Treasurer to distribute funds from the account for the purpose of developing and implementing an integrated computer system within the DMV. The system will allow for the combined assessment, billing, and collection of property taxes on motor vehicles and the issuance of registration plates.

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[56] A vehicle is not registered with the DMV either because it is a tractor, an earthmover, or some other type of vehicle that cannot be registered with the DMV or it is a car or truck and could be, but for some reason is not, registered with the DMV.

[57] Vehicle owners may get around this block by buying a new tag on the vehicle.

[58] This fee was raised from $20 to $28 in the 2005 Appropriations Act, S.L. 2005-276.

Beginning July 1, 2009, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first, the following changes will occur:

- Property tax on registered motor vehicles will be due on the date that a new registration is applied for or the fifteenth day of the month following the month in which the registration renewal sticker expired pursuant to G.S. 20-66(g).
- The Property Tax Division of the Department of Revenue shall prepare and mail a combined tax and registration notice for each registered vehicle. The notice will contain the date of the notice, the appraised value of the vehicle, the tax rate of the taxing units, a statement that the appraised value of the motor vehicle may be appealed to the assessor before the taxes and fees become delinquent, and the registration fee imposed by the DMV.
- The Department of Revenue may receive a fee for each combined notice generated for a registered vehicle. The fee must be equal to the actual cost of printing and sending the combined notice and will be subtracted from the taxes and fees remitted to the county or municipal corporation in which the vehicle is registered.
- The property taxes and registration fees must be paid either to the DMV or an agent contracting with the DMV. The taxes and fees do NOT have to be paid in the county that is the situs of the vehicle.
- The DMV or its agent may retain a fee for collecting the county and municipal taxes and fees. This fee must be an amount equal to at least 1/3 of the compensation paid for registration renewals conducted by contract agents under Chapter 20 of the General Statutes. This fee is in addition to the $1.43 that is currently paid to contract agents for each registration renewal.
- The DMV or its agent must provide a weekly financial report containing information required by the Property Tax Division to the taxing units and the DMV to enable them to account for payments received.
- G.S. 105-330.7 is repealed. It will no longer be necessary for the tax collector to send a monthly list to the DMV of classified vehicles on which taxes remain unpaid, because the taxes and registration fees will be paid to the same entity at the same time.
- Interest at the rate of 5% for the remainder of the month following the month in which the registration renewal sticker expired will also accrue on unpaid registration fees on classified motor vehicles. Interest collected on unpaid registration fees will be transferred on a monthly basis to the North Carolina Highway Fund for technology improvements within the DMV. The interest collected on unpaid property taxes will no longer go into the special account in the Treasurer's office but will remain with the taxing units.
- G.S. 20-50.3 is repealed. Once the computer system is in operation, the DMV will no longer need to furnish county tax assessors a list of registered vehicles.

Effective when the act became law, August 22, 2005, the Property Tax Division within the Department of Revenue and the DMV shall jointly study and develop a plan for determining the method of valuation of vehicles to be taxed and for implementing an integrated computer system needed to combine the registration renewal and property tax collection for motor vehicles in the State. The Divisions shall consult with representatives from the following organizations: the North Carolina Association of County Commissioners, the North Carolina League of Municipalities, the North Carolina Association of Assessing Officers, the North Carolina Automobile Dealers Association, the North Carolina Independent Automobile Dealers Association, and the North Carolina Tax Collectors Association.

The Treasurer must report to the Revenue Laws Study Committee semi-annually, with the first report due by April 30, 2006. The report must contain a detailed description of the moneys transferred and distributed from the special account.

The Property Tax Division within the Department of Revenue and the DMV must report findings and recommendations of its joint study to the Revenue Laws Study Committee, the Joint Legislative Transportation Oversight Committee, and the Fiscal Research Division by April 30, 2006.

Property Tax % Value of Motor Vehicles.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-303	**HB 988**	**Rep. Blackwood, Church**

AN ACT TO EXCLUDE HIGHWAY USE TAXES AS A FACTOR IN DETERMINING THE TRUE VALUE IN MONEY OF MOTOR VEHICLES FOR PROPERTY TAX PURPOSES.

OVERVIEW: This act provides that when a tax assessor considers the sales price of a motor vehicle in determining the true value of the vehicle for property tax purposes, the assessor may not consider the highway use tax as part of the sales price.

FISCAL IMPACT: According to the North Carolina Department of Revenue, there are no counties currently using the sales price to determine the value of motor vehicles. Most counties use pricing guides developed by Tax Equity Consultants (TEC) or the National Automobile Dealers Association to determine the average retail prices paid for motor vehicles. In some instances in which the assessed value of a vehicle is appealed by the taxpayer, assessors may use the bill of sale that includes highway use tax as documentation for changing the assessed value. To the extent that this occurs, this act will result in lower revenue for local governments. It is expected that the revenue impact would be small; however, the exact amount is not known.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2005. The act became law when signed by the Governor on August 22, 2005.

ANALYSIS: By statute, a county must appraise motor vehicles at their true value in money for property tax purposes. True value is defined as the price at which property would change hands between a willing and financially able buyer and a willing seller. In practice, assessors use a pricing guide developed by TEC Data Systems to determine the value of vehicles for property tax purposes. The pricing guide reflects the average retail price paid for motor vehicles. In determining retail prices, all costs that are necessary to acquire and operate a motor vehicle are considered. If an assessor believes the values developed in the guide are too low or too high, the assessor may consult with TEC Data Systems about the values and have a different set of values computed for use in that assessor's county. If a taxpayer disagrees with the appraised value, the taxpayer has 30 days after the date the tax notice was prepared to appeal the value. Counties will adjust an appraised value for reasons such as the vehicle's condition or excessive mileage.

Counties typically do not begin their appraisal of a new motor vehicle based on the vehicle's bill of sale. However, there are instances where a taxpayer may bring in a bill of sale to show that he or she paid less than the value at which the vehicle is assessed. A vehicle's bill of sale includes the 3% highway use tax paid on the vehicle. This act provides that when an assessor considers the sales price of a motor vehicle in determining its true value, the assessor must not consider the highway use tax paid on the vehicle.

Property Tax Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-313	**HB 116**	**Representative Brubaker**

AN ACT TO CLARIFY PRESENT-USE VALUE ELIGIBILITY, TO AMEND THE PERIOD FOR APPEAL OF A PRESENT-USE VALUE DETERMINATION OR APPRAISAL, TO MODIFY THE TAX YEAR FOR MOTOR VEHICLES THAT ARE TO BE SWITCHED FROM AN ANNUAL SYSTEM OF REGISTRATION TO A STAGGERED SYSTEM EFFECTIVE JANUARY 1, 2006, AND TO APPLY THE SAME PENALTY THAT CURRENTLY APPLIES TO PAYMENTS BY CHECK TO PROPERTY TAX PAYMENTS MADE BY ELECTRONIC PAYMENTS.

OVERVIEW: This act makes clarifying and technical changes to the present-use value statutes, clarifies the tax year for motor vehicles that are to be switched from an annual system of registration to a staggered system, and imposes a penalty for nonpayment of property taxes on an electronic funds transfer that cannot be completed because of insufficient funds.

FISCAL IMPACT: This act would only impact local revenues and no fiscal impact is expected.

(For a more complete fiscal analysis, see <u>Overview: Fiscal and Budgetary Actions, 2005 Session</u>. Available in the Legislative Library.)

<u>EFFECTIVE DATE:</u> The changes made by the act to the motor vehicle property tax statutes become effective January 1, 2006. The other provisions are effective for taxes imposed for taxable years beginning on or after July 1, 2005. The act itself became law when the Governor signed it into law on August 25, 2005.

<u>ANALYSIS:</u> This act makes changes in three different parts of the property tax statutes.

<u>Present-Use Value.</u> – Since 1973, the General Assembly has provided that farmland may be appraised, assessed, and taxed at its present-use value, as opposed to its fair market value. The present-use value classification helps preserve farmland by insulating it from the rising property tax values cause by competing market pressures to develop farmland for commercial and residential purposes. In 2002, the General Assembly provided an updated method for calculating the value of farmland in its present use. In 2004, the Department of Revenue indicated to the Property Tax Subcommittee of the Revenue Laws Study Committee that the present-use value statutes needed to be clarified to help the counties and the Department with their administration of the classification. Sections 1 through 7 of this act make those changes. These changes codify existing practices among county assessors.

The act provides that certain land defined as horticultural land may be treated as agricultural land when there is no significant difference in the cash rental rates for the land.[59] This provision applies to land used to grow horticultural and agricultural crops on a rotating basis and to land used to grow a horticultural crop that is set out or planted and harvested within one growing season.

Under the present-use value system, farmland must be part of a unit engaged in commercial production. A 'unit' is one or more tracts of farmland. Under this act, multiple units must be under the same ownership and be of the same type of classification. If the multiple tracts are located within different counties, then the tracts must be within 50 miles of a qualifying tract. Prior to this act, multiple tracts in different counties could be considered part of the same unit if they either shared the same classification or shared the same equipment or labor force. This act removes the latter condition and requires that multiple tracts in different counties must share the same classification to qualify as a unit.

For property to qualify for present-use value classification, it must meet certain ownership requirements in addition to use and income requirements. Generally speaking, a qualifying owner must own the property for four years or the property must be the home of the qualifying owner. Prior to 2002, there existed an exception to the ownership requirement that allowed an owner to immediately qualify newly acquired property for use value classification if the property was appraised at its present use value at the time title to the land passed to the new owner or the property *was eligible for appraisal* at its present use value so long as the new owner continued to use the property for farm purposes. In 2002, the General Assembly amended this exception to require the new owner to file a timely application for the newly acquired property and to agree to accept liability for the deferred taxes. The new condition of accepting liability for the deferred taxes conflicts with the old

[59] Effective with the 2003 property tax year, the value of agricultural and horticultural land is determined by the estimated cash rental rates for the land. Prior to 2003, the value of agricultural land was determined by the income of corn and soybean yields and the value of horticultural land was determined by horticultural product yields.

condition that the property *be eligible for* use value classification since there would be no deferred taxes to assume unless the property was currently appraised at its present-use value when the property was transferred. This act removes this ambiguity by setting forth two different exceptions to the ownership requirements:

- It removes the phrase 'or was eligible for appraisal at its present use value' from the first exception.
- It creates a new exception for property for which there are no deferred taxes. It will allow property *eligible for* use value classification to immediately qualify in the hands of a new owner if the new owner has other property classified at present use and files a timely application for use-value classification.

Lastly, the act establishes 60 days as the time within which a taxpayer (1) must appeal an assessor's decision regarding the qualification or appraisal of the taxpayer's property as use value property and (2) may submit additional information to reverse a disqualification of property for present-use value classification or for exemption or exclusion because of failure to submit additional information. Current law provides no time limit for presenting additional information after the assessor has disqualified the property. The 60-day time limit corresponds to the current timeframe a new owner has to file an application for use value treatment after acquiring the property. [60]

Motor Vehicles. – Sections 8 and 9 of the act clarify how the motor vehicle property tax year will be accomplished for commercial vehicles that are converting from an annual registration system to a staggered registration system. Most vehicles registered with the Division of Motor Vehicles are taxed for property tax purposes on a revolving, year-round basis that corresponds with their vehicle registration and renewal. Commercial trucks are registered under the annual system. However, in 2004 the General Assembly enacted legislation that provides for the staggered issuance of commercial vehicle and dealer license plates, effective January 1, 2006. The Department of Revenue estimates this change will affect approximately 500,000 annually registered motor vehicles. To accomplish this transition, this act provides for a motor vehicle tax year greater than 12 months during the period that the vehicles are converting from annual registration to staggered registration. This change will allow the Division to issue one-time 7- to 18-month registrations for these vehicles, resulting in an approximate equal number of expiring registrations throughout a 12-month period. Upon renewal of these one-time registrations, the subsequent registrations will be 12-month registrations. The act specifies how the tax calculation is made for tax bills when the registration cycle is not 12 months.

Electronic Funds Transfer. – Section 10 of the act provides that the same penalty and penalty waiver provisions that apply to payments of property taxes by check also apply to payment of property taxes by electronic funds transfer. If a worthless check is given for payment of property taxes, the penalty is $25 or 10% of the amount of the check, whichever is greater, subject to a maximum of $1,000. The penalty does not apply if the tax collector finds that the taxpayer inadvertently failed to draw the check on the taxpayer's account that had sufficient funds.

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[60] G.S. 105-277.4(a). The General Assembly enacted the provision requiring a new owner to submit an application for use-value classification for newly acquired property within 60 days after its purchase in 2002.

Add Agencies to Set-Off Debt Collect.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-326	**SB 682**	**Senator Holloman**

AN ACT TO EXTEND TO PUBLIC HEALTH AUTHORITIES, SANITARY DISTRICTS, AND METROPOLITAN SEWERAGE DISTRICTS THE SET-OFF DEBT COLLECTION PROCEDURES CURRENTLY AVAILABLE TO COUNTIES AND CITIES.

OVERVIEW: This act adds public health authorities, metropolitan sewerage districts, and sanitary districts to the list of agencies authorized under the Setoff Debt Collection Act to collect debts owed to them by obtaining a setoff against a debtor's North Carolina income tax refund.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act becomes effective January 1, 2006, and applies to income tax refunds determined on or after that date.

ANALYSIS: The Setoff Debt Collection Act authorizes State and local agencies to collect debts by diverting part or all of an individual's income tax refund to pay a debt the individual owes to a particular agency. Thus, the debt the individual owes the agency is set off against the individual's income tax refund. Before January 1, 2000, the setoff program was open only to State agencies. Since 2000, authorized local agencies[61] participate through a clearinghouse. Because there are so many local agencies, funneling their claims through a clearinghouse avoids an undue administrative burden on the Department of Revenue. A $15.00 collection assistance fee is added to each local agency debt submitted for setoff, which is remitted to the clearinghouse that submitted the debt. In addition, a $5.00 collection fee is added to each debt, State or local, that is submitted for setoff, which is retained by the Department of Revenue. The fees do not, however, apply to child support debts. While the use of debt setoff for State agencies is mandatory, usage by local agencies is optional. The Act only applies to debts that are at least $50 and to a refund that is at least this same amount.

This act allows public health authorities,[62] metropolitan sewerage districts,[63] and sanitary districts[64] to participate under the Setoff Debt Collection Act in the same manner as other

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[61] In 1997, the General Assembly extended the Setoff Debt collection act to counties and municipalities, effective in 2000. In 2003, the General Assembly added water and sewer authorities to the list of entities eligible to participate in debt setoff. In 2004, regional joint agencies created by interlocal agreement were added.

[62] Although a public health authority functions similarly to a county agency, it is a separate legal entity created under G.S. 130A-45.02. A public health authority is created by joint resolution of a county board of commissioners and the local board of health. It functions as a policy-making, rule-making, and adjudicatory body designed to protect and promote the public health. Among its powers, a public health authority may establish a fee schedule for services received from public health facilities. Currently, there is only one public health authority, created under this authorizing legislation, and it is the Hertford County Public Health Authority.

[63] Any two or more political subdivisions in one or more counties, or any political subdivision and any unincorporated area within one or more counties, may petition for the creation of a metropolitan sewerage district by filing a resolution with the boards of county commissioners of the county or counties within which

authorized local agencies. Like other authorized local agencies, these agencies would be authorized to submit their debts for collection by setoff through a local clearinghouse only after providing the debtor with notice, an opportunity to be heard before the authority, and an appeal process pursuant to the Administrative Procedure Act.

Fuel Tax Refund for Pumpers and Sweepers.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-377	**SB 356**	**Senator Hoyle**

AN ACT TO ALLOW A FUEL TAX REFUND FOR OFF-ROAD FUEL USE BY PUMPER TRUCKS AND SWEEPERS.

OVERVIEW: This act adds the following two vehicles to the list of vehicles that are allowed an annual refund of the motor fuel taxes paid on fuel consumed by the vehicles:

- A commercial vehicle that uses a power takeoff to remove and dispose of septage and for which an annual fee is paid to the North Carolina Department of Environment and Natural Resources under the septage management program.
- A sweeper.

FISCAL IMPACT: The fiscal impact for allowing a fuel tax refund for off-road fuel used by pumper trucks is estimated to result in the following gains to the General Fund and Local Governments and the following losses to the Highway Fund and Highway Trust Fund. There is no estimate available for sweepers.

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
GF	$124,461	$122,369	$118,142	$113,016	$111,109
HF	($458,067)	($460,701)	($461,680)	($461,084)	($464,837)
HTF	($152,689)	($153,567)	($153,893)	($153,695)	(154,946)
LG	$77,788	$76,481	$73,839	$70,635	$69,443

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the proposed district will lie. A public hearing is then held where the Environmental Commission and board of county commissioners determine whether the creation of the metropolitan sewerage district would preserve and promote the public health and welfare of the area. A sewerage district board has the authority to levy taxes on property within the district and impose charges for the services furnished. The district board may provide methods for collection of charges and measures for enforcement of collection, including penalties and the denial or discontinuance of service.

[64] The Commission for Health Services may create sanitary districts for the purpose of preserving and promoting the public health and welfare. A sanitary district is incorporated if 51% of the freeholders in the proposed district petition the county board of commissioners of the county in which all or the largest portion of the land of the proposed district is located. A sanitary district board has the authority to levy property taxes within the district and apply service charges and rates based on the benefits provided. Sanitary districts that maintain and operate a sewage system may bring suit for overdue sewer charges and disconnect the sewer lines. This remedy is not sufficient when the customer moves out of the district. The charges also become a lien on the property served and the property may be sold.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: This act became effective when it was signed into law by the Governor on September 8, 2005, and applies to motor fuel and alternative fuel consumed on or after January 1, 2006.

ANALYSIS: Certain vehicles that use motor fuel to conduct their work, as distinguished from propelling them on the highway, are allowed an annual refund of a portion of the motor fuel taxes paid. The amount of the refund is equal to 33 1/3% of the sum of the flat cents-per-gallon rate in effect during the year for which the refund is claimed and the average of the two variable cents-per-gallon rates in effect during the year. The amount of sales tax due on the fuel is deducted from the refund.

The act adds the following two types of vehicles to the list of vehicles that are eligible for this fuel tax refund:

- A commercial vehicle that uses a power takeoff to remove and dispose of septage and for which an annual fee is required to be paid to the Department of Environment and Natural Resources (DENR) under its septage management program.[65] In order to issue the refund, the Department of Revenue is not required to verify the payment of the permit fee as required by G.S. 130A-291.1.[66] If the Department, however, discovers through its auditing or investigatory procedures that those permit fees have not been paid, it may refuse to issue a refund or seek a return of the refund.
- Sweeper. A sweeper is a vehicle that vacuums up and hauls away litter in parking lots. A sweeper vehicle has an auxiliary engine that runs only when the vehicle is performing its sweeping function. A factory-installed meter gauges how much fuel is being used for that function.

The other vehicles eligible for this refund include concrete mixing vehicles; solid waste compacting vehicles; bulk feed vehicles that deliver feed to poultry or livestock and use power takeoffs to unload the feed; vehicles that deliver lime or fertilizer in bulk to farms and use power takeoffs to unload the lime or fertilizer; tank wagons that deliver alternative fuel, motor fuel, or another type of liquid fuel into storage tanks and use power takeoffs to make the deliveries; and commercial vehicles that deliver and spread mulch, soils, compost, sand, sawdust, and similar materials and that use power takeoffs to unload, blow, and spread these materials.

[65] Under G.S. 130A-291.4, DENR is responsible for administering a septage management program which includes establishing standards for transportation, storage, treatment, and disposal of septage; operator registration and training; the issuance, suspension, and revocation of permits; and procedures for the payment of annual fees.

[66] An earlier version of Senate Bill 356 allowed a refund to a vehicle for which an annual fee is "paid" to DENR, wile the ratified version allows a refund to a vehicle for which an annual fee is "required to be paid" to DENR.

GARVEE Bond Issuance.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-403	**HB 254**	**Representative Crawford**

AN ACT TO AUTHORIZE THE STATE TREASURER TO ISSUE "GARVEE" GRANT ANTICIPATION REVENUE VEHICLE BONDS ON BEHALF OF THE DEPARTMENT OF TRANSPORTATION, TO REQUIRE "GARVEE" FUNDS TO BE DISTRIBUTED IN ACCORDANCE WITH THE EQUITY DISTRIBUTION FORMULA, AND TO DIRECT THE SECRETARY OF THE DEPARTMENT OF TRANSPORTATION AND THE STATE TREASURER TO DEVELOP AN IMPLEMENTATION PLAN FOR ISSUANCE OF THE BONDS, AS RECOMMENDED BY THE JOINT LEGISLATIVE TRANSPORTATION OVERSIGHT COMMITTEE, AND TO CLARIFY THE DEFINITION OF GOVERNMENTAL UNIT FOR PURPOSES OF INTEREST RATE SWAP AGREEMENTS.

OVERVIEW: This act does two things:

- It authorizes the use of GARVEE bonds to finance projects in the Intrastate Highway System and the Transportation Improvement Program.
- It modifies the definition of 'governmental unit' for purposes of interest rate swap agreements to mirror the language in the statute authorizing swap agreements.

FISCAL IMPACT: This act is not projected to impact State revenues since the debt service for the bonds will be paid by federal funds.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: The authority to issue GARVEE bonds becomes effective February 1, 2006. The remainder of the act became effective when the Governor signed it into law on September 20, 2005.

ANALYSIS: GARVEEs, Grant Anticipation Revenue Vehicles, represent one of the tools Congress provides to the states to facilitate the development and acceleration of highway projects. With GARVEEs, states may issue bonds secured by future federal highway funds. The debt itself is a state responsibility; a GARVEE does not carry with it any guarantee for repayment from the federal government. However, the federal aid highway program represents a long-standing source of transportation revenue and many investors appear willing to accept the risk that Congress will continue to authorize highway funds for the full term of the bonds.

This act authorizes the Department of Transportation to issue GARVEE bonds to finance federal-aid highway projects. A state may elect to pledge their obligations of future federal-aid funds as the only security backing the federal share of the obligation to investors (non-recourse GARVEES) or to pledge other sources of revenue as a back-stop for the future federal-aid funds (back-stopped GARVEES). The GARVEE bonds issued under this act's authority must be non-recourse GARVEES. The notes issued under this authority are not supported by a pledge of the taxing power of the State and they must contain on their face a statement to the effect that the State of North Carolina is not obligated to pay the principal or the interest on the notes, except from the federal transportation fund revenues. The act also specifies that the bond revenues must be distributed in accordance with the equity distribution formula under G.S. 136-17.2A.[67] This part of the act becomes effective February 1, 2006; DOT may not issue GARVEE bonds before that date.

The act directs the Department of Transportation and the State Treasurer to form a committee to develop a plan to address the issues involved in issuing GARVEE bonds. The plan must be submitted to the Board of Transportation for review and comment. The final plan must be submitted by December 1, 2005, to the cochairs of the Transportation Appropriations Subcommittee and the Joint Legislative Transportation Oversight Committee.

The act limits the amount of GARVEE bonds that may be issued by requiring the State Treasurer to determine one of the following before the bonds are issued:

- That the total outstanding principal of the debt does not exceed the total amount of federal transportation funds authorized to the State in the prior federal fiscal year.
- That the maximum annual principal and interest payment of the debt does not exceed 15% of the expected average annual federal revenue for the 7-year period in the most recently adopted Transportation Improvement Program.

In federal fiscal year 2004, the amount of federal transportation funds authorized for the State was $950 million.[68] Therefore, this act would allow the State to borrow roughly $950 million. The fiscal note assumes that DOT would issue $475 million of debt in February 2006, and $475 million of debt in the spring of 2007. It also assumes that the interest rate would be 4.5% on each of the bond issues and that each bond issue would be paid off over 12 years. Based upon these assumptions, the payments on this debt would be about $1.25 billion.[69] These debt service payments would be funded from federal aid available to the State, and would displace the use of this federal aid for other projects or purposes.

Candidate projects for GARVEE financing are typically larger projects that have the following characteristics:

- They are large enough to merit borrowing rather than pay-as-you-go grant funding, with the costs of delay outweighing the cost of financing.
- They do not have access to a revenue stream (such as local taxes or tolls) and other forms of repayment (such as state appropriations) are not feasible.

[67] The 100 counties in the State are divided into seven distribution regions. G.S. 136-17.2A seeks to ensure that all the regions of the State have a percentage share of the transportation funds as determined by the formula set forth in this statute.

[68] The actual federal aid received by the State usually amounts to less than the federal aid authorized. For federal fiscal year 2004, the State received roughly $830 million in federal highway funds.

[69] Based upon an interest rate of 4.5%, roughly $300 million of this amount would be for interest expenses.

- The sponsors (generally state DOTs) are willing to reserve a portion of future year federal-aid highway funds to satisfy debt service requirements.

Unrelated to the GARVEE bond authorization, the act clarifies that the State Treasurer can enter into interest rate swap agreements between bond issues. Under G.S. 159-194, the State Treasurer can enter into swap agreements; however, the language in the definitional part of the article does not mirror the language in the authorizing statute itself. Section 4 of this act modifies the definition of 'governmental unit' to mirror the language in the statute authorizing swap agreements. The State's bond counsel requested this change.

Bill Lee / Excise Tax Refund.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-406	**SB 868**	**Senator Berger of Franklin**

AN ACT TO AMEND THE ENTERPRISE TIER STRUCTURE UNDER THE WILLIAM S. LEE QUALITY JOBS AND BUSINESS EXPANSION ACT AND TO ALLOW FOR A REFUND OF EXCISE TAX ON UNSALABLE CIGARS.

OVERVIEW: The act provides an exception to the tier designation formula under the William S. Lee Quality Jobs and Business Expansion Act, by allowing certain industrial parks located in higher-tiered counties to be treated as if they were located in an enterprise tier one area if the parks meet conditions related to government ownership, size, population of the counties, and Medicaid eligibility within the counties.

The act also gives tobacco products dealers a refund of the excise tax paid on stale or otherwise unsalable cigars returned to the manufacturer.

FISCAL IMPACT: No estimate available.

EFFECTIVE DATE: Changes to the Bill Lee Act are effective for taxable years beginning on or after January 1, 2005. The refund for unsalable cigars became effective September 1, 2005.

ANALYSIS:

The William S. Lee Quality Jobs and Business Expansion Act (hereinafter Bill Lee Act) was enacted in 1996, effective beginning with the 1996 tax year with a 2002 sunset.[70] The Bill Lee Act is a package of State tax incentives and has been modified in each subsequent year. The incentives are primarily in the form of tax credits for investment in machinery and equipment and real property, for job creation, for worker training, and for research and development. Counties are divided into five economic distress tiers based on the unemployment rate, per capita income, and population growth of the county. For many of the credits, the lower the tier of a county, the more favorable the incentive. The Bill Lee Act

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[70] See summary of S.L. 2005-241, Extend JDIG and Bill Lee Act, for discussion of the extension of the Act's sunset.

requires the Department of Commerce and the Department of Revenue to report periodically on the credits allowed by the 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 of Commerce must rank all 100 counties based on the following three factors: the rank of the county in a ranking of counties by average rate of unemployment over the preceding 12 months from lowest to highest, the rank of the county in a ranking of counties by average per capita income over the proceeding 12 months from highest to lowest, and the rank of the county in a ranking of counties by percentage growth in population over the preceding 12 months from highest to lowest. [71] Each of these factors is given equal weight. The Secretary of Commerce is required to use the latest data available in making these calculations. Counties with one of the 10 highest rankings are designated enterprise tier one, the next 15 counties are designated enterprise tier two, the next 25 counties are enterprise tier 3, the next 25 counties are enterprise tier 4, and the remaining counties are enterprise tier 5. There are numerous exceptions to this formula.[72] 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. Certain lower-population counties also enjoy exceptions that could result in those counties receiving a lower tier designation. Finally, certain industrial parks that are located at one site in two or more counties receive the tier designation of the lower-ranked county. This last exception was added in 1998 (S.L. 1998-55) to promote regional cooperation in industrial development and to avoid an industrial park that is split into two tier designations.

Exception to Tier Structure under Bill Lee Act

Section 1 of this act creates a new exception to the Bill Lee Act tier designation formula. Under this act, sites within certain industrial parks will be able to qualify for enterprise tier one status. In order to take advantage of this exception, all of the following conditions must be satisfied:

- The site is located in an industrial park created by interlocal agreement pursuant to G.S. 158-7.4.
- The industrial park is located, at one or more sites, in at least four contiguous counties.
- At least two of the counties in which the industrial park is located are designated as enterprise tier one areas.
- Four or more units of local government, or a nonprofit corporation owned and controlled by four or more units of local government, own the industrial park.

[71] Prior to the designations for the 2005 calendar year, these ranking were based on longer time periods. Unemployment and per capita income were averaged over three years rather than 12 months. There was no time period specified for measuring population growth, but it was the practice of the Department of Commerce to measure population growth by comparing the most recent estimates of population in the county with the figures derived from the last decennial federal census. See S.L. 2004-202.

[72] S.L. 2005-241 creates an exception for counties with particularly high rates of unemployment and amends the current exception for counties with small populations and high rates of poverty by eliminating the requirement related to the percent of the population living below the poverty level.

- In each county in which the industrial park is located, the park has at least 300 developable acres. The term "developable acres" includes acreage that is owned directly by the industrial park or its owners or that is the subject of a development agreement between the industrial park or its owners and a third-part owner.
- The total population of all the counties in which the industrial park is located is less than 200,000.
- In each county in which the industrial park is located, at least 16.8% of the population was Medicaid eligible for the 2003-2004 fiscal year based on 2003 population estimates.

As of the time the bill was signed into law by the Governor on September 20, 2005, the industrial park in the Kerr-Tar region is the only industrial park that was known to meet the above criteria. It is possible that other counties could enter into similar agreements in order to take advantage of the exception in the future, but the restrictions are so stringent as to make it unlikely that a significant number of high-tiered counties could qualify under this act. The four counties involved in the Kerr-Tar industrial park project are Franklin, Granville, Vance, and Warren. In 2005, Franklin County was an enterprise tier five area; Granville County was an enterprise tier three area; and Vance and Warren Counties were enterprise tier one areas.

Refund of Excise Tax on Unsalable Cigars

Section 2 of this act allows a wholesale dealer or retail dealer who has paid the 2% excise tax on cigars to apply for a refund of the excise tax if the cigars are stale or otherwise unsalable. To obtain the refund, the dealer must return the cigars to the manufacturer and send an application to the Secretary of Revenue accompanied by an affidavit from the manufacturer stating the number of cigars returned to the manufacturer. The amount of the refund is the excise tax paid less the 2% discount.[73] Similar treatment is allowed to a distributor of cigarettes. If the distributor of cigarettes is in possession of stale or otherwise unsalable cigarettes, the distributor may apply for a refund of the tax paid, less the discount allowed on the unsalable cigarettes. This act gives the same refund to dealers in possession of unsalable cigars, but not to other tobacco products.

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). In 2004, the General Assembly reinstated the discounts, but at a rate of 2% of the tax due. (S.L. 2004-84)

[73] Under current law, a wholesale dealer or retail dealer of tobacco products who timely pays the excise tax on tobacco products at the rate of 2% of the cost price is eligible for a discount equal to 2% of the tax due. This discount is intended to cover expenses incurred in preparing tax reports and the expense of furnishing a bond.

Tax Increment Financing Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-407	**SB 528**	**Senator Clodfelter**

AN ACT TO ALLOW A MUNICIPALITY TO USE PROJECT DEVELOPMENT FINANCING FOR TOURISM-RELATED DEVELOPMENT PROJECTS LOCATED IN AN ENTERPRISE TIER ONE AREA.

OVERVIEW: This act allows a municipality to use project development financing for a tourism-related development project located outside its central business district if the project is located in an enterprise tier one area.

FISCAL IMPACT: The act does not affect General Fund revenues.

EFFECTIVE DATE: The act became effective when it was signed into law by the Governor on September 20, 2005.

ANALYSIS: In November 2004, the voters approved a constitutional amendment that has enabled counties, cities, and towns to use project development financing for the public portion of certain economic development projects within a defined territorial area. Project development financing, also known as tax increment financing, allows a local government to issue bonds secured by the incremental property tax increase generated by the development financed. This financing mechanism can be used for airports, auditoriums and arenas, hospitals, museums, parking facilities, sewer systems, storm sewers and flood control facilities, water systems, street improvements, public transportation facilities, railroads, affordable housing, land development for industrial or commercial purposes, utilities, and redevelopment. The prior law restricted the amount of retail development that could be considered as a 'development project' if the project was located outside a municipality's central business district. Under that restriction, no more than 20% of a project's square footage may be proposed for use in retail sales, hotels, and other commercial uses other than office space.

The act enables municipalities to use project development financing for tourism related development in an enterprise tier one area by eliminating the 20% limitation on commercial uses for tourism-related economic development, such as developments that would feature facilities for exhibitions, athletic and cultural events, show and public gatherings, racing facilities, parks and recreation facilities, art galleries, museums, and art cents.

The act was enacted to give the City of Roanoke Rapids the opportunity to develop a music theater and entertainment district that could become a nationally recognized travel destination in North Carolina. The proposed district will encompass over 700 acres, represents an investment of an estimated $129 million, and should create over 2,595 new jobs. The district will consist of music theaters, shopping, hotels, motels, restaurants, and family recreational activities. The City of Roanoke Rapids has agreed to provide certain improvements in the proposed district and believes project development financing will be a desirable vehicle for it to use to finance these improvements. However, because the project will be located on I-95, outside the City's central business district, the 20% limitation on commercial development prevented the City from using this financing tool. The act alleviates this problem by eliminating the 20% limitation.

Energy Credit Banking/Selling Program/Fund.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-413	**SB 1149**	**Senator Jenkins**

AN ACT TO ESTABLISH A BANKING AND SELLING PROGRAM FOR CREDITS ISSUED UNDER THE FEDERAL ENERGY POLICY ACT IN ORDER TO GENERATE FUNDS FOR THE USE OF ALTERNATIVE FUELS AND ALTERNATIVE FUELED VEHICLES BY STATE DEPARTMENTS, INSTITUTIONS, AND AGENCIES AND TO EXTEND AND EXPAND THE CREDIT FOR INVESTMENT IN RENEWABLE ENERGY PROPERTY.

OVERVIEW: This act[74] extends and expands the tax credit for investing in renewable energy property as follows:

- Expands the definition of renewable energy property in G.S. 105-129.15(7) to include any biomass equipment that uses renewable biomass resources for commercial thermal or electrical generation.
- Expands the definition of renewable biomass resources in G.S. 105-129.15(6) to include spent pulping liquor.
- Increases the ceiling on the tax credit for placing renewable energy property in service for nonresidential property from $250,000 to $2.5 million.
- Includes pool heating in the residential property ceiling for solar energy equipment.
- Extends the sunset on the tax credit for investing in renewable energy property from January 1, 2006, to January 1, 2011.

FISCAL IMPACT: The following General Fund loss is estimated as a result of the extension and expansion of the renewable energy tax credit:

Fiscal Year	**Business**	**Individuals**	**Total**
2005-06	$0.00	$0.00	$0.00
2006-07	$0.02 million	$0.08 million	$0.10 million
2007-08	$0.92 million	$0.13 million	$1.05 million
2008-09	$1.95 million	$0.18 million	$2.13 million
2009-10	$3.53 million	$0.27 million	$3.80 million

[74] Changes to the tax credit for investing in renewable energy property are set out in sections 4 and 5 of the act.

2010-11	$5.36 million	$0.29 million	$5.65 million

The category "business" includes non-profit organizations with participating private entities. The above revenue losses reflect current usage of the credit. The loss is expected to be higher in the future if energy costs continue to rise.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Sections 4 and 5 of the act are effective for taxable years beginning on or after January 1, 2006.

ANALYSIS: In 1977, the General Assembly enacted legislation to provide tax credits for the construction or installation of a solar energy system to a building in North Carolina. In subsequent years tax credits encouraging the installation and use of equipment that takes advantage of other renewable energy resources were enacted. Renewable energy property is equipment that uses the renewable energy sources such as solar radiation, vegetation, organic wastes, moving water, or wind for the following purposes: to heat or cool buildings; to produce hot water, thermal, or process heat; or to generate electricity.

Under current law, the credit for investing in renewable energy property applies to any of the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; or commercial thermal or electrical generation from renewable energy crops or wood waste materials. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, and animal wastes.
- Hydroelectric generators
- Solar energy equipment
- Wind equipment

The act adds spent pulping liquor to the definition of renewable biomass resources. Spent pulping liquor is a byproduct of pulp and paper processing. To accommodate this addition to the definition of renewable biomass resources, the act also expands the definition of renewable energy property to include any biomass equipment that uses renewable biomass resources (not just renewable energy crops or wood waste materials) for commercial thermal or electrical generation.

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

TYPE OF PROPERTY	MAXIMUM CREDIT
Non residential property	The act increases the credit from $250,000

	per installation to $2,500,000 per installation
Residential property – Solar energy equipment for domestic water heating. The act clarifies that the credit also applies to solar energy equipment for pool heating.	$1,400 per dwelling unit
Residential property – Solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating.	$3,500 per dwelling unit
Residential property – All other renewable energy property for residential purposes	$10,500 per installation

The renewable energy tax credit has the following limitations and conditions:

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

The act extends the sunset on the renewable energy tax credit from January 1, 2006 to January 1, 2011, and maintains the existing sunsets on the other credits in Article 3B (Business and Energy Tax Credits) of Chapter 105 of the General Statutes.

Economic Development - Public Records.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-429	**SB 393**	**Senator Hoyle**

AN ACT TO CLARIFY THE PUBLIC RECORDS LAWS WITH RESPECT TO ECONOMIC DEVELOPMENT AND TO REQUIRE THE DEPARTMENT OF REVENUE TO PUBLISH ANNUAL REPORTS REGARDING USE OF ECONOMIC DEVELOPMENT TAX INCENTIVES.

OVERVIEW: This act requires the Department of Revenue to annually publish a list, itemized by taxpayer, disclosing information about certain tax incentives. In addition, the act clarifies that public records created with respect to a proposed location or expansion of a specific business or industrial project must be released once the project has been announced, that certain types of information are public records, and that an agency must notify applicants for and recipients of economic development incentives about public records requirements.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: The annual reporting required by the Department of Revenue becomes effective January 1, 2007; the remainder of the act became effective when the Governor signed it into law on September 22, 2005.

ANALYSIS: Generally, documents prepared or received by State agencies in the transaction of public business are public records and must be made available to the public for inspection. There are several important exceptions to the public records law that allow for withholding certain public records from disclosure. One of these exemptions is for tax information, which may be disclosed only as specifically authorized by law. Another of these exceptions relates to the location or expansion of business or industrial projects. Prior to this act, public records relating to the location or expansion of specific business or industrial projects could be withheld from disclosure so long as that disclosure would frustrate the purpose for which the public records were created. Arguably, the release of public records related to a specific project could "frustrate the purpose for which they were created" long after the project was announced.

This act clarifies that public records created with respect to the location or expansion of a specific business or industrial project may not be withheld once the project location or expansion has been announced. The act provides for a 25-business-day period for the State agency to gather and review the records before making them public. The act also specifies that when an agency is required to perform a cost-benefit analysis or similar assessment with respect to economic development incentives offered to a specific business, the assumptions and methodologies used in completing that analysis are public records and must be disclosed in the same fashion as other public records. The act requires an agency to notify the applicant or recipient of economic development incentives about these public records law requirements.

In addition to clarifying the public records law as it pertains to economic development incentives, the act creates and expands reporting requirements surrounding economic development incentives. Under the act, the Department of Commerce must make an annual report on all grant programs administered by the Department; it must specifically disclose the amount transferred to the Utility Account of the Industrial Development Fund under the JDIG Program[75] each year; and it must report employment levels for businesses receiving grants under the JDIG Program.

The Department of Revenue currently publishes an annual report, itemized by taxpayer, on credits claimed under the Bill Lee Act. It also makes annual reports on other credits to either the Revenue Laws Study Committee or the Fiscal Research Division. This act

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[75] Job Development Investment Grant Program. Part 2G of Article 10 of Chapter 143B of the North Carolina General Statutes.

requires the Department to annually publish a report on economic development tax incentives authorized by the State. The act modifies the Department's current reporting requirements so that all reports prepared by it on credits and refunds have identical reporting dates and data periods. It amends the existing reporting requirements for the following credits to require that they be itemized by taxpayer:

- Tax incentives for recycling facilities under Article 3C of Chapter 105.
- Research and development under Article 3F of Chapter 105.

It creates new reporting requirements for the following tax incentives:

- Historic rehabilitation tax credits under Article 3D of Chapter 105.
- Tax incentives for major computer manufacturing facilities under Article 3G of Chapter 105.
- Credit for North Carolina State Ports Authority wharfage, handling, and throughput charges.
- Credit for manufacturing cigarettes for exportation.
- Sales tax refunds for building materials of certain industrial facilities.

Lastly, the act directs the newly formed Economic Development Oversight Committee[76] to study the issue of public disclosure as it relates to economic development efforts. Specifically, the Committee shall study ways of providing the public information about employment levels at businesses that receive economic development incentives.

Motor Fuel Tax Chgs & Rev Laws Technical Chgs.

Session Law	*Bill #*	*Sponsor*
S.L. 2005-435	**HB 105**	**Representative Luebke**

AN ACT TO MODIFY THE TAXATION OF MOTOR FUELS, TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, AND TO ALLOW INTERSTATE PASSENGER AIR CARRIERS A REFUND OF SALES AND USE TAXES ON FUEL.

OVERVIEW: This act makes numerous changes to the motor fuels tax laws as recommended by the Revenue Laws Study Committee, makes technical and clarifying changes to the revenue laws[77] and allows for a refund of sales and use taxes paid on certain aviation fuel.

FISCAL IMPACT:

[76] Created by S.L. 2005-241.

[77] The Revenue Laws Study Committee recommended numerous technical corrections on S 159 that were incorporated into this bill.

Provision	*Fiscal Impact*
Part I. Motor Fuel Tax Changes	
Penalty provisions.	Generally, no estimate is available of the fiscal impact of the various penalties authorized or increased in this Part, but the effect is expected to be minimal.
Red Cross exemption from motor fuels tax.	Since this section conforms statute to department policy, no fiscal impact is expected.
Refund conformity.	No fiscal impact is expected.
IRP audit responsibility.	No additional funding required for the positions with auditing responsibility. Additionally, there is no increase in receipts needed for the department to administer the new or revised statutory requirements resulting from this legislation. The remaining sections deal with record keeping requirements and have no fiscal impact.
Part II. Revenue Laws Technical Changes	A review of the language of the changes to the tax law indicates that they are purely technical in nature. In many cases the new language conforms to the current administrative interpretation. No fiscal impact is expected.
Part III. Refund of Sales and Use Taxes on Fuel	
Interstate air passenger carriers.	Based on historic fuel refund data and projected fuel costs, Tax Research and Fiscal Research agree that the provision is likely to cost the State between $3.0 and $5.0 million each year the program is in effect. The change is expected to impact a fairly limited number of air carriers.
Motorsports racing teams and sanctioning bodies.	Based on data provided by some of the motorsports teams, and information gleaned from recent industry impact studies by UNC Charlotte, Fiscal Research estimates the annual State cost of this portion of the bill as approximately $1.1 million for each of the two years. The local cost is expected to be $0.6 million.

(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2005 Session. Available in the Legislative Library.)

EFFECTIVE DATE: Except as otherwise specified, this act became effective when signed into law by the Governor on September 27, 2005.

ANALYSIS:

Part I: Motor Fuel Tax Changes.

Section	Explanation

1	Penalty for failure to obtain a license. – Allows the Secretary to impose a $1,000 penalty for failure to obtain a license under G.S. 105-449.65 or G.S. 105-449.131[78] Under existing law, the Secretary has general authority to impose a penalty for failure to obtain a license. Under that general authority, the amount of the penalty imposed is equal to 5% of the amount prescribed for the license for each month the taxpayer fails to obtain the license, with a maximum penalty of 25% of the amount prescribed for the license. Because this general authority limits the penalty to a percentage of the amount prescribed for the license, it effectively bars assessing a penalty when there is no charge to obtain a license. There is no charge for the licenses issued pursuant to G.S. 105-449.65 or G.S. 105-449.131. This provision becomes effective January 1, 2006.
2	Electronic funds transfer. – Enables the Motor Fuels Division to move towards a paperless return by requiring those taxpayers who file electronically to also pay electronically. By statute the Secretary can require motor fuels taxpayers to file returns electronically. The Division plans to require motor fuel taxpayers that have schedule data information to file their returns electronically. "Schedule data information" is a separate schedule that lists all bills of lading for the fuel being reported. The information enables the Department to track fuel on a load-by-load basis. The Secretary will not require electronic filing from taxpayers who make a written request for relief from this requirement.
3	Conform refund provisions. – Conforms the refund statute applicable to motor carriers to the general rule applicable to tax refunds of overpaid taxes. Under the general administrative provisions of G.S. 105-266(a)(3), the Secretary does not have to refund a tax overpayment of less than $3.00 unless the taxpayer makes a written request for the refund. A motor carrier is entitled to a credit on its quarterly report for tax paid by the carrier on fuel purchased in this State. If the credit exceeds the amount of tax owed, the statute provides that the Secretary must refund the excess to the carrier. The statute does not set a minimum amount. This statute appears to conflict with the general administrative provision. This section clarifies that the general administrative law applicable to refunds applies to refunds payable to motor carriers.
4	Technical change. – Removes obsolete language to conform to current administrative practice. G.S. 105-449.44 establishes the calculation by which a motor carrier determines the amount of fuel used in North Carolina. The formula under previous law had not been used since 1991. In 1992, North Carolina became a participant in the International Fuel Tax Agreement. The

[78] G.S. 105-449.65 is contained in the Article dealing with gasoline, diesel fuel, and blended fuel, and requires the following to have a license: refiners, suppliers, terminal operators, importers, exporters, blenders, motor fuel transporters, and distributors who purchase motor fuel from an elective or permissive supplier at an out-of-state terminal for import into this State. G.S. 105-449.131 is contained in the Article dealing with alternative fuels and requires the following to have a license: providers of alternative fuel, bulk-end users, and retailers.

	method specified by this section conforms to the IFTA agreement and is the method motor carriers have been using to determine the amount of fuel used in this State since 1992.
5 and 22	Conforming change. – Transfers audit functions related to the International Registration Plan from the Department of Transportation, Division of Motor Vehicles to the Department of Revenue, Motor Fuels Tax Division. The International Registration Plan is the mechanism through which interstate motor carriers are licensed. It helps to ensure that the proper amount of motor fuels tax is credited to each jurisdiction in which the motor carrier travels. It has been suggested that the Department of Revenue has more expertise in auditing taxpayers and would be a more appropriate home for these audit functions. The positions associated with these audit functions were transferred July 1, 2004, through an administrative transfer.
6	Technical change. – Removes language that is no longer applicable. G.S. 105-449.47 provides that the Secretary must issue identification markers to motor carriers. Under previous law, the statute provided that the Secretary could withhold an identification marker if a motor carrier failed to comply with former Article 36 or 36A. The General Assembly repealed those articles in 1996. The authority of the Department to issue an assessment under one of those articles has expired and any uncollectible assessments issued under those articles has been written off. Therefore, the language repealed by this section is obsolete.
7	Reasons to refuse to register and issue identification marker to motor carrier. – Sets forth the reasons the Secretary could refuse to register and issue an identification marker to a motor carrier. The Department requested this change to enable it to register only applicants that are in good standing with North Carolina and other taxing jurisdictions. The statute created in this section is very similar to G.S. 105-449.73, which sets forth the reasons the Secretary may refuse to issue a license to an applicant under the motor fuel statutes. This provision becomes effective January 1, 2006.
8	Simplify criminal penalty. – Simplifies the criminal penalty imposed on persons who operate as a motor carrier in this State without obtaining the necessary registration and identification markers. A violation of the motor carrier requirements is a Class 3 misdemeanor. Under previous law it was punishable by a fine that was no less than $10 nor more than $200. This section sets the amount of the fine at $200. The civil penalty for this offense is $100. This provision becomes effective January 1, 2006.
9	Clarification of licensing requirements for multiple activities. – Clarifies the current licensing requirements by conforming them to the current Department policy and practice. This provision becomes effective January 1, 2006.
10	Technical change. – Removes obsolete language. In 1999, the General Assembly removed the licensing requirements for bulk-end users and retailers of undyed diesel fuel. The legislation did not include a conforming

	change to G.S. 105-449.69(b).
11	Clarifying change. – Changes the defined term "overdue tax debt" to the appropriate defined term "tax debt". Under the general administrative provisions in G.S. 105-243.1, a tax debt is defined as the total amount of tax, penalty, and interest due for which a notice of final assessment has been mailed to the taxpayer after the taxpayer no longer has the right to contest the debt. An "overdue tax debt" is any part of a tax debt that remains unpaid 90 days or more after the notice of final assessment was mailed to the taxpayer. A collection assistance fee is imposed on an overdue tax debt that remains unpaid 30 days or more after the appropriate fee notice is mailed to the taxpayer. G.S. 105-449.73 sets forth the reasons the Secretary can deny a license to an applicant. One of the reasons is failure to remit taxes that remain due after a taxpayer no longer has the right to contest the tax debt. Since G.S. 105-449.73 has nothing to do with the imposition of the collection assistance fee, the term "overdue tax debt" is not the appropriate term to use.
12	Conforming change. – Exempts motor fuel acquired to operate a highway vehicle owned by or leased to the American Red Cross from the motor fuel excise tax. In Department of Employment v. United States, 385 U.S. 355, 87 S.Ct. 464 (1966), the United States Supreme Court ruled that the Red Cross is an instrumentality of the United States for state tax immunity purposes. This provision codifies the current administrative practice of the Department of Revenue. This section makes another conforming change by recognizing that federal law no longer allows dyed diesel fuel to be used in intercity buses. Dyed diesel fuel indicates that the fuel is used for a nontaxable purpose under federal law. Because dyed diesel fuel may no longer be used in intercity buses under federal law, there is no need to specifically apply the State tax to dyed diesel fuel used in intercity buses. This amendment does not change the taxation of the fuel used in intercity buses: the State tax continues to apply.
13	Repeal obsolete payment procedure. – Removes the ability of a person exporting motor fuel to another state to pay the tax directly to the Department if the person is not licensed in the destination state of the motor fuel. The provision is repealed because it is no longer necessary. This provision was included in the statutes in 1996 when North Carolina first adopted "tax at the rack" to accommodate persons exporting products to a state that was not a "tax at the rack" state. Today, with the exception of Georgia, all of the surrounding states have adopted "tax at the rack". The Georgia border in the western part of the State would not be affected by this repeal because the closest terminal to the Georgia line is in Charlotte.
14	Conforming change. – Provides that a supplier must list on its return to the Secretary the number of gallons of motor fuel the supplier exchanged with another licensed supplier pursuant to a two-party exchange agreement. The Secretary currently requires this information on the supplier return.

15	Technical change. – Removes obsolete language from the catch line of G.S. 105-449.106. In 2003, the General Assembly exempted motor fuel sold to a county or city for its use from the motor fuel tax. Although the legislation authorizing the exemption made the appropriate conforming change to the refund statute, it failed to amend the catch line. This provision becomes effective when it becomes law.
16	Shipping document. – Allows the Secretary of Revenue to assess a penalty of $5,000 on a terminal operator who intentionally fails to issue a shipping document that satisfies the requirements for the shipping document. Under G.S. 105-449.115, shipping documents issued by a terminal operator must contain the following information: 1) identification of the terminal or bulk plant from which the fuel was received, 2) the date the fuel was loaded, 3) the gross gallons loaded, 4) the destination state of the motor fuel, 5) the net gallons loaded, and 6) a tax responsibility statement indicating the name of the supplier that is responsible for the tax. The Motor Fuels Tax Division has noticed a problem with some terminal operators failing to issue proper shipping documents. Without an accurate shipping document, it is difficult, if not impossible, for the Department to ensure that the proper amount of tax is being paid. This provision becomes effective January 1, 2006. This section also adds a defense to imposition of a penalty for failure to obtain a diversion number for motor fuel delivered to a state other than the destination state printed on the shipping document. In order for this defense to be applicable, the person must notify the Secretary of the diversion within 7 days after the diversion occurred and must have timely paid the tax on the diverted fuel. This part of the section becomes effective when it becomes law and applies to penalties imposed on or after January 1, 2005. Finally, this section also specifies that a civil penalty assessed against a transporter is to be paid to the Department of Crime Control and Public Safety or the Department of Revenue. Previously, the penalty could be paid to the Division of Motor Vehicles of the Department of Transportation rather than the Department of Crime Control and Public Safety. This change reflects a recent realignment of enforcement responsibilities.
17	Documentation for tank wagon. –Requires the same documentation requirements for a person who operates a tank wagon into which motor fuel is loaded at the terminal as for a person who operates a transport truck into which motor fuel is loaded at the terminal. It would also require that a copy of the invoice be kept at a centralized place of business for at least three years from the date of delivery.
18	Penalty for failing to properly mark storage facility. – Imposes a civil penalty on a person who intentionally does not properly mark the storage facility of motor fuel. Undyed fuel is subject to the motor fuel tax; dyed fuel is not. This section also specifies that a civil penalty assessed against the person failing to properly mark a storage facility is to be paid to the Department of Crime Control and Public Safety or the Department of Revenue. Previously, the penalty could be paid to the Division of Motor Vehicles of the

	Department of Transportation rather than the Department of Crime Control and Public Safety. This change reflects a recent realignment of enforcement responsibilities. This section becomes effective January 1, 2006
19 and 20	Conforming change. – Makes changes to Chapter 119 necessitated by legislation enacted in 2003. In 2003, the General Assembly voted to apply the inspection tax to dyed diesel fuels. The inspection tax is imposed on all fuel types at the rate of ¼¢ per gallon. Proceeds of the tax are used to offset the expenses of administering the motor fuels taxes. The changes in these two sections are needed to apply the tax to distributors who purchase only dyed diesel fuel.
21	Technical change. – The law provides that an applicant for a license as a kerosene supplier, kerosene distributor, or a kerosene terminal operation may file either a bond with the Secretary of Revenue or an irrevocable letter of credit. Section 21 inserts the phrase "irrevocable letter of credit" in a sentence in which it was inadvertently omitted.
23	Effective date section for this part.

Part II. Revenue Laws Technical Changes.

Section	Explanation
24	Technical change. – Adds language regarding a federal determination of gross estate tax that changes the amount of tax payable to the State. The current statute refers only to a federal correction or determination made with regard to the maximum state death tax credit allowed. As of January 1, 2005, there is no state death tax credit allowed under federal law so language needs to be added regarding gross estate tax changes.
25	Technical change. – Section 25(a) conforms the definition of "unfortified wine" in Chapter 18B to the definition in G.S. 105-113.68. The General Assembly changed the definition of "unfortified wine" in S.L. 2004-135. The definition in Chapter 18B inadvertently included an unnecessary word. Section 25(b) cross-references the applicable definitions in the Alcoholic Beverage License and Excise Tax Article to the definitions in Chapter 18B and makes stylistic changes. In addition, the change made to "wholesaler or importer" conforms to a change made in Chapter 18B in the 2003 Regular Session.
26	Clarifying change. – Clarifies that the excise tax on wine shippers is imposed only on wine shipped to North Carolina consumers.
27	Clarifying change. – Clarifies the scope of authorized disclosure of information obtained by the Secretary of Revenue under Article 2D, Unauthorized Substance Taxes. Under previous law, information obtained under article 2D was confidential and could not be disclosed, unless the disclosure was made to exchange information with certain law enforcement agencies concerning a tax imposed by the Article. The information could also

	not be used in a criminal prosecution, other than for a prosecution for a violation of the Article or unless the information was independently obtained. However, the law was somewhat ambiguous about when this disclosure between the Division and law enforcement could take place. Since the Division needs to be able to exchange information with law enforcement in order to assist with the collection of the tax and the intent of the statute was to allow such communication, this section clarifies when this information may be disclosed while preserving a person's Fifth Amendment and double jeopardy protections.
28	Clarifying change. – Clarifies that the jobs tax credit installments end if the number of jobs in this State fall below the number the taxpayer had in this State when the taxpayer claimed the credit.
29	Technical change. – Substitutes the appropriate reference to "Article, " as opposed to "section."
30	Technical change. – Repeals the sales tax exemption for sales to the North Carolina Museum of Art of paintings and other objects or works of art for public display, the purchases of which are financed in whole or in part by gifts or donations. Effective July 1, 2004, the sales tax refund for State agencies was replaced with a sales tax exemption for all State agencies. Since the NC Museum of Art is a State agency under G.S. 140-5.12, the specific exemption in Chapter 105 is unnecessary. Those sales will be covered by the broader exemption for all State agencies.
31	Clarifying change. – Clarifies that the sales and use tax exemption for free distribution periodicals, which became effective July 1, 2005, is limited to a publication that is continuously published on a periodic basis monthly or more frequently. The exemption does not apply to publications that are published monthly part of the year and less than monthly the rest of the year.
32	Administrative change. – Section 32(a) authorizes cities to receive the same information available to counties regarding claims for sales tax refunds filed under G.S. 105-164.14, which authorizes refunds for various types of entities, including interstate carriers, nonprofit organizations, certain governmental entities, State agencies, major recycling facilities, nonprofit insurance companies, and certain industrial facilities. These changes were recommendations of a joint county and city task force organized to improve the administration of local sales tax. Section 32(b) excludes from the definition of otherwise confidential tax information, information concerning sales tax refunds paid to governmental entities. It also deletes a reference to information submitted on a master application for a business license since this master application system has been eliminated now that the Business License Information Office has been moved from the Secretary of State to the Department of Commerce.
33	Administrative change. – Section 33(a) provides a sales tax refund for certain building materials used by an air courier. This section allows Fed Ex, which plans to construct a facility in North Carolina, to apply for a sales tax refund

	on its purchases of building materials. The airport authority was going to construct the facility, and it would have been entitled to a refund. However, Fed Ex now plans to construct the facility. This section entitles Fed Ex to the same exemption to which the airport authority would have been entitled. This section became effective August 1, 2005, and applies to sales made on or after that date. Section 33(b) extends the sunset date by six months from July 1, 2009, to January 1, 2010. Section 33(c) removes the sunset language from the effective date part of the 2004 law. Placing the sunset date in the statute reduces the possibility of errors and confusion when and if the relevant subdivisions are amended. This section became effective August 1, 2005.
34	Technical change. – Corrects a grammatical mistake in G.S. 105-113.82(h), 105-116.1(e), and 105-164.44F(e).
35	Technical change. – Deletes the definition of "chlorofluorocarbon refrigerant" from the White Goods Disposal Tax Article because the white goods disposal tax is no longer based on the presence of these materials.
36	Technical change. – Inserts a statutory reference due to a previous recodification. Effective January 1, 1999, the General Assembly repealed the inheritance tax (Article 1, G.S. 105-2 through G.S. 105-32) and replaced it with the current State estate tax system (Article 1A, G.S. 105-32.1 through G.S. 105-32.8.) The new G.S. 105-32.8 preserved the provisions on federal determinations, which had previously been in G.S. 105-29. However, G.S. 105-241.1(e), which sets out the statute of limitations for the Secretary to propose an assessment of tax due, was not updated to include a reference to G.S. 105-32.8.
37	Administrative change. – Makes two changes to G.S. 105-259(b). G.S. 105-259(b) prohibits State employees with access to tax information from disclosing that information to any other person unless the disclosure is for one of the reasons enumerated in that subsection. First, it corrects an agency reference in the tax information confidentiality statute to reflect that the Business License Information Office was moved from the Secretary of State to the Department of Commerce. Second, it adds a new subdivision to allow the Department of Revenue to share with a taxpayer claiming a tax credit under Article 3G (Tax Incentives for Major Computer Manufacturing Facilities), tax information about its related entities and strategic partners.
38	Technical change. – Corrects a statutory reference due to a recodification.
39	Technical change. – Corrects two statutory references due to recodifications.
40	Technical change. – Corrects a statutory reference.
41	Administrative change. – Changes the way in which local sales tax revenues are reported to more accurately account for how the proceeds are distributed.

	This is a reporting change only and does not change the distribution amounts. Under existing law prior to this act, the first 2% of the local sales taxes on food were considered Article 39 distributions. This section clarifies that the taxes distributed on a per capita basis are to be allocated as distributions under Articles 40 and 42, and that the taxes distributed on a point of delivery basis are to be allocated under Article 39. This administrative change makes it easier for local governments to track local sales tax proceeds.
42	Technical change. – Corrects a subsection reference.
43	Technical change. – Deletes an obsolete reference.
44	Clarifying change. – Clarifies reimbursement language with regard to the requirement that State and local agencies that acquire land for wetlands mitigation reimburse the county in which the land is located for its lost taxes due to the acquisition.
45	Administrative change. – Corrects the dates an occupancy tax return is due and the taxes are due.
46	Administrative change. – Increases the fees for obtaining paper and electronic certificates provided by the Secretary of State's Office for certifying a copy of any filed document relating to a domestic or foreign limited partnership. Prior to the enactment of this act, the fee was $5.00. This section increases the fee to $15.00 for a paper certificate and $10.00 for an electronic certificate. In 2002, the General Assembly increased several fees assessed by the Corporations Division of the Secretary of State's Office, including the fee for obtaining certificates and certified copies of records. In part, the new fee schedule was designed to encourage customers to use the online ordering system. Although the fee change was made for corporations and limited partnerships, a corresponding fee change was not made in the Partnership Act, which has resulted in an inconsistency. This fee increase resolves that inconsistency and makes the fees for corporations and partnerships the same.
47	Clarifying change. – Section 47(a) clarifies that the authorization for the additional local sales tax enacted in S.L. 2004-123 applies only to Dare County. Section 47(b) provides that the original bill, as amended by this act, is effective when it becomes law.
48	Technical change. – Provides that the exception in the tax secrecy statute created to correspond with a change in the law sunsets at the same time as that tax law change.
49	Technical change. – Corrects a session law reference.
50	Technical change. – Corrects the proper name for the National Association for Stock Car Auto Racing, Inc. by substituting "for" for "of."
51	Administrative change. – Repeals the conditional sunset on the gross

	premiums tax rate on medical service corporations. In 2003, the General Assembly increased the gross premiums tax rate on medical service corporations from 1% to 1.9%, effective January 1, 2004. The legislation also provided a conditional sunset on the increased tax rate once there were no longer any medical service corporations offering anything other than dental service plans. There are only two Article 65 medical service corporations in North Carolina – Blue Cross/Blue Shield and Delta Dental. At the time, Blue Cross/Blue Shield was contemplating converting to for-profit status. In doing so, it would have been subject to the 1.9% rate as well. The conditional sunset would have reduced the rate on medical service corporations back to 1%, thus reducing the rate for Delta Dental. In July 2003, Blue Cross/Blue Shield announced its intention not to pursue conversion at this time. Therefore, the conditional sunset language, which was intended to address that issue, is no longer necessary.
52	Technical change. – Reenacts S.L. 2005-120 (House Bill 1056). This bill extended the period of time allowed for the Carteret Board of County Commissioners to develop a plan and sign a contract for the construction of a convention center. It also extends by one year the date for the Board to levy the one percent (1%) room occupancy tax to the year 2008. This bill passed both the House and Senate and was enacted on June 28, 2005. However, the bill was not read on three separate days in the House. The session law is being reenacted in this bill, which is also a roll-call bill, to assure that the bill meets the constitutional roll-call requirement.
53	Technical change. – Corrects a typographical error by replacing the word "of" with the word "or."
54	Technical change. – Corrects a reference in S.L. 2005-233 to "tourism promotion" by changing it to "promote travel and tourism," which is a defined term in the statute.
55	Technical change. – Corrects incorrect statutory reference.
56	Technical change. – Inserts a sentence inadvertently omitted. This section becomes effective January 1, 2006.
57	Clarifying change. – Clarifies that HMOs are taxed at the rate of 1.9%. This section becomes effective January 1, 2007.
58	Clarifying change. – Provides that for prepayments of cable services, the first billing period is considered to start on or after February 1, 2006.
59	Clarifying change. – Clarifies the drama portion of the literary purpose for the property tax exemptions. This change was made in order to clarify the tax status of institutions such as the Carolina Theater in Guilford County.
59.1	Technical change. – Corrects incorrect statutory reference. This section becomes effective January 1, 2006.
59.2	Clarifying change. – Clarifies the application of the franchise tax to a corporation who must include in its franchise tax base the assets of a LLC

	that pays a franchise tax as an electric power company. Under previous law, G.S. 105-114 provided that a corporation subject to the general franchise tax was liable for the tax only to the extent that the tax exceeded the amount of tax paid by the corporation under any other section of the Article. This limitation did not apply when the taxes were paid indirectly by the corporation through a LLC whose assets were required to be included in the corporation's franchise tax base. This provision allows those taxes paid by the LLC to be treated in the same manner as taxes paid directly by the corporation. This change was made at the request of Duke Power in order to main the current tax treatment of the company once it has completed a corporate merger and restructuring. This section is effective for taxable years beginning on or after January 1, 2006.
60	Effective date section for this part.

Part III: Aviation Fuel Sales Tax Refund.

61	Interstate Passenger Air Carriers. – Under current law, interstate carriers are allowed a refund of a portion of the sales and use taxes paid by the carrier on fuel, lubricants, repair parts, and accessories purchased in this State. The refund is equal to a proportion of the sales and use taxes paid by the carrier in this State. The proportion is equal to the proportion of the miles traveled by the carrier in this State to the total miles traveled by the carrier. This act allows for an additional refund for interstate passenger air carriers.[79] The act allows for a refund of any amount of sales and use taxes paid by the taxpayer on fuel that exceeds $2.5 million, after taking into consideration the other refund allowed to the interstate passenger air carrier. The refund allowed by this section must be claimed on an annual basis on a form developed by the Secretary of Revenue. The change was made to encourage US Airways to maintain a hub at Charlotte Douglas International Airport. It is unknown if other airlines will benefit from this refund as well. The refund applies to purchases of fuel made on or after January 1, 2005, but before January 1, 2007.
61.1	Motorsports. – This section allows for a refund of sales and use taxes on aviation fuel paid by a motorsports racing team or motorsports sanctioning body. In order to qualify for the refund, the fuel must have been used to travel to or from a motorsports event in this State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State. For the purposes of the refund, a "motorsports event" includes a motorsports race, a motorsports sponsor event, and motorsports testing. The refund allowed by this section must be claimed on an annual basis on a form developed by the Secretary of Revenue. The refund applies to purchases of fuel made on or after January 1, 2005, but before January 1,

[79] An interstate passenger air carrier is defined as "a person whose primary business is scheduled passenger air transportation, as defined in the North American Industry Classification system adopted by the United States Office of Management and Budget, in interstate commerce."

	2007.
62	Effective date section for this part.

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