2008

FINANCE LAW CHANGES

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2008 Finance Law Changes

Deferred Property Tax Programs Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-35	**SB 1876**	**Senator Clodfelter**

AN ACT TO MODIFY THE CIRCUIT BREAKER TAX BENEFIT, TO STANDARDIZE ADMINISTRATION OF ALL DEFERRED PROPERTY TAX PROGRAMS, AND TO CORRECT THE EFFECTIVE DATE OF CHANGES TO THE HOMESTEAD EXCLUSION.

OVERVIEW: This act does the following:

- It modifies the property tax homestead circuit breaker program to ease the administration and implementation of the program.
- It consolidates the administrative provisions of North Carolina's property tax deferral programs into one statute.
- It simplifies the collection remedies for delinquent property taxes.
- It clarifies the property tax homestead income eligibility amount.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2008.

ANALYSIS:

Part I: Circuit Breaker Modifications

In 2007, the General Assembly enacted a new property tax deferral program[1] for North Carolina residents who have owned and occupied property located in the State as a permanent residence for at least five years, who are either 65 years of age or older or totally and permanently disabled, and whose income for the preceding year does not exceed 150% of the income eligibility limit for the property tax homestead exclusion.[2] The homestead circuit breaker program becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009. The amount of property tax an eligible owner may defer under the program varies depending upon the owner's income. An owner whose income is less than the income eligibility limit of the property tax homestead exclusion may defer the portion of taxes imposed on the permanent residence that exceeds four percent (4%) of the owner's income. An owner whose income is 100% to 150% of the income eligibility limit of the

[1] S.L. 2007-497.

[2] For taxable years beginning on or after July 1, 2008, the homestead exclusion income eligibility amount is $25,000. This amount is indexed annually. The amount for 2009 is $25,600.

property tax homestead exclusion may defer the portion of taxes imposed on the permanent residence that exceeds five percent (5%) of the owner's income.

The Revenue Laws Study Committee reviewed the homestead circuit breaker program during the interim. It proposed several changes to the program it received from the Department of Revenue, the School of Government, and county tax assessors and collectors. The act does the following:

- It transfers the responsibility for notifying qualifying owners of the cumulative amount of deferred taxes, including interest, from the tax assessor to the tax collector. The tax collector has all the information needed to make this notification, even in counties where the towns located in it have a separate tax collector. Also, the tax collector is able to include this information on the property tax bills.
- It eliminates the delay in using enforced collection remedies[3] for all disqualifying events other than the owner's death. Taxes deferred under the circuit breaker program become payable upon the occurrence of a disqualifying event: death of the owner, transfer of the residence by the owner, or cessation of use of the residence as a permanent residence by the owner other than a qualifying temporary absence.[4] Upon the occurrence of a disqualifying event, the amount of taxes for the year with no circuit breaker benefit plus those taxes deferred for the preceding three fiscal years, together with interest, become due. Under prior law, a tax collector could not enforce the collection of these taxes until nine months after the disqualifying event. This delay was unique among North Carolina's property tax deferral programs. The act eliminates the delay in using the enforced collection remedies for all disqualifying events other than the owner's death, where the nine-month delay remains.
- It converts the application process from a one-time application to an annual application. The application process for the property tax homestead circuit breaker was modeled after the homestead exclusion, which requires a single application. However, while eligibility for both programs is contingent on a taxpayer's income, the actual benefit received under the circuit breaker program is a function of different variables: the property value for the exclusion versus the taxpayer's income for the circuit breaker. Since the amount of the circuit breaker tax benefit is a function of the taxpayer's income, an annual reporting of income is necessary for the county to prepare the tax bill.
- It creates an exception to the tax secrecy provisions to allow agents of a county to disclose on a property tax receipt the amount of property taxes due and the amount of property taxes deferred under the homestead circuit breaker. Since the amount of taxes that can be deferred under the circuit breaker program is a function of income, and since counties make property tax records public, a person could use the amount of deferred taxes to calculate a qualifying owner's income. For this reason, the counties requested an exception to general rule that it cannot publish information about a taxpayer's income.

[3] An enforced collection remedy is one or more of the collection remedies provided in G.S. 105-266 through 105-375 for delinquent property taxes. The remedies include attachment and garnishment and foreclosure.

[4] An exception to this rule exists, allowing deferral to continue if the residence is transferred to a spouse or qualifying co-owner and that individual qualifies for deferral and elects to continue deferral.

- It synchronizes the income eligibility limit for the 4% benefit under the homestead circuit breaker with the income eligibility limit for the homestead exclusion. Under prior law, there was a one-penny discrepancy between these income limits.

Part II: Deferral Program Modifications

North Carolina has six property tax deferral programs: (i) historic district property held as future site of historic structures[5] (ii) the circuit breaker tax deferral program[6] (iii) nonprofit property held as future site of low- or moderate-income housing[7] (iv) present-use value (PUV) property[8] (v) working waterfront property[9] and (vi) historic property.[10] The act creates a set of uniform provisions, applicable to all six programs. The provisions, several of which existed under prior law but were scattered among various statutes, are now collected in G.S. 105-277.1D and are as follows:

- Deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event. This results in no change from prior law for any of the deferral programs.
- Interest accrues as of the date the taxes would have originally become due without the deferral program. This results in no change from prior law for any of the deferral programs.
- The tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program. This results in no change from prior law for any of the deferral programs.
- Liens resulting from deferred taxes are extinguished when the taxes are paid. This results in no change from prior law for any of the deferral programs.
- If part of a property on which taxes are deferred loses eligibility, the assessor determines the amount of deferred taxes that apply to that part and that amount is due and payable. Under prior law, the PUV, working waterfront property and historic property programs permitted partial loss of eligibility; the other programs[11] were an all-or-nothing system. The act permits partial loss of eligibility in all programs.
- All or part of taxes deferred may be paid at any time without affecting deferral eligibility, and partial payments are applied first to accrued interest, not the principal. The Department's construction of prior law was that a taxpayer could not make a partial payment of taxes deferred from previous years without withdrawing the property from the deferral program. This effectively forced a taxpayer to choose between paying down any accrued deferred taxes on eligible property and keeping the property in the deferral program. The act eliminates this disincentive and permits payment against accrued taxes and interest.

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[5] G.S. 105-275(29a).
[6] G.S. 105-277.1B.
[7] G.S. 105-278.6(e).
[8] G.S. 105.277.4(c).
[9] G.S. 105-277.14.
[10] G.S. 105-278(b).
[11] Future historic site, future low- or moderate-income housing site, and the circuit breaker programs.

The act also consolidates the statutory provisions relevant to when and against whom a taxing unit may utilize enforced collection remedies. An enforced collection remedy is one or more of the collection remedies provided in G.S. 105-266 through 105-375 for delinquent property taxes. The remedies include attachment and garnishment and foreclosure. The act provides two sets of rules. The first set of rules provides that collection remedies may be enforced as of the date of delinquency. The date of delinquency is determined as follows:

- For normal taxes, the date of delinquency is the date the tax begins to accrue interest. Under G.S. 105-360, that date is January 6th.
- For deferred taxes other than the circuit breaker where the disqualifying event is the death of the owner, the date of delinquency is the date a disqualifying event occurs.
- For deferred taxes under the circuit breaker where the disqualifying event is the death of the owner, the date of delinquency is the first day of the ninth month following the date of death.

The second set of rules provides against whom enforced collection remedies may be used:

- For delinquent taxes on real property, the taxing unit may proceed against the owner of record as of the date of delinquency and any subsequent owner.
- For delinquent taxes on personal property, the taxing unit may proceed against the owner of record as of January 1 of the calendar year in which the fiscal year of taxation begins.
- For delinquent taxes on registered motor vehicles, the taxing unit may proceed against the owner of record as of the date on which a new registration is applied for or on which the current vehicle registration is renewed.

Part III: Technical Change

Last year, the General Assembly enacted legislation increasing the income eligibility limit for the property tax homestead exclusion from $20,500 to $25,000.[12] The increase was supposed to take effect for taxable years beginning on July 1, 2008. A drafting error provided a different result. This act corrects the error to accomplish the intent of the original act.

Modify Appropriations Act of 2007.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-107	**HB 2436**	**Rep. Michaux, Adams, Alexander, Crawford**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL APPROPRIATIONS ACT OF 2007.

[12] Prior to S.L. 2007-497, the income eligibility amount was statutorily set at $18,000. The statutory amount is indexed annually. In 2007, the indexed income eligibility amount was $20,500. S.L. 2007-497 changed the statutory amount from $18,000 to $25,000.

OVERVIEW, FISCAL IMPACT, AND EFFECTIVE DATES: *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

Section	*Description & Effective Dates*	*Fiscal Impact*
Part I: Special Indebtedness		
27.8	*Special Indebtedness Projects* – ***Authorizes the issuance of $709,034,944 of special indebtedness to finance various capital projects over the next four fiscal years. Of this amount, no more than $345,866,944 may be issued in fiscal year 2008-2009.***	***General fund debt service for this section and Section 27.9 is $17,500,000 for fiscal year 2008-2009.***
27.9	*Two-Thirds Bonds Act of 2008* – ***Authorizes the issuance of $107,000,000 of general obligation bonds for the Green Square Project.***	***General fund debt service for this section and Section 27.8 is $17,500,000 for fiscal year 2008-2009.***
Part II: Individual & Corporate Income Tax Changes		
28.1	*IRC Update* – ***Updates the reference to the Internal Revenue Code to May 1, 2008, but decouples from the 50% bonus depreciation provision under the Economic Stimulus Act of 2008. This section is effective for taxable years beginning on or after January 1, 2008.***	***The impact on General Fund revenues is as follows:*** ***FY 2008-09: No impact*** ***FY 2009-10: Loss of $1.2 million*** ***FY 2010-11: Loss of $0.8 million*** ***FY 2011-12: Gain of $4.3 million*** ***FY 2012-13: Gain of $4.0 million***
28.7	*Close Franchise Tax Loopholes* – ***Provides that limited liability companies that elect to be taxed as S corporations are subject to the franchise tax in the same manner as other S corporations and that captive REITS are subject to the franchise tax in the same manner as a corporation. This section of the act becomes effective for taxable years beginning on or after January 1, 2009.***	***Minimal impact.***

Section	Description & Effective Dates	Fiscal Impact
28.8	*Publicly Traded Partnerships* – ***Requires a publicly traded partnership (PTP) that qualifies as a PTP under section 7704(c) of the Internal Revenue Code to file an informational return with the Secretary of Revenue that lists the partners who received more than $500 of income from the partnership during the taxable year. This section becomes effective for taxable years beginning on or after January 1, 2008.***	***Minimal impact.***
28.9	*Increase Earned Income Tax Credit to Five Percent* – ***Increases the State's refundable earned income tax credit from 3.5% to 5%, effective for taxable years beginning on or after January 1, 2009.***	***Reduces General Fund revenues by $20.9 million beginning in fiscal year 2009-2010.***
28.25	*Expand Renewable Energy Tax Credit* – ***Allows an income tax credit for donating funds to a unit of State or local government for the purpose of enabling that unit to acquire renewable energy property. This section is effective for taxable years beginning on or after January 1, 2008.***	***Reduces General Fund revenues by $100,000 annually.***
28.27	*Tax Deduction for the Sale of a Manufactured Home Community to Manufactured Homeowners* – ***Creates an income tax deduction equal to the taxable gain reported by a taxpayer from the qualified sale of a manufactured home community. This section is effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2015.***	***Reduces General Fund revenues by approximately $100,000 annually.***
Part III: Sales Tax Changes		

Section	Description & Effective Dates	Fiscal Impact
28.6	Exempt Disaster Assistance Debit Sales – Exempts from sales tax tangible personal property purchased with a client assistance debit card issued for disaster assistance relief by a State agency or a federal agency or instrumentality. This section became effective August 1, 2008, and applies to purchases made on or after that date.	Reduces General Fund revenue by approximately $500,000 annually.
28.12	Sales Tax Holiday for Certain Energy Star Rated Appliances – Creates a sales tax holiday for energy efficient products for the first weekend of November. The holiday applies to the following Energy Star products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps and geothermal heat pumps, ceiling fans, dehumidifiers, and programmable thermostats. This section became effective July 16, 2008.	Reduces General Fund revenue by $1.4 million annually.
28.19	State Sales Tax Exemption for Baked Goods Sold by Artisan Bakeries – Exempts bakery items sold by an artisan bakery from State sales tax, effective January 1, 2009.	Reduces General Fund revenues by $1.6 million for fiscal year 2008-2009 and by approximately $3.5 million for each year thereafter.
28.20	Prohibit Tax on Interior Design Services – Exempts from sales tax interior design services provided in conjunction with the sale of tangible personal property. This section became effective August 1, 2008.	Reduces General Fund revenues by $100,000 annually.
28.21	1%, $80 Cap on Excise Tax on Machinery Refurbishers – Applies a 1% privilege tax, with an $80 cap, in lieu of sales tax on equipment purchased by an industrial machinery refurbishing company that is used in repairing or refurbishing tangible personal property. This section became effective July 1, 2008, and applies to purchases made on or after that date.	Reduces General Fund revenues by $300,000 for fiscal year 2008-2009 and by $500,000 annually each year thereafter.

Section	Description & Effective Dates	Fiscal Impact
28.22	*Clarify 501(c)(3) Sales Tax Refund* – ***Provides a definitive category of the type of nonprofit entity entitled to a semiannual sales and use tax refund. This section became effective July 1, 2008, and applies to purchases made on or after that date***	***Minimal fiscal impact.***
Part IV: Economic Incentives		
28.2	*Extend Credit for Research & Development* – ***Extends from 2009 to 2014 the sunset on the income tax credit for qualified North Carolina research expenses or North Carolina University research expenses.***	***Reduces General Fund revenues as follows:*** ***FY 2008-09: $1.0 million*** ***FY 2009-10: $2.1 million*** ***FY 2010-11: $2.3 million*** ***FY 2011-12: $2.5 million*** ***FY 2012-13: $2.6 million***
28.3	*Extend Low-Income Housing Credit* – ***Extends from 2010 to 2015 the sunset on the income tax credit that may be allocated to developers of low-income housing projects by the North Carolina Housing Finance Agency.***	***Reduces General Fund revenues as follows:*** ***FY 2008-09: -0-*** ***FY 2009-10: -0-*** ***FY 2010-11: -0-*** ***FY 2011-12: $22.1 million*** ***FY 2012-13: $45.2 million***
28.4	*Extend Mill Rehabilitation Credit* – ***Extends the sunset for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011. Under prior law, the credit expired for qualified rehabilitation expenses occurring on or after that date.***	***Reduces General Fund revenues as follows:*** ***FY 2008-09: -0-*** ***FY 2009-10: -0-*** ***FY 2010-11: $1.5 million*** ***FY 2011-12: $3.4 million*** ***FY 2012-13: $4.2 million***
28.5	*Extend Sunset for State Ports Tax Credit* – ***Extends from 2009 to 2014 the sunset on the income tax credit allowed to a taxpayer who loads or unloads cargo at either of the State-owned port terminals.***	***Reduces General Fund revenues as follows:*** ***FY 2008-09: $1.0 million*** ***FY 2009-10: $2.0 million*** ***FY 2010-11: $2.0 million*** ***FY 2011-12: $2.0 million***
28.10	*Extend Sunset for Small Business Employee Health Benefits* – ***Extends from 2009 to 2010 the sunset on the tax credit available to small businesses that provide health benefits to all of their full-time employees.***	***Reduces General Fund revenues as follows:*** ***FY 2008-09: $8.5 million*** ***FY 2009-10: $17.7 million*** ***FY 2010-11: $10.1 million***

Section	Description & Effective Dates	Fiscal Impact
28.23	Extend Aviation Fuel Refunds ***– Extends from January 1, 2009, to January 1, 2011, the sunset on the following two sales tax refund provisions:*** • ***Aviation fuel used by an interstate passenger air carrier.*** • ***Aviation fuel used by a motorsports racing team to travel to or from a motorsports.***	***Reduces General Fund revenues as follows:*** ***FY 2009-10: $1.6 million*** ***FY 2010-11: $3.2 million*** ***FY 2011-12: $1.6 million***
28.24	Expand Film Industry Credit ***– Extends from 2009 to 2014 the sunset on the 15% tax credit available for productions over $250,000. The provision also expands the definition of qualifying expenses. This section is effective for taxable years beginning on or after January 1, 2008.***	***Reduces General Fund revenues as follows:*** ***FY 2008-09: $0.1 million*** ***FY 2009-10: $8.5 million*** ***FY 2010-11: $26.7 million*** ***FY 2011-12: $27.5 million*** ***FY 2012-13: $28.4 million***
28.26	Increase Qualified Business Venture Tax Credit Cap ***– Increases from $7 to $7.5 million the total amount of all qualified business investments credits that may be taken each year. This section is effective for investments made on or after January 1, 2008.***	***Reduces General Fund revenues as follows:*** ***FY 2009-10: $0.5 million*** ***FY 2010-11: $0.5 million*** ***FY 2011-12: $0.5 million*** ***FY2012-13: $0.5 million***
Part V: Estate & Gift Tax Changes		
28.17	Modify Estate Tax Law – ***Modifies the estate tax law to remove property from the estate tax base that the State cannot tax. This section became effective July 16, 2008, applies retroactively to the estates of decedents for which the statute of limitations for claiming a refund had not expired as of December 28, 2007.***	***Reduces General Fund revenues by $2 million in fiscal year 2008-2009; reduces revenues by approximately $500,000 annually thereafter.***
28.18	Repeal Gift Tax Law ***– Repeals the gift tax, effective January 1, 2009, and applicable to gifts made on or after that date.***	***Reduces General Fund revenues by $17.5 million for fiscal year 2009-2010.***
Part VI: Property Tax Changes		

Section	Description & Effective Dates	Fiscal Impact
28.9	*Provide a Property Tax Exclusion for Honorably Discharged Disabled Veterans and Their Surviving Spouses* – ***Establishes a property tax homestead exemption for disabled veterans equal to the first $45,000 of the property's appraised value, effective for property tax years beginning on or after July 1, 2009.***	***No impact on State General Fund revenues. Reduces local government revenues by approximately $4.3 million.***
Part VII: Administrative Changes		
28.16	*Small Business Protection Act* – ***Requires the Department to reduce an assessment for sales and use taxes imposed on a small retailer if certain circumstances exist and to document advice given to taxpayers in certain situations. The majority of this section became effective when the Governor signed the act into law on July 16, 2008. The requirement that the Department document advice given to taxpayers related to sales tax application becomes effective January 1, 2009. The requirement that the Department document advice related to whether a taxpayer must register as a retailer or wholesale merchant under Article 5 of Chapter 105 becomes effective July 1, 2009.***	***Reduces General Fund revenues by $2.2 million for fiscal year 2009-2010 and by $500,000 annually thereafter.***
28.28	*Procedure for Tax Class Actions* – ***Establishes a procedure for initiating or joining a tax class action in which a taxpayer is seeking the refund of a tax paid under an alleged unconstitutional statute. This section is effective October 1, 2008, and applies to actions filed on or after that date.***	***Indeterminable.***

ANALYSIS:

Part I: State Indebtedness

Special Indebtedness. – Section 27.8 authorizes the issuance of $709,034,944 of special indebtedness to finance a variety of State capital projects over the next four fiscal years. Of this amount, only $345,866,944 may be issued or incurred during fiscal year 2008-2009. This

amount of indebtedness is within the recommended guidelines of the NC Debt Affordability Advisory Committee.[13] The NC Debt Affordability General Fund Model Guidelines recommends that General Fund debt service should be targeted at no more than 4% of General Fund revenues and should not exceed 4.75% of General Fund revenues. Based on projected General Fund revenues, the model calculates that the State could annually authorize $479,700,000 of new tax-supported debt over the next five years and remain within its targeted ratio. This section became effective when the Governor signed the act into law on July 16, 2008.

Special indebtedness[14] is non-voted debt that is typically secured only by an interest in the State property being acquired or improved. The term 'special indebtedness' covers both financing contract indebtedness and limited obligation bond indebtedness. Financing contract indebtedness may take the form of a lease purchase, an installment purchase, or a certificate of participation.[15] The form of debt anticipated for these issuances is limited obligation bonds. Since 2000, the State has relied exclusively on the authorization of special indebtedness to finance capital projects.

The capital projects financed in this section through special indebtedness include the following:

- Facilities for the University of North Carolina.
- Additions to several correctional institutions.
- The purchase of State judicial facilities located at 901 Corporate Drive in Raleigh.
- The acquisition of State park lands and conservation areas for the Land for Tomorrow initiative.
- Various other State capital projects, such as the completion of an oyster hatchery, improvements at the State ports in Morehead City and Wilmington, expansion and renovation to the polar bear exhibit at the N.C. Zoo, and construction of a Southeastern North Carolina Agriculture Center Pavilion.

Two-Thirds Bonds Act of 2008. – Section 27.9 authorizes the issuance of $107,000,000 of non-voted general obligation bond indebtedness to finance the Green Square Project. This section became effective when the Governor signed the act into law on July 16, 2008.

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[13] The 2008 Debt Affordability Study may be accessed at www.nctreasurer.com.

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

[15] Certificate of participation indebtedness involves a plan of finance in which a special corporation obtains funds to pay the cost of a capital facility to be financed through the delivery by the special corporation of certificates of participation. Limited obligation bond indebtedness does not require the presence of a special corporation.

General obligation bond indebtedness is secured by the faith and credit and taxing power of the State. As a general rule, general obligation bond indebtedness must be approved by the voters. However, under Article V, Sec. 3(a)(f) of the North Carolina Constitution, the State may issue non-voted general obligation bonds in an amount not to exceed 2/3 of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. Based upon this formula, the State could have issued up to $125,000,000 of non-voted general obligation bonds for fiscal year 2008-2009.

The Green Square Project consists of an office building for the Department of Environment and Natural Resources, the construction of a Nature Research Center for the NC Museum of Natural Science, and an underground parking deck with 426 spaces. The project also consists of another parking deck, authorized in S.L. 2006-231, which will house up to 900 spaces. The total cost of the project, excluding the parking deck authorized in 2006, is $150,000,000. The General Assembly appropriated $25,000,000 for the project last year. Parking receipts will service the debt for parking construction and the Friends of the Museum of Natural Science have committed $27,500,000 towards the cost of the Nature Research Center and $15,500,000 towards the cost of the exhibits.

Part II: Individual and Corporate Income Tax Changes

IRC Update. – Section 28.1 updates from January 1, 2007, to May 1, 2008, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. However, this section also requires an 85% addback of the bonus depreciation allowed under the Economic Stimulus Act of 2008 in order to achieve revenue neutrality for fiscal year 2008-2009. The Revenue Laws Study Committee recommended this provision, and the Governor included it in his revenue recommendations. This section is effective for taxable years beginning on or after January 1, 2008.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[16] The General Assembly determines each year whether to update this reference.[17] Updating the 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. Changing the reference date to May 1, 2008, incorporates, with the one major exception mentioned above, the changes made by the following acts: the Economic Stimulus Act of 2008, the Mortgage Forgiveness Debt Relief Act of 2007, and the Small Business and Work Opportunity Tax Act of 2007.[18]

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[16] 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.

[17] 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."

[18] A more detailed summary of recent amendments to the Code is available upon request.

Enacted on February 13, 2008, the Economic Stimulus Act of 2008[19] (ESA) was a $152 billion package designed to stimulate the economy through rebates for individual taxpayers and incentives for businesses.[20] Those incentives are the 50% bonus depreciation provision for qualifying property placed in service in 2008, the increased limits for section 179 expensing of qualified property in 2008, and increased depreciation limits for 'luxury' autos predominantly used for business. North Carolina is not conforming to the bonus depreciation provision but does conform to the other business incentives.

- **50% Bonus Depreciation Provision**.[21] Under this section, North Carolina decouples from the federal accelerated depreciation schedule allowed under the ESA. Over the life of an asset placed in service during 2008, taxpayers will be able to deduct the same amount of the asset's basis under both federal and State law; it is just that the timing of the deduction will differ. To accomplish this decoupling, the section does two things:
  - It requires a taxpayer to add back to federal taxable income 85% of the accelerated depreciation amount[22] in the year the accelerated depreciation is claimed for federal purposes.[23]
  - In tax years beginning on or after January 1, 2009, it allows a taxpayer to deduct from federal taxable income the total amount of the add-back required for either the 2007 or 2008 tax year, divided into five equal installments.

  This means that for State tax purposes, a taxpayer may deduct a greater depreciation amount in the outlying tax years, which will be the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back. The purpose of this recovery provision is to enable the taxpayer to have the same basis in assets for federal and State purposes. Without this deduction provision, a taxpayer would have a different basis in the depreciable asset for State and federal purposes and would have to keep separate books and records for State and federal purposes until the disposal of the asset. In effect, the add-back and subsequent deduction will affect the timing of the impact of bonus depreciation on the State but it will not increase or decrease the total amount of revenue the State receives over the affected years.

  Under the ESA, a taxpayer is entitled to depreciate in the first year 50% of the adjusted basis of certain qualified property placed in service during the 2008 calendar year.[24] To claim bonus depreciation, the property must be one of the following types:

[19] P.L. 110-185.

[20] The rebates, which are technically "advance credit payments," do not impact State revenues and are not discussed in this analysis.

[21] Bonus depreciation allows a business to claim more of a deduction up front and spread the remainder out over the normal depreciation schedule. However, over the life of the asset the taxpayer still receives the same benefit. Congress has authorized bonus depreciation several times to encourage business investment, specifically after September 11, 2001. The Jobs Creation and Worker Assistance Act of 2002 provided a 30% bonus depreciation allowance. The Jobs and Growth Tax Relief Reconciliation Act of 2003 extended the sunset and increased the amount to 50%.

[22] The accelerated depreciation amount for property placed in service in 2008 is 50%.

[23] The add-back means that for State tax purposes, a taxpayer deducts less in that tax year than the taxpayer would have deducted if the State conformed to the accelerated depreciation provision.

- Eligible for the modified accelerated cost recovery system (MACRS) with a depreciation of 20 years or less.
- Water utility property
- Off-the-shelf computer software
- Qualified leasehold property.

Generally speaking, bonus depreciation is available for every item of tangible personal property, except inventory, property used outside the U.S., and property depreciated under the alternative depreciation system. Other than computer software, it is not available for intangibles. Bonus depreciation is not allowed if property is sold in the same year that it is placed in service.

- **Increased Section 179 Expensing Limits. –** This section conforms to the increased expensing limits authorized under the ESA. In general, a qualifying taxpayer may elect to treat the cost of certain property as an expense and deduct it in the year the property is placed in service instead of depreciating it over several years. This property is frequently referred to as section 179 property, after the relevant section in the Code. To be eligible, the property must be tangible personal property that is actively used in the taxpayer's business for which a depreciation deduction would be allowed. The property must be used more than 50% for business and must be newly purchased property. Generally, taxpayers take the expensing deduction first and claim section 168(k) depreciation on any remaining basis.

  Prior to the ESA, the deduction was limited to $128,000 of the cost of the property with a phase-out at $510,000 for 2008. The new law temporarily doubles the limitation to $250,000.[25] The threshold for reducing the deduction is also increased to $800,000 with a complete phase-out once qualifying purchases exceed $1.05 million. These limitations apply only to property purchased and placed in service in tax years beginning in 2008. The limitations will return to the lower levels for tax years beginning in 2009.

- **Increased Depreciation Limits for 'Luxury' Autos.** – This section conforms to the increased the depreciation limits on luxury vehicles under the ESA.[26] A luxury vehicle is one that costs more than the 'luxury auto price floor', which is adjusted annually for inflation along with the depreciation limits. The first-year limit on depreciation for passenger vehicles placed in service in 2008 is projected to be $2,960 for automobiles and $3,160 for vans and trucks. The new law raises the cap by $8,000 for a maximum first-year depreciation of $10,960 for autos and $11,160 for vans and trucks.

Close Franchise Tax Loopholes. – Section 28.7 changes the franchise tax laws as follows to conform with changes the General Assembly made in 2006 and 2007 to the corporate income tax laws:

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[24] The placed-in-service date is extended one year, through December 31, 2009, for property with a recovery period of 10 years or longer, for transportation property, and for certain aircraft.

[25] The new law does not alter the section 179 limitation imposed on sport utility vehicles, which have an expense limit of $25,000.

[26] These limits were increased when bonus depreciation was previously available.

- It provides that limited liability companies (LLCs) that elect to be taxed as S corporations for income tax purposes are subject to the franchise tax in the same manner as other S corporations
- It provides that captive real estate investment trusts (REITs) are subject to the franchise tax since they are treated as corporations for income tax purposes.

The Revenue Laws Study Committee recommended these changes, upon the suggestion of the Department of Revenue.[27] This section is effective for taxable years beginning on or after January 1, 2009.

Prior to 2006, a LLC did not pay franchise tax. In 2006, the General Assembly amended the definition of 'corporation', as it applies to the franchise tax statutes, to include a LLC that elects to be taxed as a C corporation for federal income tax purposes.[28] The Department of Revenue began to receive questions from S corporations as to whether they could convert to a LLC and elect to be treated as an S corporation for income tax purposes, thereby becoming exempt from franchise tax.[29] To curb this potential franchise tax loophole, this section makes a similar change to the one enacted in 2006; it provides that a LLC that elects to be treated as a corporation for income tax purposes, either a C corporation or a S corporation, is also considered a corporation for franchise tax purposes.

In 2007, the General Assembly limited a corporation's ability to use captive REITs to avoid State taxes by disallowing the dividend paid deduction when a REIT is a captive REIT.[30] The effect of this change is that a captive REIT is treated as a regular corporation for income tax purposes. This section provides that a captive REIT will also be treated as a regular corporation for franchise tax purposes. Under the current franchise tax law, a REIT may, in determining its value for franchise tax purposes, deduct the aggregate market value of its investments in the stocks, bonds, debentures, or other securities or evidences of debt of other corporations, partnerships, individuals, municipalities, governmental agencies or governments. This section changes the statute to provide that this deduction may only be used by a REIT that is not a captive REIT. A REIT is an organization that uses the pooled capital of many investors to purchase and manage real estate. A captive REIT is one that is owned or controlled by a single entity.

Publicly Traded Partnerships. – A partnership doing business in this State must file an information return with the Department of Revenue that gives the name and address of each person who would be entitled to share in the partnership's net income, if distributable, and the amount each person's distributive share would be. A partnership that files a report must also furnish to each partner the information needed by that partner to file a North Carolina income tax return. For nonresident members of a partnership, the partnership must pay income tax for that partner based on the partner's distributive share.

Section 28.8 changes the reporting and payment requirements that apply to a publicly traded partnership (PTP) that is described in section 7704(c) of the Internal Revenue Code. It requires a qualifying PTP to report annually to the Department the partners in the PTP who received more than $500 of income rather than report the income received by every partner.

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[27] HB 2508 and SB 1755.
[28] S.L. 2006-66, Section 24A.2.
[29] In 2005, S corporations paid more than $50 million in franchise tax.
[30] S.L. 2007-323, Section 31.18.

It also exempts qualifying PTPs from the requirement to pay tax on the partnership income received by a nonresident. The Revenue Laws Study Committee recommended this tax law change.[31] In making this recommendation, the Committee sought to strike a balance between the costs and burden of compliance with the reporting requirements for both the PTPs and the Department and the benefits gained by compliance. This section is effective for taxable years beginning on or after January 1, 2008.

A PTP is a limited partnership the interests in which are traded on stock exchanges such as the New York, American, and NASDAQ exchanges. Unlike a traditional partnership, a PTP has tens of thousands, and sometimes hundreds of thousands, of unitholders. A PTP's unitholders can change daily in trades on public exchanges. A PTP determines who its unitholders are once a year so the PTP can send K-1s to the unitholders.

PTPs initially came into existence during the 1980s as a means for companies to raise large amounts of capital needed to build or buy capital-intensive assets, like pipelines. When initially created, PTPs were taxed as partnerships. Congress began reviewing the PTP structure and its use in 1986. Congress determined that the structure was needed for certain types of entities in energy related businesses and it enacted legislation allowing PTPs described in section 7704(c) of the Code to continue to be treated like a partnership for income tax purposes. All other types of PTPs are taxed as a corporation. A PTP described in section 7704(c) of the Code is one that generates 90% of its income from qualified sources. Qualified sources include real estate activities, mineral or natural resources activities like exploration, production, mining, refining, marketing, and transportation of oil, gas, minerals, geothermal energy, and timber. There are approximately 90 PTPs in the country that meet the description in section 7704(c) of the Code, and 10 of these PTPS are located in North Carolina.

The Multi-State Tax Commission (MTC) adopted a model statute in December 2003 that exempts PTPs described in section 7704(c) of the Code from paying tax on partnership income received by a nonresident member so long as the PTP agrees to file an annual information return reporting the name, address, and taxpayer identification number of each unitholder with an income in the state in excess of $500. This section adopts the substance of the MTC model statute. Twenty-six states have excluded PTPs from tax payment requirements for nonresident partners through either specific legislation or administrative action. Eight states exempt PTPs from reporting distributions to its partners except for distributions of income that exceed $1,000 during the taxable year.

Increase Earned Income Tax Credit to Five Percent. – Section 28.9 increases the amount of the State's refundable earned income tax credit from 3.5% of an individual's federal earned income tax credit amount to 5%, effective for taxable years beginning on or after January 1, 2009.[32] The General Assembly enacted a refundable State earned income tax credit in 2007, effective for taxable years beginning on or after January 1, 2008.

The Internal Revenue Code provides an earned income tax credit for individuals who work and whose adjusted gross income does not exceed a specified amount. The credit is intended to offset some of the increases in living expenses and social security taxes and provide an incentive for low-income families to work instead of collect welfare. The amount of the

[31] HB 2508 and SB 1755.
[32] HB 2642.

credit may exceed the amount of tax owed by the taxpayer. If the credit allowed exceeds the amount of tax imposed, the excess is refundable to the taxpayer.

The amount of the federal credit varies depending upon whether the taxpayer has children and the amount of earned income the taxpayer has. The credit is phased out as the taxpayer's earned income rises. The earned income amounts and the credit amounts are indexed annually to inflation.

Tax Deduction for the Sale of a Manufactured Home Community to Manufactured Homeowners.[33] – Section 28.27 allows a taxpayer to deduct from federal taxable income the taxable gain from a qualified sale of a manufactured home community. A 'qualified sale' is a sale of land comprising a manufactured home community that is transferred in a single purchase to a group composed of a majority of the manufactured home community leaseholders, or to a nonprofit organization representing such a group. To qualify for this deduction, the taxpayer must give notice of the sale to the North Carolina Housing Finance Agency.[34] The deduction becomes effective for taxable years beginning on or after January 1, 2008, and expires for taxable years beginning on or after January 1, 2015.

Part III: Sales Tax Changes

Exempt Disaster Assistance Debit Sales. – Section 28.6 exempts from sales tax tangible personal property purchased with a client assistance debit card issued for disaster assistance relief by a State agency or a federal agency or instrumentality. The American Red Cross (ARC) is an instrumentality of a federal agency. Another example of a federal agency or instrumentality that may utilize this exemption would be the Federal Emergency Management Agency (FEMA). This section became effective August 1, 2008, and applies to purchases made on or after that date.

A state may not impose its sales tax on purchases made by the federal government or an instrumentality of the federal government. G.S. 105-164.13(17) specifically exempts from North Carolina sales tax 'sales which a state would be without power to tax under the limitations of the Constitution or laws of the United States or under the Constitution of this State.' Sales made pursuant to a disbursing order issued by a federal governmental agency or instrumentality is considered a sale to the government that is exempt from taxation. However, for purposes of the sales tax exemption, there is a significant difference between a debit card and a disbursing order: the purchaser, for purposes of the sales tax exemption, is the disaster victim when a debit card is used and it is the disbursing entity when the disbursing order is used. This section extends the same sales tax treatment that exists for purchases made through a disbursing order issued by a federal agency or instrumentality to purchases made with a client assistance debit card issued by it. This section became effective August 1, 2008, and applies to purchases made on or after that date.

The Revenue Laws Study Committee recommended this tax law change after representatives of the ARC brought the issue to the Committee's attention.[35] Over the last few years, the ARC has begun giving disaster victims debit cards to purchase tangible personal property. The ARC began using debit cards because it believes they are more efficient, effective, and

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[33] The House Finance Committee originally considered the tax deduction in House Bill 1700.

[34] G.S. 42-14.3 requires an owner of a manufactured home community to notify the owners of the homes in the community of intent to convert the property to another use.

[35] SB 1703 and HB 2336.

less bureaucratic for the victim and less administrative effort and expense for the organization. The ARC client assistance card clearly identifies itself as one issued by the ARC. The ARC has the ability to see from its reports of the card's use the amount purchased and the store from which the goods were purchased. Unlike the old disbursing order system, the ARC does not have a cash register receipt describing the specific items purchased. The client assistance card authorization form is a contract between the ARC and the disaster victim. The contract stipulates the types of items the card may be used to purchase. In the event of inappropriate purchases, the card can be suspended.

Sales Tax Holiday for Certain Energy Star-Rated Appliances. – Section 28.12 creates a State and local sales and use tax exemption, applicable during the first weekend in November,[36] for the following Energy Star-rated products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps and geothermal heat pumps, ceiling fans, dehumidifiers, and programmable thermostats.[37] An Energy Star-rated product is one that meets the energy efficient guidelines set by the United States Environmental Protection Agency (EPA) and the United States Department of Energy and is authorized to carry the Energy Star label. The exemption does not apply to the sale of a product for use in a trade or business or to the rental of a product. This section became effective when the Governor signed the act into law on July 16, 2008.

The EPA introduced Energy Star in 1992 as a voluntary labeling program designed to identify and promote energy-efficient products to reduce greenhouse gas emissions. Energy Star-labeled products deliver the same or better performance as comparable models while using less energy and saving money. The program delivers the technical information and tools that aid in choosing energy-efficient solutions and best management practices. In 1996, EPA began including major appliances, office equipment, lighting, home electronics, and more in its Energy Star program. In 2007, Energy Star products delivered energy and cost savings of about $16 billion, and, over the past decade, the program has encouraged such technological innovations as efficient fluorescent lighting, power management systems for office equipment, and low standby energy use.

North Carolina participates in the Streamlined Sales and Use Tax Agreement. Under that Agreement, a state may not have a sales tax holiday unless the items to be exempted during the holiday are specifically defined in the Agreement's provisions concerning sales tax holidays. Until recently, the Agreement did not have a definition in its provisions governing sales tax holidays for energy efficient products; therefore, North Carolina could not institute a sales tax holiday for these products and remain compliant with the Agreement. As of April 2, 2008, the necessary definitions have been added to the Agreement, thus permitting the establishment of a sales tax holiday for energy efficient products. North Carolina has had a sales tax holiday during the first weekend in August for certain qualifying school supplies and articles of clothing since 2001.[38]

State Sales Tax Exemption for Baked Goods Sold by Artisan Bakeries. – Section 28.19 reduces the sales tax applicable to bakery items sold by artisan bakeries by exempting them from the general State sales tax rate. Effective January 1, 2009, bakery items sold by an artisan bakery

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[36] The holiday period begins 12:01 AM on the first Friday of November and ends 11:59 PM on the following Sunday.
[37] The House first considered the sales tax holiday for energy star products in HB 2605. The Governor included a similar provision in his budget recommendation to the 2008 General Assembly.
[38] G.S. 105-164.13C.

will be taxed at the applicable local sales tax rate, as opposed to the combined general rate applicable to prepared foods. An artisan bakery is one that meets both of the following requirements:

- It derives over 80% of its gross receipts from bakery items.
- Its annual gross receipts, combined with the gross receipts of all related persons, do not exceed $1,800,000.

For several years, North Carolina has grappled with the issue of the taxation of bakery items. The term 'bakery item' is a subset of the defined term 'prepared food'. North Carolina imposes a higher sales tax rate on prepared food than food.[39] The distinction between food and prepared food often becomes complex.[40] The Senate Finance Committee heard testimony from many small bakeries across the State that they received conflicting information about the applicable tax rate they should impose on their bakery items. The conflicting information resulted in many bakeries being assessed additional tax, along with interest and penalties, because they taxed their bakery items at the incorrect, lower rate. The bakeries also argued that the differential tax rates imposed an unfair economic burden on their goods.

North Carolina is one of the 17 member states that have modified their sales and use tax laws to comply with the uniform provisions of the Streamlined Sales and Use Tax Agreement (Agreement). The Agreement is a multistate agreement that seeks to simplify and modernize sales and use tax administration in the member states. The Agreement does not influence whether a state imposes sales and use tax on an item or exempts it from tax. However, if a member state chooses to tax an item or exempt an item, it must adhere to the provisions concerning the definition of an item as defined in the Agreement.

The Agreement, as it existed when North Carolina adopted the uniform definitions for food and prepared food in 2001, did not include a distinction among the types of prepared food. Therefore, the choice before the General Assembly was to either tax all prepared food or exempt all prepared food. The State chose to tax all prepared food.

Later versions of the Agreement included a carve-out for bakery items from the defined term 'prepared food' to address problems some states began encountering in this area. The carve-out provides that bakery items may be taxed differently than other types of prepared food if they are sold without eating utensils provided by the seller. The Agreement defines 'bakery items' as bread, rolls, buns, biscuits, bagels, croissants, pastries, donuts, Danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas.

[39] There is a local sales tax of 2% on food while prepared food is subject to the general State sales tax rate of 4.25% and applicable local rates, which range from 2.5% to 2.75%. Several cities and counties impose a prepared food tax, in addition to the State and local sales tax.

[40] Any food item prepared by a retailer and sold by the retailer to a consumer is a prepared food and is subject to the State and local sales tax rates. A similar product produced by someone else, but sold by the same retailer, is food and is exempt from State sales tax. For example, slaw prepared by Harris Teeter and sold in its deli section is prepared food. Slaw produced by someone else and sold at Harris Teeter is food. Likewise, the same product may be taxed differently depending upon where it is purchased. For example, a donut purchased at the place where it is made is prepared food. The same donut purchased at a grocery store is food.

This section provides that bakery items, as that term is defined in the Agreement, are taxed as food if the item is sold by an artisan bakery.[41] The section does not lower the tax rate on all bakery items.[42] It also does not change the application of the local meals taxes because the act does not change the definition of prepared food. Therefore, in the applicable jurisdictions, the meals tax will continue to apply to all bakery items, regardless of who sells them.

Prohibit Tax on Interior Design Services. – Section 28.20 eliminates the sales and use tax on interior design services provided in conjunction with the sale of tangible personal property. This section became effective August 1, 2008. Charges for interior design or consulting services by an interior designer or decorator are not subject to sales or use tax. However, charges for services made in conjunction with the sale of tangible personal property are subject to sales or use tax because they are considered part of the sales price of the property. The definition of 'sales price' is the total amount or consideration for which tangible personal property is sold, leased, or rented. The consideration may be in the form of cash, credit, property, or services necessary to complete the sale.[43]

Discerning when services constitute part of the sales price of a product is often difficult with respect to transactions in which the product transferred is largely the result of personal services. At the two extremes, there is no great difficulty. When an attorney draws a will, there is no difficulty in concluding that services have been rendered, even though the document the client receives embodying the services constitutes tangible personal property. At the other extreme, when an artist renders a painting, the sale of the painting is a sale of tangible personal property, even though the value of the painting is attributable to the talent of the artist and not the cost of the canvas and paint. The great difficulty lies with transactions in the middle. Determining the proper treatment of services rendered in connection with the sale of a product is among the most frequently litigated issues in the area of sales tax.

The rule a number of states use to help resolve the difficulty of determining when services rendered should constitute part of the sales price of a product is whether the 'true object' of the buyer was to acquire the finished product or the service rendered. If the true object sought by the buyer is to obtain the property produced by the service, then the services are necessary to complete the sale and should be included in the computation of the sales price of the product.

Over the past several months, the Department of Revenue audited some interior designers and decorators and assessed sales tax on services they found necessary to complete the sale of the tangible personal property sold by the designer or decorator. Many of the interior designers and decorators appealed the assessment of the tax and brought the issue to the attention of legislators.[44] This section does not affect the assessments imposed under the prior law.

This section also does not address other transactions in which the tangible personal property transferred is largely the result of personal services. The Department issued a technical

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[41] Under the Agreement, a state may enact an entity-based exemption for a product defined in the Agreement so long as the state defines the product consistent with its definition in the Agreement.
[42] SB 1630 would have reduced the sales tax rate applicable to all bakery items, regardless of who sold them.
[43] G.S. 105-164.3(37).
[44] SB 1657 passed the Senate Finance Committee and became the basis for this section in the budget.

bulletin on May 1, 2008, that provides guidance as to when services and sales are subject to sales or use tax. The bulletin provides the following guidelines:

- Charges for services rendered before the sale of tangible personal property are not subject to sales or use tax. A taxpayer's records must clearly establish that an agreement to sell tangible personal property was made after the completion of interior design services.
- Charges for services unrelated to the sale of tangible personal property are not subject to sales or use tax.
- Charges for services with incidental sales of property are not subject to sales or use tax. An incidental sale is defined as a sale where the charges for the tangible personal property equal 20% or less of the total combined charges for the tangible personal property.

1%, $80 Cap on Excise Tax on Machinery Refurbishers. – Section 28.21 expands Article 5F of Chapter 105 of the General Statutes to provide that the 1% privilege tax, with a cap of $80, applies to an industrial machinery refurbishing company that purchases equipment or an attachment or repair part for equipment used by the company in repairing or refurbishing tangible personal property owned by a third party. Property subject to the excise tax under Article 5F is exempt from sales and use tax. The change from a sales tax to a privilege tax not only means a lower tax rate for the property purchased but also means that retailers are not responsible for collecting and remitting the tax. The change became effective July 1, 2008, and applies to purchases made on or after that date.[45]

The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Sales and Use Tax Agreement that states must simplify their sales tax rates. The 2001 legislation, which became effective January 1, 2006, repealed the 1% sales tax rate, with an $80 cap, imposed on mill machinery purchased by a manufacturing industry or plant and replaced it with a privilege tax having the same rate. The Article has been expanded since its enactment to apply to purchases of fuel and equipment and machinery by a number of different industries, including:

- Fuel, other than electricity or piped natural gas, purchased by a manufacturing industry or plant to operate the industry or plant.
- Certain personal property purchased by a major recycling facility.
- Equipment purchased by a research and development company in the physical, engineering, and life sciences and used by that company in the research and development of tangible personal property.
- Equipment purchased by a software publishing company that is used in the research and development of tangible personal property.
- Equipment purchased by an eligible datacenter.

[45] SB 1745, as passed by the Senate, would have made this provision effective July 1, 2006, and applicable to purchases made on or after that date and to assessments made on or after that date for prior purchases. This bill became the basis for this provision. However, the retroactive effective date was not retained.

The Senate Finance Committee originally considered the issue of whether purchases of machinery and equipment by a machine refurbisher should be treated similarly to mill machinery purchased by a manufacturing industry in Senate Bill 1745.[46] For purposes of the mill machinery provision in Article 5F, a "manufacturing industry or plant" is an entity which manufactures articles for sale or some equivalent commercial purpose. The Department of Revenue held in both private letter rulings and at least two final decisions that a business that refurbishes or refinishes items of tangible personal property owned by a third party performs a service and is not engaged in manufacturing. Consequently, the machinery and equipment used in the refurbishing process was not eligible for the 1% privilege tax rate prior to the passage of this legislation. Instead, the purchases were subject to the combined general rate of sales and use tax.

Clarify 501(c)(3) Sales Tax Refund.[47] – Section 28.22 provides objective criteria to determine whether an organization is a nonprofit charitable institution eligible to receive a semiannual refund of sales and use taxes paid by it on direct purchases of tangible personal property and services used to carry on the work of the nonprofit entity. This section became effective July 1, 2008.

Prior to this change, the Department of Revenue had to determine whether a nonprofit entity requesting a sales and use tax refund qualified as a 'charitable institution'.[48] To make its determination, the Department relied on past determinations and court decisions. Under *Southmister, Inc. v. Justice*, the court defined a charitable organization as one "engaged in the relief or aid to a certain class of persons, a corporate body established for public use, or a private institution created and maintained for the purposes of dispensing some public good or benevolence to those who require it." In May of 2008, the North Carolina Court of Appeals appeared to expand the definition of charitable organization in *The Lynnwood Foundation v. N.C. Department of Revenue* when it affirmed a trial court's ruling that the Department erred in denying a sales and use tax refund to The Lynnwood Foundation. In 2004, the Department determined that the Lynnwood Foundation[49] no longer qualified[50] as a charitable organization for purposes of the sales and use tax refund for the following reasons: it did not engage in relief or aid to a charitable class; it operated for profit; and it did not use the taxed property for a charitable purpose. The Lynnwood Foundation appealed the decision and the trial court granted summary judgment in the Lynnwood Foundation's favor. The trial court found that the preservation of historic sites was a charitable purpose; that the Lynnwood Foundation's overall expenses exceeded its overall income; and that the

[46] Under SB 1743, the change in the law would have become effective July 1, 2006, and applied to purchases made on or after that date and to assessments made on or after that date for prior purchases. The provision enacted in this act did not retain the retroactive effective date.

[47] The Senate Finance Committee originally considered this issue in Senate Bill 2106.

[48] Under prior law, the refund applied to educational institutions, churches, orphanages, and *other charitable or religious institutions* not operated for profit. It continues to apply to nonprofit hospitals and qualified retirement facilities.

[49] The Lynnwood Foundation was incorporated in 1996 as a charitable organization to preserve and restore the Duke Mansion. In 1997 the Department determined that the Lynnwood Foundation was entitled to a refund of a portion of sales and use tax paid.

[50] The Lynnwood Foundation began operating the Duke Mansion as a conference and lodging facility in 1998. The Department reexamined the Lynnwood Foundation's status as a charitable organization within the meaning of the sales and use tax refund statute in 2002.

Lynnwood Foundation only sought a refund for the sales and use taxes it paid on items that it used in carrying out its charitable work.[51]

This section seeks to clarify the prior law, not to expand it. It provides a bright line test for determining whether a nonprofit entity is a charitable one by relying upon section 501(c)(3) of the Internal Revenue Code (Code) and the National Taxonomy of Exempt Entities (NTEE). The NTEE is a classification system categorizing charitable organizations with 501(c)(3) status by organizational mission into 26 subgroups based on Internal Revenue Service (IRS) activity codes. The activity codes provide detail on the operational activities of an organization that has been granted 501(c)(3) status. The IRS assigns an activity code to a charitable organization based on information provided by the organization at the time of application for 501(c)(3) status.

Effective July 1, 2008, a nonprofit entity may receive a sales tax refund if it is exempt from income tax under section 501(c)(3) of the Code but not designated as one of the following organizations under the NTEE:

- Community improvement, capacity building organization.
- Public, society benefit, multipurpose organization.
- Mutual/membership benefits organization.
- Organization whose mission or purpose is unknown.

According to the National Center for Charitable Statistics, as of November 2006 there were 11,901 active North Carolina based organizations with IRS 501(c)(3) status.[52] Of these 11,901 active organizations, 599 are classified within one of the four NTEE classifications excluded from receiving a sales tax refund. It is not known how many of these organizations received a sales tax refund under the prior law. Likewise, an organization that may have been determined by the Department to be ineligible for a sales tax refund in the past may be eligible under the new law. The Fiscal Research Division expects that the number of organizations and quantity of refunds affected by the change will be minimal.

Expand Renewable Energy Tax Credit. – Section 28.25 expands the income tax credit available to a taxpayer who donates funds to a tax-exempt nonprofit organization for the purpose of providing fund for the organization to invest in renewable energy property[53] to include similar donations made to a unit of State or local government. A taxpayer who claims this credit may not also claim the donation as a charitable contribution. This section became effective for taxable years beginning on or after January 1, 2008.

[51] The Foundation paid more than $239,000 in sales and use taxes from July 2004 through December 2005. It sought to recover $14,700. During the same period, the Foundation expended over $2 million towards preserving the property.

[52] An active organization is one that filed a federal 990 Form with the IRS between November 2004 and November 2006.

[53] Renewable energy property includes 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; commercial thermal or electrical generation from renewable energy crops or wood waste materials; hydroelectric generators; solar energy equipment; and wind equipment. Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals.

The amount of the credit is equal to the taxpayer's share of the credit the governmental entity could claim under G.S. 105-129.16A[54] if it was subject to tax. The credit under G.S. 105-129.16A is equal to 35% of the cost of the property placed in service. The taxpayer's share of the credit is equal to the following calculation: (taxpayer's donation / cost of the renewable energy property of governmental entity placed in service that year as a result of the donation) X (the amount of the credit the governmental entity could claim if it were subject to tax). The credit must be taken in the year in which the property is placed in service.[55] The credit may be taken against either the income tax or the franchise tax and it may not exceed 50% of the taxpayer's of the tax against which it is claimed.

A governmental entity must keep a record of all donations it receives for renewable energy property and the amount of the donations used for this purpose. If the entity places renewable energy property in service, it must give each taxpayer who made a donation a statement setting out the amount of the credit the taxpayer qualifies for, a description of the renewable energy property placed in service, the cost of the property, the amount of the credit the entity could claim under G.S. 105-129.16A if it were subject to tax, and the taxpayer's share of the credit allowed. If the donations made for the renewable energy property exceed the cost of the property, the entity must prorate each taxpayer's share of the credit.

Part IV: Economic Incentives

This act extends the sunsets on and, in some instances, expands the scope of several tax credits. Tax credits are one of many economic incentives offered by the State designed to attract and maintain businesses in North Carolina. In 1998, the Revenue Laws Study Committee recommended that sunsets be placed on virtually all of the tax credits as a means to review and reevaluate those credits to determine whether they are accomplishing their intended goal. The Committee engaged in this review process during the 2007 interim and recommended extensions for the following three credits: the credit for research and development, the credit for the State Ports Authority, and the credit for small business employee health benefits. During the 2008 Session, the General Assembly extended or modified the sunset on three additional credits: the credit for low-income housing, the credit for mill rehabilitation, and the film industry credit. In addition to the extension of these credits, the General Assembly expanded the scope of the film industry and renewable energy tax credit and increased the cap on the qualified business venture tax credit.

These economic incentives are described more fully as follows and appear in the order in which they appear in the budget.

Extend Credit for Research & Development. – Section 28.2 extends for five years, until the year 2014, the sunset on this tax credit. Prior to the enactment of this section, the credit was scheduled to expire for taxable years beginning on or after January 1, 2009. This section became effective when the Governor signed the act into law on July 16, 2008.

In 2004, the General Assembly enacted this credit as an alternative to the Bill Lee research and development credit, which was set to expire along with the entire Bill Lee Act on January 1, 2006. A taxpayer that has qualified North Carolina research expenses or North

[54] G.S. 105-129.16A is repealed effective for renewable energy property placed into service on or after January 1, 2011.
[55] The installment requirements in G.S. 105-129.16A for nonresidential property do not apply to this credit.

Carolina university research expenses is allowed a credit. The taxpayer must satisfy Bill Lee Act requirements related to employee wages, the provision of health insurance, the taxpayer's Occupational Safety and Health Act record, and the taxpayer's environmental record. A taxpayer with overdue tax debts is not prohibited from taking this credit.

The credit amount varies. For North Carolina university research expenses, the credit amount is equal to 20% of the amount the taxpayer paid to the university for the research and development. For all other qualified research expenses, the credit is equal to a percentage of the expenses. Specifically, the rate is 3.25% for small businesses[56] and for research and development conducted in a development tier one area. For other research and development expenditures, the rate ranges from 1.25% to 3.25% as the amount of those expenditures increases.

Extend Low-Income Housing Credit. – Section 28.3 extends the sunset on the low-income housing tax credit from January 1, 2010, until January 1, 2015. Although the sunset was not scheduled to expire for two more years, developers of low-income housing begin their work months in advance and need to know what financing will be available as they secure options on sites. This section became effective when the Governor signed the act into law on July 16, 2008.

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

In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit.[57] Under current law, a taxpayer may elect to receive the credit in the form of either a credit against tax liability or a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount. Historically, project developers have almost always elected the loan option. Neither a tax refund generated by the credit, nor a loan received as a result of the transfer of the credit is considered taxable income by the State. Although a State tax refund is considered taxable income by the IRS if the taxpayer itemizes deductions, a private letter ruling from the IRS provides that the loan proceeds are not.

Extend Mill Rehabilitation Tax Credit. – Section 28.4 extends the sunset for rehabilitation projects for which an application for an eligibility certification is submitted on or after January 1, 2011. Under prior law, the credit expired for qualified rehabilitation expenses occurring on or after that date. This section also makes clarifying and stylistic changes. This section is effective for taxable years beginning on or after January 1, 2008.

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[56] A small business is a business whose annual receipts, combined with the annual receipts of all related persons, does not exceed $1,000,000.

[57] Under the original version of the State credit, a project developer had to sell the tax credits to receive funds to finance the project. Developers indicated that the process of selling the credits was complex and that they sold for no more than 45 cents on the dollar. In 2002, the General Assembly modified the way in which developers benefited from the credit to promote efficiency and cost savings while providing the same level of incentives.

North Carolina allows a tax credit for rehabilitating vacant historic manufacturing sites if the taxpayer spends at least $3 million to rehabilitate the site. To qualify for the credit, the site must satisfy all of the following conditions:

- The site was used as a manufacturing facility or for purposes ancillary to manufacturing, as a warehouse for selling agricultural products, or as a public or private utility.
- The site is a certified historic structure or a State-certified historic structure.
- The site has been at least 80% vacant for a period of at least two years immediately preceding the date the eligibility certification is made.

The amount of the credit is a percentage of the qualified rehabilitation expenditures, and the percentage varies depending on the enterprise tier location of the site and the eligibility for the federal credit as follows:

- Development tier one or two area – 40% of qualified rehabilitation expenditures or rehabilitation expenses, regardless of whether the taxpayer is allowed a federal credit.
- Development tier three area – 30% of qualified rehabilitation expenditures and the taxpayer is allowed a federal credit. No credit is allowed if the site is located in a development tier three and the taxpayer is not allowed a federal credit.

The credit may be claimed against the franchise tax, the income tax, or the gross premiums tax. If the credit is taken for income-producing property, it may be taken in the year the property is placed in service. If the credit is taken for non-income-producing 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 amount of the tax against which the credit is claimed for the taxable year reduced by the sum of all credits allowed, except payment of tax made by the taxpayer. Any unused portion of the credit may be carried forward for the succeeding nine years. This credit may be taken in place of the credit for historic rehabilitation, not in addition to it.

A pass-through entity may allocate the credit among any of its owners without limitation as long as the owner's adjusted basis in the pass-through entity is at least 40% of the amount of credit allocated to the owner.[58] An owner of a pass–through entity that qualifies for the credit will forfeit a portion of any credit the owner has received if both of the following conditions are met:

- The owner disposed of the interest within five years from the date the eligible site is placed into service.
- The owner's interest in the pass-through entity is reduced to less than two-thirds of the owner's interest in the pass-through entity at the time the eligible site was placed into service.

The forfeiture of an owner's interest is not required if the change in ownership is the result of the owner's death or the merger, consolidation, or similar transaction requiring approval by the shareholders, partners, or members of the entity, to the extent the entity does not

[58] A pass-through entity may also allocate the credit for rehabilitating an historic structure among its owners in the same manner as provided in this provision.

receive cash or tangible property in the transaction. A taxpayer or owner of a pass-through entity that forfeits a credit is liable for all past taxes avoided as a result of the credit plus interest computed from the date the taxes would have been due if the credit had not been allowed.

Extend Sunset for State Ports Tax Credit. – Section 28.5 of the act extends for five years, until the year 2014, the sunset on this tax credit. Prior to the enactment of this section, the credit was scheduled to expire for taxable years beginning on or after January 1, 2009. This section became effective when the Governor signed the act into law on July 16, 2008.

In 1992, the General Assembly enacted the State Ports tax credit to encourage exporters to use the two State-owned port terminals in Wilmington and Morehead City. At that time, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. Over the years, the credit has been expanded and the sunset has been extended four times.

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

Extend Sunset for Small Business Employee Health Benefits. – Section 28.10 extends from January 1, 2009, to January 1, 2010, the sunset on this tax credit. This section became effective when the Governor signed the act into law on July 16, 2008.

Effective for taxable years beginning on or after January 1, 2007, a small business[59] that provides health benefits to all of its full-time employees[60] is eligible for a tax credit. 'Providing health benefits' means one or more of the following:

- The taxpayer pays at least 50% of the premiums for health insurance coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee.
- The employee has existing coverage under one or more of the following: Medicare; Medicaid; a government funded program; a health insurance or benefit arrangement that provides benefits similar to or in excess of benefits provided under the basic health care plan.

The credit amount is equal to $250 per employee for whom the taxpayer pays the health insurance premium, not to exceed the taxpayer's cost of providing the health insurance benefit. The taxpayer may use the credit against either its income tax or its franchise tax liability. The credit may not exceed 50% of the taxpayer's tax liability. Any unused portions of the credit may be carried forward for five years.

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[59] A 'small business' is a taxpayer that employs no more than 25 full-time employees.
[60] An 'eligible employee' is one that works a normal workweek of 30 or more hours and whose total wages or salary received from the business does not exceed $40,000 on annual basis.

Under the Internal Revenue Code, an employer may deduct premiums paid for health insurance cost of its employees as a business expense. The credit is in addition to any expense deduction the taxpayer claimed on its income tax return for the health insurance costs.

Extend Aviation Fuel Refunds.[61] – Section 28.23 extends the sunset for refunds of the State sales and use tax paid on fuel used by interstate passenger air carriers and on aviation fuel used by a professional motorsports racing team or a motorsports sanctioning body from January 1, 2009, to January 1, 2011.[62] To receive a refund, a taxpayer must submit a refund request in writing and include any information and documentation required by the Secretary of Revenue. The request is due within six months after the end of the calendar year for which the refund is claimed.

In 2005, the General Assembly allowed a sales and use tax refund to an interstate passenger air carrier for the net amount of sales and use tax paid by it on fuel during a calendar year in excess of $2,500,000.[63] The 'net amount of sales and use taxes paid' is the amount of sales tax paid by the interstate passenger air carrier less the refund of that tax allowed to all interstate carriers under subsection (a) of G.S. 105-164.14.[64] The refund for which the sunset provision is being extended is in addition to the refund allowed under G.S. 105-164.14(a).

In that same year, the General Assembly enacted a refund of sales and use taxes paid on aviation fuel 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.

Expand Film Industry Credit and Extend Sunset. – Section 28.24 extends for four years, until January 1, 2014, the sunset on this tax credit and makes several other changes to the credit. This section became effective for taxable years beginning on or after January 1, 2008.

This credit is 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. In order to obtain the credit, the taxpayer must have qualifying expenses in excess of $250,000. 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.
- Compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue. Under prior law, any amount paid to an individual who receives in excess of $1 million with respect to a single

[61] The Senate Finance Committee originally considered the sunset extension in Senate Bill 2113.
[62] S.L. 2006-66 extended the sunset on these two sales tax refund provisions from January 1, 2007, to January 1, 2009.
[63] S.L. 2005-435.
[64] Under subsection (a), an interstate carrier is 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.

production may not be included in a qualifying expense. The section modifies this limitation by allowing a production company to include in its qualifying expenses up to $1 million in compensation paid to a highly compensated individual.[65] Any amount paid in excess of $1 million continues to be disallowed.

This section makes three additional changes to the credit. First, it allows a production company to include in its qualifying expenses the cost of insurance coverage for production-related insurance that is obtained on the production. The expenses do not qualify if the insurance coverage is purchased from a related member, which is defined in the current law. Second, it requires a taxpayer who claims the credit to file an intent-to-film notice with the North Carolina Film Office. The notice must include the name of the production, the name of the production company, the name of a financial contact for the production company, the proposed dates on which the production company plans to begin filing the production, and any other information required by the NC Film Office. This provision codifies current administrative practice.[66] Finally, it requires a taxpayer to acknowledge in the production credits both the North Carolina Film Office and the regional film office responsible for the geographic area in which the filming of the production occurred.

Increase Qualified Business Venture Tax Credit Cap. – Section 28.26 increases from $7 to $7.5 million the total amount of all qualified business investment credits that may be taken each year.[67] Demand for the credit exceeded $7 million in 2006 and totaled more than $6.5 million in 2007. This section is effective for investments made on or after January 1, 2008.

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

[65] 'Highly compensated individual' is defined as 'An individual who directly or indirectly receives compensation in excess of one million dollars ($1,000,000) for personal services with respect to a single production. An individual receives compensation indirectly when a production company pays a personal service company or an employee leasing company that pays the individual.'
[66] A production may not claim the credit until the production is complete. As written, the notification and acknowledgement requirements are conditions to receiving the credit. It would be possible for a company that has begun production to be denied a credit because it failed to meet these requirements, even though the requirements did not exist at the time the company began, or possibly completed, its production.
[67] The Senate considered this issue in Senate Bill 1628.

investment was made. This credit is currently set to expire for investments made on or after January 1, 2011.

Part V: Estate & Gift Tax Changes

Modify Estate Tax Law. – Section 28.17 modifies the formula for calculating North Carolina estate tax on estates that include property located in another state by excluding the value of that property from the estate tax payable to North Carolina, as recommended by the Revenue Laws Study Committee.[68] The section became effective July 16, 2008, and applies retroactively to the estates of decedents for which the statute of limitations for claiming a refund had not expired on December 27, 2007. [69] A personal representative of an estate for which the statute of limitations had not expired may file a claim for refund under G.S. 105-241.6. The statute provides that the general statute of limitations for obtaining a refund of an overpayment of tax is the later of the following:

- Three years after the due date of the return. – A North Carolina estate tax return is due on the date a federal estate tax return is due. A federal estate tax return is due nine months from the date of death. An extension of time to file a federal estate tax return is an automatic extension of the time to file a State tax return.
- Two years after payment of the tax.

For estates with property only in North Carolina, the North Carolina estate tax equals the amount of the credit allowed on the federal estate tax return for state estate tax paid, as the federal law provided in 2001. If an estate has property in more than one state, the federal credit amount must be prorated between North Carolina and the other states in which the estate has property. In 2002, the Estate Tax Section of the North Carolina Bar Association recommended a change in the calculation formula from a net value ratio to a gross value ratio. The recommended change also provided that when the estate of a North Carolina decedent included out-of-state property, the North Carolina estate tax would be calculated as the amount of the 2001 tax credit reduced by the lesser of the amount of estate tax paid to the other state or the amount of the 2001 tax credit times the value of the out-of-state property divided by the value of the gross estate.

In calculating the estate tax payable in North Carolina for an estate that includes property located in a state that does not impose an estate tax, the formula, prior to its modification by this section, provided that the North Carolina estate tax would be reduced by zero, because that is the lesser of the amount paid to the state that does not impose an estate tax. This calculation resulted in North Carolina's estate tax being imposed on property that is not located within its taxing jurisdiction. The application of the formula was especially problematic for North Carolina because the states surrounding North Carolina do not have an estate tax. Virginia repealed its estate tax, effective July 1, 2007. Georgia, South Carolina, and Tennessee have not had an estate tax since January 1, 2005, because their estate tax equals the amount of the state estate tax credit allowed on the federal estate tax return. In

[68] SB 1756.

[69] A case has been filed in Mecklenburg County, *Stowe v. Department of Revenue*, to recover North Carolina estate taxes imposed on property located in South Carolina. The plaintiffs argue in their complaint that the formula for calculating North Carolina estate tax due when property is located in more than one state is unconstitutional because it provides less than a full reduction of the tax attributable to the out of state property when the other state does not impose an estate tax, or imposes an estate tax less than the prorated federal credit amount. The plaintiffs filed the complaint on December 27, 2007.

2001, Congress phased out the state estate tax credit over four years by reducing it 25% in 2002, 50% in 2003, 75% in 2004, and by repealing it entirely in 2005.[70]

This section modifies the formula for calculating North Carolina estate tax on estates that include property located in another state by prorating the federal credit amount between North Carolina and the other states in which the estate has property. It does so by eliminating the 'lesser of" language that sometimes results in North Carolina's estate tax being imposed on property located in another state.

Repeal Gift Tax Law. – Section 28.18 repeals North Carolina's gift tax law, effective January 1, 2009. The nuances of North Carolina's gift tax laws make the transfer of property through gifts difficult and complicate estate planning. The North Carolina Association of CPAs and the Estate and Gift Tax Section of the North Carolina Bar Association have consistently recommended that North Carolina eliminate or simplify its gift tax law. The Revenue Laws Study Committee recommended legislation to the 2007 General Assembly to reform the State's gift tax to more closely conform to the federal tax, but the General Assembly did not enact the bill. Although the Committee did not recommend legislation on this issue this session, it recognized the need to simplify the State's gift tax laws.

With the repeal of the gift tax in North Carolina, Connecticut and Tennessee remain the only two states in the nation to impose a tax on gifts. Some of the reasons for repealing North Carolina's gift tax law included:

- North Carolina taxes gifts at varying graduated rates based on the relationship between the donor and the donee.[71] It favors transfers between spouses by exempting those transfers from tax. It favors transfers to children and parents by giving those transfers the lowest rates as well as a cumulative exemption amount of $100,000. Transfers to other close family members are taxed at higher rates and do not enjoy the benefit of an exemption. Transfers to more distant relatives or to persons who are not related are taxed at the highest rate.
- North Carolina's gift tax structure does not conform well to the federal gift tax structure.[72] The federal gift tax is part of a somewhat unified gift-estate tax system at the federal level. As part of that system, the federal gift tax has a lifetime exemption amount of $1,000,000. This amount is much larger than the State exemption amount and is available regardless of the relationship between the donor and donee. One result of this difference is that some transfers made while the donor is alive are

[70] The federal estate tax changes were part of the Economic Growth and Tax Relief Reconciliation Act of 2001. Under the provisions of that Act, the state estate tax credit phased-out, the federal estate tax exclusion amounts increased gradually, and the top rates decreased gradually until 2010 when the tax is repealed. However, the provisions are currently set to expire for estates of decedents dying after December 31, 2010. Effective January 1, 2011, the federal estate tax law will return to the provisions that existed in the year 2000 unless Congress enacts new legislation. Therefore, effective 2011, the state estate tax credit will exist again and the applicable exclusion amounts and tax rates will return to the amounts that existed in 2000.

[71] North Carolina is the only state whose gift tax rate structure differs depending on the relationship between the donor and the donee.

[72] Connecticut's gift tax structure conforms to the federal gift tax system. North Carolina and Tennessee's does not.

taxable in North Carolina, although the same transfer made by a decedent would not be taxable.[73]

- There are sometimes differences in the valuation of a gift for State and federal tax purposes. This discrepancy most commonly occurs with respect to the valuation of annuities. For State purposes, statutes mandate an interest rate of 6% be used in determining the value of the annuity; for federal purposes, the current prevailing interest rate is used.
- A donee assumes the donor's basis when property is transferred by gift. A donee assumes a stepped-up basis when the property is transferred through an estate.

Part VI: Property Tax Exclusion for Honorably Discharged Disabled Veterans and their Surviving Spouses.

Section 28.11 repeals the property tax exclusion for the first $38,000 in assessed value of housing for disabled veterans receiving benefits under 38 U.S.C. § 2101 and, in its place, creates a property tax homestead exclusion equal to the first $45,000 in assessed value of a permanent residence owned by an honorably discharged veteran or the unmarried surviving spouse of an honorably discharged veteran. This exclusion does not have an age requirement or an income requirement. The exclusion becomes effective for taxes imposed for taxable years beginning on or after July 1, 2009.

To receive the exclusion, a property owner must file an application[74] with the county tax assessor. To qualify for the exclusion, the property owner must meet one of the following requirements, or be the unmarried surviving spouse of a person who met one of these requirements:

- A disabled veteran who receives benefits under 38 U.S.C. § 2101.
- A disabled veteran certified by the U.S. Government or the U.S. Department of Veterans Affairs as a person with a permanent total disability that is service-connected.

A taxpayer who receives the disabled veteran property tax exclusion may not benefit from any other homestead property tax exclusion. However, if the permanent residence is owned by more than one person who is not the taxpayer's spouse, and a co-owner qualifies for a property tax relief program, then the co-owner may receive the benefits of that program.[75] The exclusion allowed to either co-owner may not exceed the co-owner's proportionate share of the valuation of the property and the amount of the exclusion allowed to all co-owners may not exceed the greater of two applicable exclusion amounts.

North Carolina also provides the following property tax exclusions for disabled veterans:

[73] Accountants and estate planning attorneys found that the consequences of the gift tax affects the estate planning of middle-income citizens in that it discourages them from transferring a farm or small business to their natural heirs during their lifetime because they cannot afford to pay the applicable State gift tax.
[74] The application need be filed only once.
[75] G.S. 105-277.1 provides a property tax exclusion for elderly or disabled taxpayers who meet an income eligibility limit.

- A property tax exclusion for a motor vehicle given by the U.S. Government to veterans on account of disabilities they suffered in WWII, the Korean, Conflict, or the Vietnam War.

- A property tax exclusion for a motor vehicle owned by a disabled veteran if the vehicle has been altered with special equipment to accommodate a service-connected disability. A service-connected disability is an injury incurred or disease contracted in or aggravated by active service. The disability must be loss of one or both hands or feet, permanent loss of use of one or both hands or feet, or permanent impairment of vision of both eyes.

Part VII: Administrative Changes

Small Business Protection Act. – Section 28.16 provides small businesses with certain protections related to their sales and use tax obligations, it requires the Department of Revenue to establish and implement procedures for improving customer service and quality control measures with regard to advice given to taxpayers in certain areas of the tax law, and it directs the Revenue Laws Study Committee to study issues related to the interpretation and application of certain areas of the sales and use tax law.

Under this section, the Secretary is required to reduce an assessment for sales and use taxes made against a small business as the result of an audit and waive any associated penalties if all of the following conditions are met:

- The annual gross receipts of the business and all related persons for the calendar year preceding the year in which the audit period begins do not exceed $1.8 million dollars.

- The business remitted all the sales and use taxes it collected during the audit period.

- The business had not been told by the Department in a prior audit to collect sales and use taxes in the circumstance that is the basis of the assessment.

- The business made a good faith effort to comply with the sales and use tax laws and the assessment is based on the incorrect application of one of the following complex areas of these laws:
  - The rate of tax that applies to prepared food.
  - The distinction between a retailer and a performance contractor.
  - The distinction between a service that is necessary to complete the sale of tangible personal property, which is taxable, and a service that is incidental to the sale of tangible personal property, which is not taxable.
  - The determination of whether a person is a manufacturer.

The amount of the reduction is a percentage of the assessment and varies depending on the average monthly gross receipts of the business:

Avg. Monthly Gross Receipts	Reduction of Assessment
$0-50,000	98%
$50,001-100,000	95%
$100,001-150,000	90%

In addition to applying prospectively to future assessments and claims for the refund of an assessment, this section also has limited retroactive application. Specifically, it applies to assessments that are pending as of July 15, 2008, to assessments that have been identified in a notice of final assessment under former G.S. 105-241.1 prior to July 15, 2008, or to assessments that became collectible but have not been paid as of July 15, 2008. If, however, an assessment was paid within six months after it became collectible, then the taxpayer may also be eligible for a reduction if a timely claim for refund could be filed.

During the 2008 Session, the Senate and House Finance Committees heard from a number of small business owners who expressed concern and confusion regarding the application to their particular businesses of certain sales and use tax provisions and, in some instances, verbal information provided by the Department of Revenue that they believed to be erroneous or unclear. This section attempts to address either the actual or perceived issues of quality control within the Department with respect to verbal advice given to taxpayers. Specifically, this section requires the Department to document certain conversations with taxpayers, regardless of whether the conversation is conducted by phone or in person. Effective January 1, 2009, the Department must document advice given to a taxpayer when the taxpayer provides identifying information, asks about the application of a tax to the taxpayer in specific circumstances, and requests that the Secretary document the advice in the taxpayer's records. The documentation must set out the date of the conversation, the question asked, and the advice given. This requirement does not apply in a conference or presentation-type setting. Effective July 1, 2009, the Department must document in a similar manner a conversation with a taxpayer who is not registered as a retailer or a wholesale merchant under Article 5 of Chapter 105 of the General Statutes when the taxpayer identifies himself, describes the business in which he is engaged, and asks if he is required to be registered under Article 5.

Under current law, a taxpayer may request in writing specific advice from the Department. If the Department furnishes erroneous written advice in response, and the taxpayer reasonably relies on that advice, the taxpayer is not liable for any penalty or additional assessment attributable to the erroneous advice. However, the same protection does not apply with regard to verbal advice. Effective July 16, 2008, when the act became law, this same protection is extended to taxpayers with regard to erroneous verbal advice provided that Departmental records establish that the erroneous advice was given.

This section rewrites the offer and compromise statute so that it more accurately reflects current practice, is adjusted for inflation, and eliminates the requirement that the Department obtain approval from the Attorney General unless the matter is in litigation. It also adds a new condition under which the Department may settle a tax liability for less than that asserted to be due; that is, when the collection of an amount greater than the amount offered would produce an unjust result under the circumstances. The rewrite of this statute is intended, in part, to provide the Department with additional flexibility with regard to offers and compromise.

This section requires the Department to do two things. First, the Department must establish and implement by July 1, 2010, a plan to record telephone calls received at the Taxpayer Assistance Center for training, customer service, and quality control purposes. Second, the Department must report to the Revenue Laws Study Committee, prior to the convening of the 2009 General Assembly, on customer service improvement initiatives.

Finally, it directs the Revenue Laws Study Committee to study the following issues related to the interpretation and application of certain areas of the sales and use tax law that frequently cause confusion among taxpayers and often result in inadvertent noncompliance:

- The taxation of services necessary to complete the sale of tangible personal property and standards for distinguishing between a service that is taxable as one that is necessary to complete the sale and a service that is incidental to the sale of tangible personal property.
- The applicability of the sales and use tax to performance contracts and standards for distinguishing between performance contractors and retailers.
- The distinction between food and prepared food under the sales and use tax laws and whether to eliminate this distinction by applying a uniform, revenue-neutral rate to all food.

Procedure for Tax Class Actions. – Section 28.28, which was a recommendation of the Revenue Laws Study Committee, establishes a procedure for taxpayers seeking to initiate or join a class action in order to obtain a refund of tax paid due to an alleged unconstitutional statute. This section became effective October 1, 2008, and applies to civil actions filed on or after that date.

The Revenue Laws Study Committee spent a significant amount of time examining this issue. Prompted by requests from both the North Carolina Bar Association and the North Carolina Association of Certified Public Accountants, the Committee first examined the issue in 2002. The Committee revisited the issue in 2006 as part of its broader, in-depth study of the procedures related to the review of disputed tax matters. Most recently, in its report to the 2008 Regular Session of the 2007 General Assembly, the Committee determined that the existing law needed to be clarified because of ambiguity surrounding recent judicial interpretations of the 'protest statute', which was the prior mechanism for bringing a civil suit for a refund of tax. The purpose of this legislation is to identify and protect the potential liability of the State for tax refunds and to give taxpayers, the Department, and practitioners clear guidance as to the proper procedure governing tax-related class actions.

- **Authority**. – Neither the law prior to 2007, nor the law in place prior to the effective date of this act expressly allows for a class action for the refund of a tax. However, the North Carolina courts have allowed civil actions brought under the former protest statute[76] to be certified as class actions. Effective January 1, 2008, a new statute governs the conditions under which a civil action may be initiated by a taxpayer for the refund of a tax based on the alleged unconstitutionality of a statute.[77] However, the statute is silent with regard to class actions. This section provides specific statutory authority for tax class actions, which may be brought only on the grounds of an alleged unconstitutional statute.
- **Bringing a Tax Class Action**. – A taxpayer who wishes to commence a class action challenging the constitutionality of a tax statute and who seeks to represent the class must meet certain requirements. First, the taxpayer must meet the same requirements

[76] G.S. 105-267.
[77] G.S. 105-241.17.

that any other taxpayer is required to meet in order to bring a civil action. Those requirements are as follows:

- The taxpayer must receive a final determination from the Department after a review and conference.
- The taxpayer must commence a contested case at the Office of Administrative Hearings (OAH).
- OAH subsequently dismissed the case for lack of jurisdiction because the sole issue in the case is the facial constitutionality of a statute.
- The taxpayer has paid the tax, penalties, and interest due in the final determination.
- The civil action is filed within two years of the dismissal from OAH.

Second, the taxpayer must also comply with any requirements under Rule 23 of the North Carolina Rules of Civil Procedure. North Carolina courts have required compliance with Rule 23 in prior tax class actions, so the requirement is not new, but this section sets out the requirement explicitly in statute.

Finally, this section adds a new requirement for bringing a tax class action. The taxpayer's claims must be typical of the claims of the class members in order for the taxpayer to serve as the class representative. This language mirrors language in Rule 23 of the Federal Rules of Civil Procedure. Whether a claim is 'typical' is an issue for the court to determine when approving the class representative.

- **Joining a Tax Class Action.** – In order to become a member of a tax class action, a taxpayer must be eligible and must affirmatively elect to participate as a member of the class.
  - Eligibility. – A taxpayer is eligible to become a member of the class if the taxpayer could have filed a claim for refund as of the date the class action was commenced or as of a subsequent date set by the court, whether or not the person actually filed a claim. For purposes of determining this eligibility, a class action 'commences' upon the later of the date a complaint is filed alleging the existence of a class or the date a complaint is amended to allege the existence of a class.
  - Affirmative Election. – An eligible taxpayer becomes a member of a class by affirmatively indicating a desire to be included in the class in response to a notice of the class action. A taxpayer who joins a class is not required to exhaust the administrative review process; only the class representative must do so.
- **Procedure. –** The procedure for notifying potential class members, the content of the notice, and the method by which potential class members indicate a desire to be included in the class in response to the notice must be approved by the court. This procedure may include ordering the Department of Revenue to provide the class representative with a list of names and last known addresses of all taxpayers who are readily determinable by the Department and are eligible to become a member of the class. The class representative must advance the costs of notification.

- **Statute of Limitations.** – The general statute of limitations for obtaining a refund of overpayment of tax is the later of three years after the due date of the return or two years after payment of the tax. Without a class action mechanism, each taxpayer seeking a refund of a tax paid under an alleged unconstitutional statute would have to file a claim for refund within the statute of limitations period and exhaust the administrative and judicial review process.

  One general principle of class actions is that the filing of a suit tolls the statute of limitations for all prospective class members until class certification is denied. If certification is denied, the limitations period begins to run again and plaintiffs may file their own individual claims. This same principle applies to tax class actions. The statute of limitations for filing a claim for refund on the grounds of an unconstitutional statute is tolled for a taxpayer who is eligible to become a member of a class action. The tolling begins on the date the class action is commenced. For a taxpayer who does not join the class, the tolling ends when the taxpayer does not affirmatively indicate a desire to be included in the class as provided by the court. For a taxpayer who does join the class, the tolling ends when the court enters any of the following:

  - A final order denying certification of the class.
  - A final order decertifying the class.
  - A final order dismissing the class action without an adjudication on the merits.
  - A final judgment on the merits.

- **Effect on Nonparticipating Taxpayers.** – Class actions are designed to adjudicate, in a single action, the claims of numerous parties with similar claims. One objective of a class action judgment is to prevent future litigation of claims that were, or could have been, litigated in the class action. Thus, the legal principles of 'claim preclusion' and 'issue preclusion' arise in the class action context. Claim preclusion means that a final judgment on the merits in a case is conclusive as to the rights of the parties to that case and bars them from bringing a subsequent action involving the same claim. In the class action context, the application of claim preclusion means that the judgment applies to the entire certified class. In certain instances, it can also bind nonparties. It does not, however, bar an individual who elects not to participate in the class action from bringing his or her own claim. Issue preclusion bars the same parties from relitigating in a subsequent action an issue that was litigated in a prior action. Courts have generally held that a successful defendant in a prior class action suit may not assert issue preclusion in a subsequent suit against a plaintiff who opted out of the earlier class action. Similarly, when a class prevails in an earlier action, an individual who opted out of that class who now chooses to bring his or her own individual claim against the same defendant may not assert issue preclusion in that case.

  This section provides that the principles of claim preclusion and issue preclusion apply to tax class actions in the same manner in which they apply to class actions generally. It further specifies that if a final judgment on the merits is entered in a class action in favor of the class, the following applies to an eligible taxpayer who did not become a member of the class:

- The taxpayer is not entitled to share in any monetary relief awarded to the class.
- If the taxpayer has been assessed for failure to pay the tax at issue in the class action and the taxpayer has not paid the assessment, then the assessment is abated.
- The taxpayer is relieved of any future liability for the tax that is the subject of the class action.

2008 Budget Technical Corrections.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-118	**HB 2438**	**Rep. Michaux, Tolson, Yongue**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER MODIFICATIONS TO THE STATE BUDGET.

OVERVIEW: Section 3.10 of this act allows an annual sales and use tax refund for materials used to build a facility that manufactures solar electricity generating materials. The remainder of this act does not impact the tax laws and is not discussed below.

FISCAL IMPACT: This section is expected to reduce General Fund revenues by $348,813 in fiscal year 2010-2011.

EFFECTIVE DATE: Section 3.10 of this act became effective July 1, 2008, applies to purchases made on or after that date, and expires for purchases made on or after January 1, 2013.

ANALYSIS: Section 3.10 of this act adds 'solar electricity generating materials manufacturing' to the list of industries entitled to an annual refund of the sales and use tax paid by the owner of the industry on building materials and supplies, fixtures, and equipment used to construct a facility that will be used primarily to manufacture solar electricity generating materials. Solar electricity generating materials manufacturing is defined as the development and production of one or more of the following:

- Photovoltaic materials or modules used in producing electricity.
- Polymers or polymer film primarily intended for incorporation into photovoltaic materials or modules used in producing electricity.

The industries currently eligible for the refund include the following: air courier services; aircraft manufacturing; bioprocessing; computer manufacturing; financial services, securities operations, and related systems development; motor vehicle manufacturing; pharmaceutical and medicine manufacturing and distribution of pharmaceuticals and medicines; and semiconductor manufacturing.

Photovoltaics (PV) are solar cells made and composed of semiconductor materials that are used to convert sunlight directly into electricity. The current solar industry in the United States employs some 20,000 employees in high value, high tech jobs and is expected to grow

toward a workforce of 150,000 by the year 2020.[78] DuPont is a materials and technology supplier to the PV industry. It offers products needed for PV module production, such as polymer films, resins, sheets, and conductive pastes. DuPont has one facility in Bladen County and another in Kentucky that produce polymers needed to manufacture polymer film. The company is looking to expand this industry. United Solar Ovonic is a company headquartered in Michigan that specializes in thin film solar technologies and the manufacture of thin film solar electric modules and laminates. It, too, is looking to expand its operations.

To be eligible for this refund, the Secretary of Commerce must certify that the owner of the facility will invest at least $50 million of private funds in the construction of the facility, if the facility is located in a development tier one area, and at least $100 million if the facility is located elsewhere in the State. In addition to the investment requirement, a solar electricity generating materials manufacturing business must also meet a wage standard in order to qualify for the sales tax refund. A business meets the wage standard if it pays the lesser of an average weekly wage that is equal to or greater than 110% of the average weekly wage for the State or the average weekly wage for the county.

If the owner does not make the required minimum investment within 5 years after the first refund is received, the owner forfeits all refunds already received. Upon forfeiture, the owner is liable for not only the tax due, but also interest computed from the date each refund was received. A person that fails to pay the tax and interest due within 30 days after the date of forfeiture is subject to the penalties provided in G.S. 105-236. A request for a refund must be in writing and must be submitted within six months after the end of the State's fiscal year. A refund applied for after the due date is barred. The refund provision expires for purchases made on or after January 1, 2013.

Rev Laws Tech., Clarifying, & Admin Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-134	**SB 1704**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE TAX AND RELATED LAWS.

OVERVIEW: This act makes technical, clarifying, and administrative changes to the revenue laws, the motor fuel tax laws, and related statutes, as recommended by the Revenue Laws Study Committee.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Except as otherwise provided, these changes became effective when the act was signed into law by the Governor on July 28, 2008.

ANALYSIS:

[78] "Energy Alternatives and Jobs." 2000. Renewable Energy World, 3(6): November/December, pp. 26 32.

Part I: 911 Technical Changes

Section	Explanation
1.(a)	Allows the 911 Board to adjust allocations to ensure local governments receive, at a minimum, the same revenues the local government collected in 911 fees for the fiscal year ending June 30, 2007.
1.(b)	Changes from calendar year to fiscal year the time frame in which the Board can make changes in allocation percentages to conform to the Board's accounting practices.
1.(c)	Clarifies that the Eastern Band of the Cherokee Nation is an eligible PSAP and can receive disbursements from the 911 Fund, even though the Nation is exempt from Chapter 159, the Local Government Finance Act. Its per capita distribution amount will be based upon the most recent federal census estimates of the population living on the Qualla Boundary.
1.(d)	Extends the moratorium on the collection of the 911 fee from prepaid wireless providers from the 2008 calendar year to the first nine months of the 2009 calendar year.

Part II: Work Opportunity Tax Credit (WOTC) Changes

2.(a)	Clarifies that the WOTC is limited to 6% of the federal credit for wages paid in the same taxable year for positions located in North Carolina. Places a sunset on the credit effective for taxable years beginning on or after January 1, 2012. These changes are effective for taxable years beginning on or after January 1, 2008.
2.(b) &(c)	Clarifies that an employer cannot deduct the wages paid as a business expense from state taxable income if the employer takes the WOTC for those wages.

Part III: Reform Tax Appeal Changes

3	Conforms the due date of the franchise tax return and the corporate tax return. Section 10 of S.L. 2007-491 extended by one month the due date for filing a franchise tax return. Section 14 of that act made a corresponding change for corporate income tax returns. Since franchise tax and corporate income tax are reported on the same form, the effective dates must conform. However, the way the act was drafted, the one-month extension for franchise tax would occur in 2008 while the one-month extension for corporate income would take place in 2009. This section corrects the inconsistency by repealing Section 10, effective retroactively to January 1, 2008, and by reenacting the provision, effective January 1, 2009. With this change, the one-month extension will take effect for both taxes beginning in 2009.

	Inserts language inadvertently omitted in a rewrite of the franchise tax statute in 2007. Section 10 of S.L. 2007-491 rewrote for clarity the subsection imposing the franchise tax. The rewrite inadvertently omitted existing language requiring a corporation to determine its tax liability based on "the books and records of the corporation at the close of the income year." This section puts this language back in the statute.
4	Conforms the corporate tax return to the franchise tax return. S.L. 2007-491 added chief financial officers to the list of corporate officers authorized to sign franchise tax returns and deleted the secretary, the assistant secretary, and the assistant treasurer. However, similar changes were not made in the corresponding corporate income tax statute. Since the franchise tax return and the corporate income tax return are on the same form, the statutes need to match. This section makes that conforming change to the corporate tax statute.
5	Provides that a taxpayer may file a request for review of the Department of Revenue's proposed denial of a refund at any time by the date that inaction by the Department is considered a proposed denial of the refund but within 45 days of receiving actual notice of a proposed denial by the Department. This section addresses that concern, as recommended by the Department, and is effective for taxable years on or after January 1, 2008. Under the new administrative review process, the Department of Revenue is required to take action on a request for a refund within six months after the request has been filed. If the Department denies the request, it must send a notice to the taxpayer, and the taxpayer has 45 days to request a review of the proposed denial. However, if the Department fails to take any action within six months, the request is considered denied, and the taxpayer has 45 days from that point to request review. The purpose of this provision is to allow a taxpayer to move forward in the administrative review process despite inaction by the Department. However, concerns have been raised that the running of this 45-day period without actual notice from the Department may create a potential trap that bars taxpayers from appealing the denial.
6	Clarifies that the validity of a proposed denial of refund is not affected by the Department's failure to timely issue a notice of final determination. The Department must issue a final determination within nine months after the taxpayer requests a review of a proposed denial of a refund or a proposed assessment of tax. The relevant statute specifically provides that failure to timely issue a notice of final determination does not affect the validity of a proposed assessment but is silent as to the impact on a proposed denial of refund.
7	Replaces the word 'tax,' which is a defined term, with the word 'amount' for consistency. The purpose of this change is to clarify that if a taxpayer does not send in the amount shown due with a return, the Department can collect the principal amount of the tax, any applicable penalties, such as failure to pay, and interest.

8	Makes a conforming change in the motor fuel tax law regarding the new administrative review process.
9	Allows government agency lab reports to be admitted into evidence in a contested tax case hearing without requiring agency personnel testimony. S.L. 2007-491 made special provisions for contested tax cases heard at the Office of Administrative Hearings. Among them, a law enforcement report may be admitted into evidence without the testimony of personnel from the law enforcement agency. The Motor Fuels Tax Division of the Department requested a similar provision for government agency lab reports used in the enforcement of the motor fuel tax laws.

Part IV: Collection Changes

10	Adds partners and managers of a partnership (who may or may not be a partner) to the list of officers or, as rewritten, 'responsible persons' whom the Department may assess. The Department requested this change. This section also rewrites the section for clarity and style and places the statute in a more logical location within the Article. Individual officers and directors of a corporation are usually not liable for corporate debts or obligations. This is in contrast to partnership debts and liabilities, which are chargeable personally to the individual partners. However, by statute, a 'responsible officer' of a corporation or a limited liability company may be held personally liable for certain unpaid trust taxes owed by the business entity. These taxes include sales and use, motor fuels, and income withholding taxes. A 'responsible officer' is defined as the president, treasurer, and the CFO of a corporation, the manager of a LLC, and any other officer of a corporation or a member of a LLC who has a duty to pay taxes on behalf of the entity. The Department is authorized to enforce collection by proposing an assessment against the officer. Under prior law, there was no similar statutory authorization to assess partners for these taxes. Instead, the Department, like any other creditor of a partnership, would be required to sue in order to collect this liability. Once a judgment was obtained, the Department could seek to execute the judgment. This section became effective July 1, 2008, and applies to taxes that become collectible on or after that date.

Part V: Sales Tax Changes

11	Specifies how the tax on gross receipts from periodic payments made pursuant to agreements entered into before the effective date of the sales tax rate changes is to be reported. This section is a transitional provision for the 'Medicaid swap' enacted in the 2007 Session by S.L. 2007-323. Under the swap, the local sales and use

	tax rate decreases by ¼ cent in 2008-09 and again in 2009-10, and the State sales and use tax rate increases by the same amount. The combined State and local rates do not change; instead, the allocation of the combined rate between the State and the counties changes. Periodic payments consist of lease and rental payments and installment sale payments. Sales and use tax is due on lease and rental payments when the payments are billed. For installment sales, the tax application differs depending on whether the retailer reports on an accrual basis or a cash basis. A retailer on an accrual basis reports all the sales tax due on an installment sale when the sale is made. A retailer on a cash basis reports sales tax when each installment payment is received. This provision requires retailers who receive periodic payments from existing contracts to report them at the current State and local rates. This eliminates confusion about what to report and how to report it. Without this provision, a retailer who receives periodic payments will have receipts from existing contracts that are reportable at State and local rates that differ from the State and local rates that apply to periodic payments from new contracts.

Part VI: Occupancy Tax Changes

12.(a)	Provides that an interpretation by the Department of Revenue of a State sales tax law provision applies to a local law that references that provision. As the result of an independent audit by at least one county, questions arose among local governments and within the tourism industry regarding what constitutes 'gross receipts' for occupancy tax purposes. Most local occupancy tax acts state that a county or city may levy a room occupancy tax on "the gross receipts derived from the rental of any room…that is subject to sales tax imposed by the State under G.S. 105-164.4(a)(3)." Therefore, if an item of tangible personal property or a fee associated with the rental of an accommodation is subject to sales tax under G.S. 105-164.4(a)(3), then it is also subject to the local occupancy tax. While the Department can offer an interpretation of the State sales tax laws, it does not have statutory authority to offer an interpretation of the application of local occupancy tax laws, which it does not administer.
12.(b) & (c)	Provides that collectors of occupancy tax may allocate revenues for vacation packages that do not otherwise meet the definition of a bundled transaction. In January of 2008, the Department issued a technical bulletin related to the rentals of accommodations. In that bulletin, the Department clarified that the bundling provisions in G.S. 105-164.4D apply to vacation packages. For example, a vacation package may include lodging, meals, and greens fees for one price. The lodging is subject to sales and local occupancy tax, the meals are subject only to sales tax, and the greens fees are not subject to either sales or occupancy tax. The bundling provisions

	allow a hotel operator to allocate the revenues between taxable and exempt portions of the package. The allocation may be part of a hotel's internal records and is not required to appear on the customer's bill. A 'bundled transaction' is defined as a sale that includes at least one taxable item and at least one exempt item. Since the release of the bulletin, the tourism industry has sought clarification of whether the allocation rules apply to vacation packages consisting only of taxable items, since those packages do not otherwise meet the definition of a bundled transaction. The clarification is needed because although the entire vacation package may be subject to sales tax, not all items may be subject to occupancy tax. The collectors would like the ability to allocate those revenues.

Part VII: Medicaid Technical Changes

13	Ensures that counties spend as much on public school capital outlay as they would have in the absence of the Medicaid swap. Part of the swap changes the distribution of taxes imposed under Article 42 from a per capita basis to a point of collection basis. A county whose sales tax revenue decreases as a result of this conversion is required to continue to fund public school capital outlay at the amount that would be required in the absence of the conversion.
14	Makes two clarifying changes to the hold harmless calculation. The first is a technical change that describes the hold harmless calculation in a way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. The second change eliminates a potentially circular calculation of the amount of local sales and use tax revenue to be distributed. It does not change the amount of any tax or hold harmless payment. The prior law could be construed to calculate the amount of various hold harmless payments on the basis of an amount that includes a deduction for the payment that is attempted to be calculated, which is circular. The hold harmless payments are now both pegged, in part, on amounts distributed under Article 39 of Chapter 105 of the General Statutes and deducted from those amounts. This section resolves the problem by making it clear that the hold harmless payments are calculated on the basis of amounts allocated for distribution before any subtraction for the hold harmless payments. References in Article 39 and Chapter 1096 of the 1967 Session Laws are replaced with a direction in G.S. 105-522(b) to deduct the city hold harmless payment from the amount of local sales and use tax revenue otherwise allocated under those provisions for distribution to a county. Subsection (a) adds an

	instruction in G.S. 105-522(b) to deduct the payment. Subsection (b) removes the instruction from Article 39 of Chapter 105. Subsection (c) removes the instruction from Chapter 1096.
15	Makes three changes to the hold harmless calculation. First, it inserts the city hold harmless amount into the calculation of the county hold harmless payment, thereby ensuring that the intent of the General Assembly is fulfilled. G.S. 105-523(a) states that each county is to benefit from the Medicaid swap by at least $500,000. The current calculation for determining a county's hold harmless payment, however, does not include the amount a county is required to give to its cities in order to hold them harmless from the repealed local sales taxes. Subsection (a) adds the cost of the city hold harmless to the calculation of the county hold harmless payment. Subsections (d) and (f) repeal changes to G.S. 105-523 that were to take effect in 2009, and subsection (h) reinserts those same changes into the amended G.S. 105-523 while preserving the amendments added by subsection (a). Second, it makes the same technical change to G.S. 105-523(b)(3) that Section 14 makes to G.S. 105-522(a)(2). The technical change describes the hold harmless calculation in a simpler way that does not require a reference to local sales taxes on food. The change in the description does not change the amount of the hold harmless. The local sales taxes on food are administered as if they were State taxes and are included, in part, in the amount distributed under Article 40 but are not part of the amount allocated under G.S. 105-486. Third, it changes the city hold harmless formula and the county hold harmless formula that apply to fiscal years beginning in 2009-2010 to match these formulas to the ones used in the tables that calculated the impact of the swap. The prior law incorrectly included a ¼% tax distributed on the basis of point of origin as one of the elements of the formulas. The Medicaid swap is based on the repeal of ½% local sales and use taxes distributed on a per capita basis and the conversion of a ¼% per capita tax to a ¼% point of origin tax. To reflect this, the reimbursement formula needed to be changed to delete the reference to a ¼% point of origin tax and replace it with a ¼% per capita tax. Subsections (c), (d), and (f) of this section repeal the provisions that contain the incorrect reference and subsections (g) and (h) insert the correct reference in the formulas. Subsections (b), (e), and (i) make conforming changes; they repeal sections that use terminology that does not match the revised reimbursement sections and replace them with a provision that uses terminology that is consistent with the revised sections.

Part VIII: Motor Fuel Tax Law Changes

The changes made by this part are effective January 1, 2009.

16 Makes clarifying and conforming changes and numbers the definitions sequentially. Adds definitions for terms used in the motor fuel tax statutes.

Under IFTA, a 'qualified motor vehicle' is one used, designed, or maintained for transportation of persons or property that meets one or more of the following conditions: has two axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds; has three or more axles regardless of weight; or has a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds when it is combined with another vehicle

17	Corrects a punctuation error.
18	Changes the statute to reflect current practice. Provides that the Department may include information received from the State Highway Patrol when determining the potential liability of a motor carrier. The SHP used to be located within the DMV. Incorporates defined terms.
19	Incorporates defined terms. Clarifies that recreational vehicles that are qualified motor vehicles under the IFTA would need to be registered. Also, the use of the defined term 'qualified motor vehicle' means that special mobile equipment would need to be registered. Although the law's definition of 'motor vehicle' arguably included special mobile equipment, the Department has not been requiring the registration of special mobile equipment. However, other IFTA states do require the registration of special mobile equipment.
20	Incorporates the commonly used term 'decal' for 'identification marker'.
21	Repeals an unnecessary statute. G.S. 105-252 and G.S. 105-254 give the Secretary the authority to prepare the appropriate forms and require the necessary information on those forms.
22	Incorporates the commonly used term 'decal' for 'identification marker'. Modernizes the language.
23	Incorporates the commonly used term 'decal' for 'identification marker'.
24	Revises the definitional statute to define commonly used terms, to incorporate definitions from other statutes, and to refer to federal regulations. It numbers the definitions sequentially.
25	Incorporates into the licensing statute the requirement that a for hire transporter have a license and specifies that a biodiesel provider is not required to have a separate license as a blender.
26	Makes conforming and grammatical changes. It removes definitions that have been incorporated into the definitional statute and it corrects the spelling of the term 'bulk end-user'.
27	Corrects the spelling of the term 'bulk end-user'.
28	Incorporates the defined term 'supplier'.
29	Incorporates the defined term 'in-State supplier'.
30	Provides that an importer's license must indicate the category of the importer, just like a supplier's license must indicate the category of the

supplier.

31	Clarifies the payment responsibilities of all license holders.
32	Specifies when the tax is payable on fuel grade ethanol. Effective January 1, 2009, the tax is payable when it is removed from a terminal or is produced in the State or imported to the State and not delivered to a terminal. Under law, it is taxable when it is blended. Specifies that a tax is payable when motor fuel is transferred 'behind-the-rack' to a person who is not licensed as a supplier, as required by law.
33	Provides that the supplier who sold motor fuel to an unlicensed exporter is jointly and severally liable for the tax imposed on that fuel. The statute provides similar joint and several liability for motor fuel sold to an unlicensed distributor; for motor fuel sold by an unlicensed supplier; and for dyed diesel fuel.
34	Makes a conforming change to the change made in Section 32 concerning taxation of fuel grade ethanol.
35	Makes a conforming change to the change made in Section 32 concerning transfers to unlicensed persons.
36	Corrects a grammatical error.
37	Corrects the spelling of the term 'bulk end-user'.
38	Corrects the spelling of the term 'bulk end-user' and 'end-seller'.
39	Corrects the spelling of the term 'bulk end-user'. Prohibits a supplier from transferring motor fuel from a terminal to a marine vessel unless the person to whom the fuel is transferred is a licensed supplier.
40	Identifies the tax responsibility of purchasers to the supplier.
41	Removes the requirement to sort the fuel by type on the reporting form; the requirement is not longer necessary due to electronic filing. It provides the Department with the ability to sort.
42	Corrects the spelling of the term 'bulk end-user'.
43	Makes a conforming change to administrative practice. It provides that terminal operators who are required to be licensed in this State must report transactions from out-of-state terminals with this State as its destination. It also changes the structure of the statute for uniformity purposes.
44	Requires only motor fuel transporters who transport motor fuel for hire to file reports of fuel movements. This reverses a change made last year that required all distributors and others who transport motor fuel for themselves and not for hire to file the reports.
45	Changes the structure of the statute for uniformity purposes.
46	Changes the catchline of the statute to more accurately reflect the contents of the statute. It specifies that the refunds are monthly refunds; this change reflects current practice. It also provides that an out-of-state bulk end-user

	must be registered as an exporter if requesting a refund for exports from a North Carolina bulk plant.
47	Specifies that the refund is a monthly refund; this change reflects current practice.
48	Corrects the spelling of the term 'end-user'.
49	Deletes the provisions for refunds filed upon application because all refunds are filed on an annual basis, a quarterly basis, or a monthly basis.
50	Clarifies the content of the shipping document.
51	Makes a conforming change to administrative practice and terminology.
52	Uses the defined term 'person'; that term incorporates a distributor.
53	Corrects the spelling of the term 'bulk end-user'. Cross-references the definition of highway to the defined term in the definitional statute.
54-58	Corrects the spelling of the term 'bulk end-user'.
59	Cross-references the defined terms in the definitional statute and renumbers the subdivisions sequentially.
60	Makes a conforming change to add the defined terms of aviation gasoline and jet fuel to the statute that imposes the ¼-cent inspection tax and provides that the tax on these two types of fuel are payable as specified by the Secretary of Revenue.

Part IX: Combined Motor Vehicle and Property Tax Registration System

61	Repeals current statutory provisions on the required memorandum of understanding because they are recodified in G.S. 105-330.11 as enacted by § 64 of this act.
62	Clarifies that an application for property tax exemption or exclusion is not required for vehicles qualifying for an exemption or exclusion listed in G.S. 105-282.1(a)(1). This change prevents the need to apply for an exemption for government owned vehicles and vehicles listed as inventory.
63	Clarifies the statute. Directs the Treasurer to report to Revenue Laws annually instead of semiannually.
64	Recodifies the provisions on the memorandum of understanding required between the Departments of Revenue and Transportation with respect to implementation of the combined collection system for vehicle registrations and property taxes.
65, 66	Delays the effective date of the combined system from July 1, 2010, to July 1, 2011.

Part X: Other Changes

67	Removes a provision that refers to a repealed statute for subdivision.
68	Allows an unauthorized substance tax officer to testify in court concerning an offense committed against that individual in the course of administering the Article. Currently, information obtained under Article 2D (Unauthorized Substance Taxes) is confidential and may not be disclosed, unless the disclosure is made to exchange information with certain law enforcement agencies concerning a tax imposed by the Article. The information may also not be used in a criminal prosecution, other than for a prosecution for a violation of the Article or unless the information is independently obtained. The Department requested this change due to a specific incident involving an officer who was assaulted but was prohibited from testifying about the incident.
69	Corrects an incorrect citation.
70	Clarifies a reference to a 'year' in a tax credit statute is a reference to a 'taxable year.'
71	Codifies the long-standing practice of the Department that it is able to correct errors concerning a taxpayer's liability whenever they are brought to the Department's attention.
72	Makes a clarifying change to the property tax exemption for historic preservation property.
73	Repeals the North Carolina Rural Redevelopment Authority (NCRRA). The NCRRA is an inactive entity. It was created by S.L. 2000-148 but was never appointed or funded. Creation of the Authority was a recommendation of the 1999 North Carolina Rural Prosperity Task Force, which was established by Governor Jim Hunt and chaired by Erskine Bowles. As envisioned by the Task Force, the Authority would administer a revolving loan fund, the Rural Investment Fund, as well as an investment fund, the Long-Term Rural Development Fund. No money was ever appropriated to these funds. Subsection (a) repeals the statutes that create the Authority and set out its duties. Subsections (b) through (e) make conforming changes. Specifically, subsection (b) repeals the Authority's exemption from the general prohibition against a State agency competing with private enterprise. Subsection (c) deletes the Authority from the list of boards and commissions on which legislators may not serve. Subsection (d) repeals the Authority's exemption from the State Personnel Act. Subsection (e) changes a cross-reference to a definition of regional partnership that is now set out in a statute that is repealed in subsection (a); it replaces the cross-reference with the substance of the definition and updates the definition to reflect the accurate names of the regional economic development partnerships.

74	Clarifies that the ½% sales tax for transit purposes authorized for Mecklenburg County exempts purchases of food.
75	Corrects a statutory reference.
76	Provides for the proration of taxation when property in a county law enforcement service district is annexed by a municipality.
77	Corrects proper name of one of the regional partnerships.
78	Provides that information concerning tax credits may be provided to consultants for the Joint Select Committee on Economic Development Incentives to compile statistical data. The consultants are employees of the University of North Carolina at Chapel Hill and are subject to the same confidentiality requirements as an employee of the State of North Carolina.

Tax on Short-Term Heavy Equipment Rentals.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-144	**SB 1852**	**Senator Brunstetter**

AN ACT TO RESOLVE PROBLEMS WITH APPLYING PROPERTY TAX TO HEAVY EQUIPMENT RENTED ON A SHORT-TERM BASIS BY REPLACING THE PROPERTY TAX ON THIS EQUIPMENT WITH A TAX ON THE GROSS RECEIPTS FROM RENTING THE EQUIPMENT.

OVERVIEW: This act replaces the property tax on certain heavy equipment that is offered at retail for short-term lease[79] or rental with a local option gross receipts tax for certain heavy equipment that is offered at retail for short-term lease or rental.

FISCAL IMPACT: No General Fund impact. The act is revenue neutral for local governments overall, however, individual jurisdictions will experience changes in revenue depending on where sales occur.

EFFECTIVE DATE: The property tax exemption for heavy equipment becomes effective for taxes imposed for taxable years beginning January 1, 2009. A local option gross receipts tax on heavy equipment may not become effective before January 1, 2009.

ANALYSIS: This act excludes from property tax certain heavy equipment that is offered at retail for short-term lease or rental, if the heavy equipment is leased or rented by a person whose principal business is the short-term lease or rental of heavy equipment, effective for taxes imposed for taxable years beginning on or after January 1, 2009. It replaces the

[79] A short-term lease is a lease or rental for a period of less than 365 days. (G.S. 105-187.1). Under current law, a long-term lease agreement generally requires the lessee to list and pay the property taxes due on the heavy equipment.

property tax on heavy equipment with a local option gross receipts tax. A local option tax may not become effective before January 1, 2009. The act clarifies that short-term heavy equipment is exempt from property tax regardless of whether a county or city imposes a gross receipts tax. In recent years, several owners of heavy equipment rental businesses expressed concerns about the unfairness and administrative inconsistencies of levying and collecting property tax on this equipment.

The local option tax applies to the gross receipts derived from the short-term rental or lease of earthmoving, construction, or industrial equipment that is mobile, weighs at least 1,500 pounds, and meets one or more of the following requirements:

- It is a self-propelled vehicle that is not designed to be driven on a highway.
- It is industrial lift equipment, industrial material handling equipment, industrial electrical generation equipment, or similar piece of industrial equipment.

The gross receipts tax rate that may be imposed by counties is 1.2% and the rate that may be imposed by cities is 0.8% for a combined rate of 2.0% if the heavy equipment rental business is located in a city. The gross receipts are subject to the local tax only if they are subject to the sales tax.

The gross receipts tax is paid quarterly and is due on the last day of the month following the end of the quarter. The tax is sourced based on the place from which the equipment is delivered and is intended to be added to the amount charged for the rental and paid to the heavy equipment business by the lessee.

The Department of Revenue is authorized to disclose otherwise confidential taxpayer information to counties and cities when it relates to the administration of the heavy equipment rental tax.

Property Tax Modifications.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-146, as amended by S.L. 2008-187[80]	**SB 1878**	**Senator Clodfelter**

AN ACT TO MODIFY THE SCHEDULE FOR GENERAL REAPPRAISALS OF REAL PROPERTY IN THE STATE TO REDUCE THE DISCREPANCY BETWEEN THE PROPERTY TAX VALUE OF PROPERTY AND ITS MARKET VALUE, TO MODIFY THE OWNERSHIP REQUIREMENTS OF PRESENT-USE VALUE PROPERTY TO REFLECT COMMON FORMS OF LAND OWNERSHIP, TO ALLOW PROPERTY TO REMAIN IN PRESENT-USE VALUE WHEN THE DEFERRED TAXES ARE

[80] Section 47.6 of S.L. 2008-187, the 2008 technical corrections bill, eliminates a codification conflict created in House Bill 1889 and Senate Bill 1878.

PAID AT THE TIME OF TRANSFER AND THE NEW OWNER CONTINUES TO FARM THE PROPERTY, TO CLASSIFY LOW-INCOME HOUSING PROPERTY, TO EXCLUDE FROM PROPERTY TAX PRESCRIPTION DRUGS GIVEN AS FREE SAMPLES, TO EXCLUDE FROM PROPERTY TAX EIGHTY PERCENT OF THE APPRAISED VALUE OF A SOLAR ELECTRIC SYSTEM, AND TO DIRECT THE REVENUE LAWS STUDY COMMITTEE TO STUDY THE EFFECT THAT THIS ACT HAS ON STAFFING NEEDS OF THE DEPARTMENT OF REVENUE AND THE DEFINITION OF INCOME AS IT APPLIES TO THE HOMESTEAD EXCLUSION.

OVERVIEW: This act makes the following changes to the property tax laws:

- Part I of the act retains the octennial schedule for reappraisal of real property but requires counties with a population of 75,000 or greater to advance the general reappraisal if the sales assessment ratio for the county drops below .85 or becomes greater than 1.15.[81] This part becomes effective July 1, 2009.
- Part II of the act modifies the present-use value ownership requirements to reflect modern estate planning and allows property to remain in present-use value when deferred taxes are paid at the time of transfer and the new owner continues to farm the land and files an application for present-use value status. This part is effective for taxable years beginning on or after July 1, 2008.
- Part III of the act classifies qualified North Carolina low-income housing developments as a special class of property and requires valuation of the property to be based on the actual (rent-restricted) income. This part is effective for taxes imposed for taxable years beginning on or after July 1, 2009.
- Part IV of the act exempts from property tax free samples of prescription drugs given to physicians and other medical practitioners to dispense free of charge in the course of their practice. This part is effective for taxable years beginning on or after July 1, 2008.
- Part V of the act excludes 80% of the appraised value of a solar energy electric system from property tax. This part of the act is effective for taxable years beginning on or after July 1, 2008.
- Part VI of the act directs the Revenue Laws Study Committee to study the following: whether the Department of Revenue needs positions to perform sales assessment ratio studies in additional counties and other functions related to the act, and the

[81] The Senate version of SB 1878 required counties to advance the general reappraisal if the sales assessment ratio for the county dropped below .90 for the previous year. The House version required counties to advance the general reappraisal if the sales assessment ratio for the county dropped below .70 or became greater than 1.10 for the previous year. The conference report required the advanced general reappraisal only for a county whose population is 75,000 or greater and when the county's sales assessment ratio dropped below .85 or became greater than 1.15.

definition of income as it applies to the homestead exclusion. This part became effective when the act was signed into law by the Governor on August 2, 2008.

FISCAL IMPACT: There is minimal impact on local government revenue associated with the changes to the reappraisal schedule, the PUV ownership requirements, the property tax exemption for sample prescription drugs, and the partial property tax exclusion for solar energy electric systems. The valuation change for low-income housing is estimated to reduce local government revenues by $21 million. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: See **OVERVIEW.**

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

Part I: Reappraisal Schedule

Counties are required to reappraise real property at least once every eight years. The law allows counties to advance the octennial schedule by adopting a shorter cycle, such as every four or six years. Each year, the Department of Revenue studies property values in every county and compares the value of the parcels as a function of their sales price with the value of the parcels as indicated by their assessed tax value. The Department notifies each county of the resulting sales assessment ratio on April 15 of the year following the study.

The act requires a county with a population of 75,000 or greater to advance its octennial reappraisal schedule if its sales assessment ratio drops below .85 or becomes greater than 1.15 in the previous year.[82] This change would occur when the assessed value differs from the sales price of the property by more than 15%. A county required to conduct a new reappraisal under this act must implement the new values by January 1 of the third year following the year the notification of the triggering sales assessment ratio was made. The act retains the octennial reappraisal schedule for all other counties. This part of the act becomes effective July 1, 2009, and applies to notices sent on or after that date.

The genesis for this Part came from a recommendation of the Revenue Law Study Committee. The act directs the Revenue Laws Study Committee to study the effect of the changes to the reappraisal schedules in this Part. Its study of the issue should consider whether new positions within the Department of Revenue are needed to perform sales assessment ratio studies in additional counties each year. This directive to the Committee was prompted by concerns raised by some of the smaller counties regarding whether they could handle the expense of more frequent reappraisals.

Part II: Present-Use Value Property Changes

Part II of the act makes changes to the present-use value (PUV) program, as recommended by the Revenue Laws Study Committee. These recommendations were proposed to the Committee by representatives of county tax assessors, the North Carolina Association of County Commissioners, the UNC School of Government, the North Carolina Farm Bureau,

[82] According to the most recent annual population estimates as certified by the State Budget Officer, each of the following counties has a population of 75,000 or greater: Alamance, Brunswick, Buncombe, Burke, Cabarrus, Caldwell, Catawba, Cleveland, Craven, Cumberland, Davidson, Durham, Forsyth, Gaston, Guilford, Harnett, Henderson, Iredell, Johnston, Mecklenburg, Moore, Nash, New Hanover, Onslow, Orange, Pitt, Randolph, Robeson, Rockingham, Rowan, Union, Wake, Wayne, and Wilson.

and the Department of Revenue. The changes are effective for taxes imposed for taxable years beginning on or after July 1, 2008.

The General Assembly created the PUV program in 1973. The program provides that farmland meeting certain ownership, size, and use requirements will be provided special property tax treatment.[83] The land is appraised and taxed at its PUV as opposed to its fair market value.[84] The difference between the taxes due on the PUV and taxes that would have been payable in the absence of the special tax treatment is known as 'deferred taxes'. When the land no longer qualifies for PUV treatment, the taxpayer is liable for the property taxes due in the year of disqualification plus the deferred taxes for the three previous years, with interest.[85]

In recent years, taxpayers as well as county tax assessors have voiced concerns about the complexities of the ownership requirements, and taxpayers have raised concerns about the perceived unfairness of these requirements. For example, qualifying land had to be individually owned, which meant that the land could be owned by a natural person, a business entity, a tenancy in common, a trust or a testamentary trust. If the land was owned a business entity or trust, all members of the business entity had to be natural persons, and beneficiaries of a trust had to be natural persons. If the land was owned by tenants in common, then a tenant in common could be a natural person or a business entity but not a trust. These restrictions did not allow for the use of modern estate planning vehicles such as a family limited partnership or family limited liability company. There was also no rationale for excluding certain trusts as a tenant in common.

The act addresses some of these concerns by changing the definition of 'individually owned' as follows:

- The awkward reference to 'owned by a natural person' is changed to 'owned by an individual'.
- Members of a business entity are no longer restricted to individuals and now include trusts and other business entities. A qualified business entity, however, may not be a corporation whose shares are publicly traded and none of its

[83] The farmland must be used for agricultural, horticultural, or forest purposes and be engaged in commercial production under a sound management program. Agricultural and horticultural land are also required to have one tract that produces at least $1,000 average gross income for the three years preceding the year the tax benefit is claimed. During the 2007 Session, the agricultural land classification was amended to include agricultural land used as an aquatic species farm, effective in the 2008-2009 tax year. During the 2008 Session, the PUV statutes were amended to allow property appraised at PUV and subject to a conservation easement to continue to qualify for use value appraisal if the taxpayer received no more than 75% of the fair market value of the donated property as compensation. Also wildlife conservation land was designated a special class of property for property tax purposes and authorized to be appraised and taxed as if it were classified as agricultural land under the PUV system. See S.L. 2008-171

[84] PUV is usually much less than market value.

[85] No deferred taxes are due if the property loses its classification for one of the following purposes: (1) the land is enrolled in the federal Conservation Reserve Program and is no longer in production and therefore does not meet the income requirement, (2) the land is conveyed by gift to certain exempt organizations and governmental entities. This applies to conveyances by gift to nonprofit organizations where the property will qualify for exclusion from the tax base because it is real property that will be exclusively used for educational and scientific purposes as a protected natural area, or where the property will be exclusively used for nonprofit historic preservation purposes, or (3) the property is conveyed by gift to the State, political subdivisions of the State, or the United States.

members may be corporations whose shares are publicly traded. When the membership of a business entity includes a business entity or a trust, then all members of the business entity and all beneficiaries of the trust must be individuals. These individuals are deemed to be indirect members of the qualified business entity.[86] The law continues to require the principal business of the business entity to be in agriculture, horticulture, or forestry, and each member must be actively engaged in one of these activities or related to a member who is actively engaged in one of these activities. Also, if the land is leased, all members of the business entity must be individuals and relatives.

- Beneficiaries of a trust may be a business entity as long as the members of the business entity are individuals who either created the trust or who are relatives of the creator. These individuals are deemed to be indirect beneficiaries.
- A tenant in common may include a trust in addition to an individual and business entity.

The following are examples of land that now qualify for PUV under the act, but would not have qualified under the prior law:

- A corporation applies for PUV. Four shareholders of the corporation are individuals who are actively engaged in farming the land and one shareholder is an LLC. The members of the LLC are all relatives of one of the individual shareholders. Under prior law, the corporation would not qualify because it has an LLC as a member.
- A tenancy in common applies for PUV, and one of the tenants is a trust. Under prior law, the property would not qualify because all tenants were required to be individuals or business entities.
- An LLC applies for PUV, and one of the members of the LLC is a trust. All beneficiaries of the trust are children of the individual members of the LLC that owns the land. Under prior law, the LLC would not qualify because the trust was not an individual.

There has been a long-standing exception to the standard ownership requirement that a person must own the land for four years. Under the exception, land may continue to be appraised at its PUV value when it is transferred to a new owner and the new owner (i) continues to use the land for its current PUV classification, (ii) files an application for PUV, and (iii) assumes the deferred taxes. This exception has been interpreted not to apply when the seller pays more than the current year's taxes at the time of transfer. In this situation, the seller is deemed to have voluntarily removed the property from the PUV program, and the new owner may have to wait four years to qualify for PUV. The act allows the land to remain in PUV when the deferred taxes are paid at the time of transfer. The new owner will

[86] The indirect ownership determination does not stop at the first tier of the business entity that owns farmland. For example, if a business entity has as one of its members an LLC and one of the members of the LLC is another LLC, then the indirect ownership will apply to any member of the second LLC if the member is an individual who is actively engaged in farming the land or a relative of an individual who is actively engaged in farming the land.

become liable for subsequent deferred taxes when the land no longer qualifies for the PUV program.[87]

Part III: Low-Income Housing Property

Part III of the act provides an additional property tax incentive for owners of low-income housing developments to which the North Carolina Housing Finance Agency has allocated a federal tax credit, effective for taxes imposed for taxable years beginning on or after July 1, 2009. Under prior law, an assessor appraised low-income qualified property using one of the following three generally accepted methods of appraisal:

- Cost approach - estimates property value by summing the land value and the depreciated value of any improvements.
- Income approach - estimates value by capitalizing an income stream into present value through the use of capitalization rates of the net operating income[88] which is usually by dividing the annual NOI by the capitalization rate.
- Sales comparison approach – estimates value by comparing a property's characteristics with those of comparable properties which have recently sold in similar transactions.

The act requires the assessor to use the income approach to determine the tax value of property allocated housing tax credits. The tax assessor must take into account any applicable rent restrictions and may not include tax credits as income of the property if those credits result from section 42 of the Internal Revenue Code or G.S. 105-129.42. In so doing, the property value determination is constrained solely to the use of the actual rental income as opposed to what a similarly situated property would be able to generate in rental income if the property were not subject to rent restrictions.

In 1986, Congress enacted the federal Low Income Housing Tax Credit to fund housing for low- and moderate-income households. Each state receives a limited amount of credit each year. The Internal Revenue Service (IRS) allocates the per capita low-income housing tax credit to state housing agencies such as the North Carolina Housing Financing Agency (HFA), which in turn allocate the credit to project developers who agree to lower project rents for low-income tenants. In 1999, North Carolina authorized a State income tax credit modeled after the federal housing credit. The State credit permits a taxpayer to receive the credit in the form of either (i) a credit against tax liability or (ii) a loan generated by transferring the credit to the HFA in return for a 0% interest 30-year balloon loan equal to the credit amount.[89] Neither a tax refund generated by the credit, nor a loan received as a result of the transfer of the credit is considered taxable income by the State.

Part IV: Prescription Drugs Given as Free Samples

Part IV of the act exempts from property tax free samples of drugs that are required by federal law to be dispensed only on prescription and are given to physicians and other

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[87] See Section 2.2 of S.L. 2008-35.

[88] The capitalization rate is a measure of the ratio between the cash flow produced by an asset and either the price paid for the asset or its current market value. The Net Operating Income (NOI) equals gross potential income minus vacancy minus operating expenses (excluding debt service or depreciation charges).

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

medical practitioners to dispense free of charge in the course of their practice, effective for taxable years beginning on or after July 1, 2008. Under prior law, drug samples in doctors' offices were treated as business personal property or supplies and subject to property tax. These drug samples do not come under the definition of inventory, which is exempt from property tax, because they are not goods held for sale in the regular course of business.

Part V: Solar Energy Electric Systems

Part V of the act exempts 80% of the appraised value of a solar energy electric system from property tax, effective for taxable years beginning on or after July 1, 2008. A solar energy electric system converts solar energy into electricity.[90] Currently, there are no solar energy electric systems being taxed. However, there are plans to construct a massive solar power plant in Davidson County which is expected to provide enough power for 2,600 homes. Also, two systems were built this year in Asheboro and Raleigh.

North Carolina provides other tax incentives for solar energy. G.S. 105-277(g) designates buildings equipped with solar energy heating and cooling systems as a special class of property and, for property tax purposes, assesses the buildings as if they are equipped with a conventional heating or cooling system rather than assign an additional value for the difference in cost between the solar energy or cooling system and a conventional system typically found in the county.[91] G.S. 105-129.16A and G.S. 105-129.16H provide an income tax credit for investing in renewable energy property, which would include a solar energy electric system. The credit is equal to 35% of the cost of the property placed in service. For non-residential property the maximum credit is $2.5 million per installation.

Economic Development Modifications.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-147	**SB 2075**	**Senator Berger of Franklin**

AN ACT TO CLARIFY QUALIFICATIONS FOR THE EXCEPTION FOR MULTIJURISDICTIONAL INDUSTRIAL PARKS TIER DESIGNATION AND TO PROVIDE FOR A TEMPORARY INCREASE IN THE CAP ON AMOUNTS COMMITTED UNDER THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM.

OVERVIEW: This act clarifies that the sale of parcels of land from a multijurisdictional industrial park (MIP) for industrial or commercial purposes does not change the original tier status of the MIP or the availability of the incentives to successive purchasers based on its original tier status. It also increases the cap on amounts committed under the Job Development Investment Grant Program (JDIG).

[90] S.L. 2007-307 requires utilities to provide a designated amount or percentage of power from renewable energy resources as a portion of their overall provision of electricity.
[91] This classification does not include solar energy electric systems.

FISCAL IMPACT: The total maximum cost of increasing the JDIG cap will be $120 million, or $10 million per year for the next 12 years. This estimate assumes that the maximum amount of total annual liability is awarded.

EFFECTIVE DATE: This act became effective when signed by the Governor on August 2, 2008.

ANALYSIS: Any two or more units of local government may enter into contracts or agreements to jointly undertake the development of an industrial or commercial park or site. The lowest development tier incentive status is granted to the entire MIP, regardless of the tier designation of each individual county, if certain criteria are met. One of the criteria is that there be 250 developable acres in each county where the park is located. As a county sells property in the MIP to businesses to carry out the purposes of the MIP, a county may not be able to meet the prerequisite number of acres it must own in the MIP. This act clarifies that the sale of parcels of land from a MIP for industrial or commercial purposes does not change the original tier status of the MIP or availability of the incentives to successive purchasers based on its original tier status.

The act also temporarily raises the maximum amount of total annual liability for grants for agreements entered into in calendar year 2008 under the Job Development Investment Grant Program from fifteen million dollars ($15,000,000) to twenty-five million dollars ($25,000,000).

Supplemental PEG Support.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-148	**SB 1716**	**Senator Clodfelter**

AN ACT TO CLARIFY THE DISTRIBUTION OF SUPPLEMENTAL PEG SUPPORT FUNDING AND TO CLARIFY THAT THE SERVICE AREA OF A CITY INCLUDES ANY AREA SUBSEQUENTLY ANNEXED BY THAT CITY.

OVERVIEW: This act does the following:

- It clarifies the distribution of supplemental PEG channel support funding. This part of the act was a recommendation of the Revenue Laws Study Committee, the League of Municipalities, and the Southeast Association of Telecommunications Officers and Advisors.
- It amends the video franchising statutes to clarify that, if the stated boundary of a cable service district is the boundaries of a city, the service area includes any subsequent annexations by the city.

FISCAL IMPACT: This act is expected to have no fiscal impact on General Fund revenues.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 2, 2008, and affects distributions made in fiscal year 2008-2009.

ANALYSIS: In 2006, the General Assembly established uniform taxes for video programming services by applying the combined general rate of sales tax to all video programming services and by repealing the authority local governments had to impose a local franchise tax. It preserved the local government revenue stream by distributing part of the sales tax revenues from telecommunications and video programming services to the counties and cities, based on the amount of cable franchise tax imposed during the first six months of fiscal year 2006-2007 plus any subscriber fees imposed during that same period.[92]

Of the revenue distributable to local governments, $2 million a year is allocated for supplemental PEG channel support. A PEG channel is a public, educational, or governmental access channel provided to a county or city. The $2 million allocation is distributed to counties and cities with qualifying PEG channels. The annual amount per qualifying PEG channel is $25,000. A county or city may not receive supplemental PEG channel support for more than three PEG channels. The amount distributed to a county or city as supplemental PEG channel support must be used by it for the operation and support of PEG channels. If the total amount distributed for qualifying PEG channels in a fiscal year is less than $2 million, the Secretary must credit the excess amount to the PEG Channel Fund to be used for matching local grants for PEG channel support.

When the General Assembly considered the legislation in 2006, the available data indicated there would be 36 qualifying PEG channels. For the March 2008 distribution, the Department of Revenue received PEG channel certifications for 276 channels. Some of the discrepancy is believed to be due to confusion on the form used by the Department which may have resulted in some channels being double counted or receiving a distribution when they did not qualify.

The act clarifies the distribution requirements, reduces the number of channels receiving the distribution, and provides that all qualifying PEG channels receive supplemental PEG support funding. The act defines in the distribution statute what constitutes a 'qualifying PEG channel' (a channel with character generated programming that does not exceed 15% of eight hours of scheduled programming and is operated for at least 90 days during the year). A county or city must certify all qualifying PEG channels and allocate the proceeds it receives equally among all of its certified PEG channels. A distribution must be made to the PEG channel within 30 days of the county or city's receipt of the supplemental PEG support revenue. This modifies the prior law, in which a county or city could only receive supplemental funding for three PEG channels. These changes address the concerns of some qualifying PEG channels regarding whether supplemental funding is being distributed fairly among the channels by ensuring (i) that each qualifying PEG channel receives supplemental funding, even if a county or city has more than three qualifying channels; (ii) that each qualifying PEG channel receives an equal amount of funding; and (iii) that each qualifying PEG channel receives the funding in a timely manner.

The act also defines a PEG channel operator, requires a county or city to include the name of the PEG channel operator for each qualifying PEG channel it certifies, and requires the

[92] The purpose of using the 'first six months of fiscal year 2006-2007' was to capture the most recent local franchise tax rates imposed on cable companies and the most recent subscriber fees imposed on consumers of cable service.

county or city to distribute the proceeds to the PEG channel operator. This change better ensures that the money is distributed by the local government for the use of the PEG channels. In addition, where a single PEG channel has more than one operator or the PEG channel is claimed by more than one local government, the change ensures that the funds go to the operator of the PEG channel. It limits a PEG channel operator from being included in multiple certifications for the same PEG channel, which should reduce the number of qualifying PEG channels by eliminating much of the double counting that currently occurs. The act also provides a method to account for revenues that are distributed in error by requiring any county or city that received a distribution in error to submit a revised certification and return all funds received in error. Such funds are added to the amount to be distributed in the following year as supplemental PEG support funding.

Finally, the act allows the Secretary of Revenue to request additional information and extends from July 15, 2008, to September 15, 2008, the period of time a county and city has to make its certification in 2008. The act permits the Department to make the distribution of supplemental PEG channel support for the quarter ending June 30, 2008, based upon the qualifying PEG channel certifications in effect for fiscal year 2007-2008 distributions.

The Senate added a provision to the enacted legislation to address an issue with the video franchising statutes. The act amends the video franchising statutes to clarify that, if the stated boundary of a cable service district is the boundaries of a city, the service area includes any subsequent annexations by the city. Prior law was interpreted as requiring a new notice of franchise to be filed for the newly annexed area. The act requires a new filing only if the original notice of franchise stated that the boundaries of the service area were the boundaries of the city, as those boundaries existed on a day certain.

Sales Tax Refund for Certain Nonprofits.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-154	**HB 2509**	**Representative Gibson**

AN ACT TO AUTHORIZE A SEMIANNUAL SALES AND USE TAX REFUND TO A NONPROFIT ORGANIZATION THAT PROCURES, DESIGNS, CONSTRUCTS, OR PROVIDES FACILITIES TO A CONSTITUENT INSTITUTION OF THE UNIVERSITY OF NORTH CAROLINA.

OVERVIEW: This act allows a semi-annual refund of sales and use taxes paid by a nonprofit organization that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina.

FISCAL IMPACT: The act is estimated to reduce General Fund revenues by more than $1.5 million in fiscal year 2008-2009 and by approximately $450,000 in each year thereafter. The act will also reduce local revenues by $810,000 in fiscal year 2008-2009 and by approximately $190,000 each year thereafter. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective retroactively to January 1, 2004, and applies to purchases made on or after that date. A refund claim for the period January 1, 2004 through December 31, 2007, will be considered timely filed if it is submitted to the Department of Revenue by October 15, 2008.

ANALYSIS: Direct purchases by a State agency, which by definition includes The University of North Carolina, may be exempt from State and local sales and use tax.[93] A State agency may also receive a quarterly refund of local sales and use taxes paid by it indirectly on building materials, supplies, fixtures, and equipment that become part of a facility owned or leased by the agency.[94] This act provides similar sales and use tax treatment to a nonprofit entity that procures, designs, constructs, or provides facilities to a constituent institution of The University of North Carolina[95] by expanding the list of nonprofit organizations allowed a semi-annual refund of sales and use tax to include this type of nonprofit organization. The act specifically allows the refund to an entity exempt from taxation as a disregarded entity of such a nonprofit organization.

The act provides a refund to a type of nonprofit entity that was denied a sales tax refund from the Department of Revenue in 2004 on the grounds that the nonprofit organization did not qualify as one of the statutorily eligible entities.[96] One such entity, Affinity Housing LLC, filed a lawsuit against the Department challenging the Department's denial of its refund claim. Affinity Housing LLC is a single-member LLC of Western Carolina University Research and Development Corporation, a section 501(c)(3) nonprofit entity formed to aid and promote the educational and charitable purposes of Western Carolina University. Affinity Housing LLC constructs housing facilities for WCU. The act makes the application of the change retroactive to January 1, 2004, and applicable to purchases made on or after that date. This time period will allow Affinity Housing LLC to receive the refund it originally sought.

Constituent institutions of The University of North Carolina have begun to use nonprofit organizations to procure, design, and construct facilities, such as student housing and dining facilities, on their behalf. An institution leases property to a nonprofit organization and the nonprofit organization constructs the facility on the property. The institution leases the facility from the nonprofit and usually operates and manages the facility. The lease payments made by the institution, recouped through rents charged to students, enable the nonprofit to pay the indebtedness on the facility. At the conclusion of the lease and the retirement of the debt, the ownership of the facility lies with the institution. The General Assembly recognized the trend in 2004 when it expanded the property tax exemption for educational property[97] by exempting property held by a nonprofit entity for the sole benefit of a university located in the State and by expanding the definition of educational purposes to include the operation of a student housing facility or a student dining facility.[98]

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[93] G.S. 105-164.13(52).

[94] G.S. 105-164.14(e).

[95] A constituent institution would include the universities as well as the North Carolina School of the Arts and the North Carolina School of Science and Mathematics. See G.S. 116-4.

[96] See analysis of Section 28.22 of S.L. 2008-107. It specifies the type of nonprofit entities entitled to a sales and use tax refund. The nonprofit entity described in this act does not meet the criteria developed by that act.

[97] G.S. 105-278.4

[98] S.L. 2004-173

The above process has continued to evolve. The institutions have found that privatized facility projects cost less to construct and are completed sooner than traditional facility projects, primarily because the projects are not subject to the State's bidding laws and construction process. At its inception, some of the financing was private financing. Increasingly, the financing is secured through self-liquidating revenue bonds. Today, most of these projects are included in the bond projects submitted to the General Assembly for its approval by The University of North Carolina. The Treasurer's Office exercises oversight of the lease agreements between the institutions and the nonprofit entities.

Resale of Tickets via Internet.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-158	**SB 1407**	**Senator Hartsell**

AN ACT TO PROTECT CUSTOMERS WHEN PURCHASING TICKETS VIA THE INTERNET AND TO PROHIBIT THE USE OF SOFTWARE TO UNFAIRLY PURCHASE TICKETS OVER THE INTERNET.

OVERVIEW: The act allows the Internet resale of admission tickets in excess of the price printed on the ticket unless the venue where the event occurs prohibits resale, and it prohibits the use of software to unfairly purchase tickets.

FISCAL IMPACT: No fiscal impact estimate is available at this time.

EFFECTIVE DATE: The act became effective when signed into law by the Governor on August 3, 2008, and expires June 30, 2009. Liability and duty to report are not affected by the expiration date of the act.

ANALYSIS: Under current law, it is a Class 2 misdemeanor for a seller or reseller of an admission ticket to charge more than "…the combined face value of the ticket, tax,[99] and the authorized service fee.[100] Because reselling tickets online is a new and growing business, the act provides an exception to the prohibition against admission tickets being resold on the Internet at a price greater than the price printed on the face of the ticket.

The act includes a number of provisions designed to protect the customer and the venue. First, the act makes it an unfair and deceptive trade practice for a person to knowingly sell, give, transfer, use, distribute, or possess software that is primarily designed or produced for the purpose of interfering with the operation of a ticket seller who, pursuant to a written agreement with the venue, sells admission tickets over the Internet. A ticket seller, as well as the venue, has standing to bring a private right of action under the Unfair and Deceptive Trade Practice Act. Under G.S. 75-1.1, each individual violation of the statute constitutes a

[99] The tax on the sale of admission prices for entertainment events is a gross receipts tax of 3%. See G.S. 105-37.1.

[100] The service fee is limited to no more than $3.00 unless the promoter of the event and the ticket sales agency, in writing, agree to and make known to the public a different amount.

separate violation. If a person is found to have violated the statute, the aggrieved person is entitled to treble the amount of damages fixed by the verdict. The act requires a person who resells admission tickets to report to the Department of Revenue by the 10th day after the end of each month on the gross receipts received during the previous month from reselling admission tickets for events in the State. The report must include the total amount of gross receipts derived from resell activity (minus the face value on the tickets), the event and venue for which each ticket was sold, the entity from which the reseller purchased each ticket, the amount the reseller paid for each ticket, the price received by the reseller for each ticket, the name and address of reseller-purchasers of each ticket, and any other information required by the Department.

In addition, the act requires a person who resells admission tickets online to provide a ticket guarantee that must be conspicuously displayed on the person's Website and to direct a prospective purchaser to the ticket guarantee before completion of a resale transaction. Additionally, the ticket guarantee must provide a purchaser with a full refund of the amount paid for the ticket if the event is cancelled, the purchaser is denied admission through no fault of the purchaser, or the ticket is not delivered to the purchaser and the failure to receive the ticket results in the purchaser's inability to attend the event. A person may withhold handling and delivery fees from a refunded amount if the Website informs the purchaser of this policy. Finally, a venue may prohibit a person from reselling tickets to an event it sponsors if it files a notice of prohibition with the Secretary of State and posts the notice on its Website and on the Website of the primary ticket seller. A prohibition may not become valid until 30 days after the notice is posted on the Website. The prohibition expires on December 31 of each year unless the venue renews its prohibition.

The bill, as originally introduced in the Senate, provided for the imposition of a 3% gross receipts privilege tax on the difference between the price of the ticket sold and the face price on the ticket.[101] This provision was deleted from the bill when the bill was in the House Finance Committee. The sunset date will necessitate the General Assembly revisiting this issue during the 2009 Session.

Future Conveyances/Special Assessments.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-165, as amended by S.L. 2008-187	**HB 1770**	**Representative McComas**

AN ACT TO CLARIFY THE AUTHORITY OF THE PARTIES TO CONSERVATION AND PRESERVATION AGREEMENTS TO INCLUDE PROVISIONS IN THE AGREEMENTS FOR THE PAYMENT OF FEES UPON FUTURE CONVEYANCE OF PROPERTY SUBJECT TO THE AGREEMENTS AND TO ALLOW SPECIAL ASSESSMENTS TO BE PAID IN MORE THAN TEN ANNUAL INSTALLMENTS AND TO BE PLEDGED TO THE

[101] The gross receipts tax is currently imposed on the face price of the ticket when it is originally sold.

REPAYMENT OF REVENUE BONDS ISSUED FOR CRITICAL INFRASTRUCTURE NEEDS.

OVERVIEW: Sections 2 and 3 of this act give counties and cities an opportunity to finance long-term capital projects related to water and sewer infrastructure, stormwater infrastructure, public transportation, schools, and roads through the issuance of revenue bonds that will be paid by levying special assessments on the affected properties. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: There is no impact on General Fund revenues.

EFFECTIVE DATE: These sections became effective when signed into law by the Governor on August 3, 2008, and expire on July 1, 2013. The expiration does not affect the validity of assessments imposed or bonds issued or authorized under the provisions of this act prior to the effective date of the expiration.

ANALYSIS: Sections 2 and 3 of this act give counties and cities an opportunity to use assessments as a financing tool for long-term capital projects related to water and sewer infrastructure, stormwater infrastructure, public transportation, schools, and roads. The act accomplishes this goal by enacting new articles within Chapter 153A and Chapter 160A supplementing the current authority counties and cities have to levy assessments and issue revenue bonds.[102] Counties and cities will be able to pay for a project for which an assessment is imposed solely with revenue bonds to be paid from the assessments or from a combination of financing sources that include revenue bonds, general obligation bonds, and general revenue. This change will particularly aid counties and cities that face increased demands for infrastructure improvements as a result of rapid growth and development. The act gives counties and the cities located within the counties the authority to impose assessments for the following projects:

- Providing sanitary sewer systems, including community sewerage facilities for the collection, treatment, and disposal of sewage or septic tank systems and other on-site collection and disposal facilities or systems.
- Providing storm sewers and flood control facilities, including levees, dikes, diversionary channels, drains, catch basins, and other facilities for storm water drainage.
- Providing water systems, including facilities for the supply, storage, treatment, and distribution of water.
- Providing public transportation facilities, including equipment for public transportation, buses, surface and below ground railways, ferries, and garage facilities.
- Providing school facilities, including schoolhouses, buildings, plants and other facilities, physical and vocational educational buildings and facilities, including in connection therewith classrooms, laboratories, libraries, auditoriums, administrative offices, gymnasiums, athletic fields, lunchrooms, utility plants, garages, and school buses and other necessary vehicles.

[102] See Article 9A of Chapter 153A (Counties) and Article 10A of Chapter 160A (Cities and Towns) of the act.

- Providing streets and sidewalks, including bridges, viaducts, causeways, overpasses, underpasses, and alleys; paving, grading, resurfacing, and widening streets; sidewalks, curbs and gutters, culverts, and drains; traffic controls, signals, and markers; lighting; and grade crossing and the elimination thereof and grade separations.

The governing body of a county or city may not impose assessments under the new articles unless it receives a petition for the project to be financed through assessments signed by at least a majority of the owners of the property assessed. The county board of commissioners or city council must establish an assessment method that will most accurately assess property according to the benefits conferred upon it by the project for which the assessment is made. In establishing the assessment method, the county board of commissioners or city council must first determine the project's total estimated cost, and a preliminary assessment roll may then be prepared before the costs of the project are incurred based on the estimated cost of the project.[103] Unlike assessments currently imposed under Article 9 of Chapter 153A and Article 10 of Chapter 160A, the cost of assessments imposed for these infrastructure projects may include any expenses allowed under the State and Local Government Revenue Bond Act. The primary expense allowed under the Revenue Bond Act that is not considered under Article 9 and Article 10 is interest on the bonds or notes issued in anticipation of the revenue bond issuance during construction and an establishment of debt service reserves. Also, unlike assessments the county or city may currently impose, assessments issued for long-term infrastructure projects under the act must be paid in annual installments over a period not to exceed 30 years.[104] These annual payments are due on the date property taxes are due.

In addition to other financing tools available for infrastructure projects, the act provides that an infrastructure project for which an assessment may be imposed under the new articles may be considered a revenue bond project for purposes of the State and Local Government Revenue Bond Act, and that the assessments imposed under the new articles may be considered revenues for purposes of the Act. All of the provisions governing revenue bonds in Article 5 of Chapter 159 apply to the new articles. To issue revenue bonds, a county or city must first apply to the Local Government Commission (LGC) for approval of the revenue bond issue. The State and Local Government Revenue Bond Act sets forth the matters the LGC must consider before giving a county or city approval to issue revenue bonds. It must determine that the proposed revenue bond issue is necessary, that the amount proposed is adequate and not excessive, that the proposed project is feasible, that the county's or city's debt management procedures and policies are good, and that the proposed revenue bonds can be marketed at reasonable interest costs.

Except as otherwise provided under these new articles, the provisions for imposing special assessments under Article 9 of Chapter 153A and Article 10 of Chapter 160A apply to the special assessments imposed under these new articles. Under Article 9 and Article 10, when a county or city decides to finance all or part of a project by special assessments, it must first adopt a preliminary assessment resolution that describes the project, the proposed basis for making the assessment, and information concerning the cost of the work and the terms of

[103] Sections 47.5.(a) and (b) of S.L. 2008-187, the 2008 technical corrections bill, clarify that a preliminary assessment roll may be prepared based on the estimated cost of the project, corrects a statutory reference, and adds a phrase that was inadvertently omitted.

[104] Assessments under Articles 9 and 10 must be paid in full unless the county or city provides that they may be paid in annual installments, which may not be more than 10 years.

payment of the assessment. If the basis for making the assessment is either the area of land benefited by the project or the valuation of the land benefited by the project, then the resolution must contain a description of the boundaries of the area benefited. The county or city must hold a public hearing on the matter, prepare a preliminary assessment roll, and publish a confirmation of the assessment roll once it is adopted. An owner of property against which an assessment is made may file a notice of appeal to the General Court of Justice if the owner is dissatisfied with the amount of the assessment. Unpaid assessments bear interest at a rate fixed in the assessment resolution. A county or city may foreclose assessment liens under procedures provided by law for the foreclosure of property tax liens.

Wildlife Land Property Tax Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-171	**HB 1889**	**Rep. Harrison, Gibson, Hill, Brubaker**

AN ACT TO PROVIDE PROPERTY TAX RELIEF FOR QUALIFYING WILDLIFE CONSERVATION LAND, TO CLARIFY THE PRESENT-USE VALUATION OF PROPERTY SUBJECT TO A CONSERVATION EASEMENT, AND TO PROVIDE A PROPERTY TAX EXEMPTION FOR LEASEHOLD INTEREST IN CERTAIN EXEMPTED PROPERTY.

OVERVIEW: This act does three things:

- It designates wildlife conservation land as a special class of property for property tax purposes and provides that it may be appraised and taxed as if it were classified as agricultural land under the present-use value system. This part of the act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2010.
- It provides that property appraised at its present-use value will continue to qualify for present-use value when the owner donates the property for conservation purposes so long as the property is subject to a conservation easement that qualifies for the conservation income tax credit for donated lands and the owner received no more than 75% of the fair market value of the donated property as compensation. This part of the act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2010.
- It exempts from property tax a leasehold interest in property if the property itself is exempt from property tax because it is owned by a unit of government and the property is used to provide affordable housing for employees of the unit of government that owns the property. This part of the act became effective for taxes imposed for taxable years beginning on or after July 1, 2008.

FISCAL IMPACT: The fiscal impact of this act will affect local government revenues. The North Carolina Wildlife Commission has indicated that no reliable data is available regarding

the number of acres that may qualify for the wildlife conservation classification; therefore, no estimate is available for this part of the act. The difference in the assessed value of property subject to a conservation easement and property in the present-use value program do not significantly differ; therefore this part of the act is expected to have minimal impact. Lastly, the act provides a property tax exemption for certain leasehold interests in exempt property. At the present time, Dare County is the only county that has property that will be impacted by this change and the impact is expected to be minimal.

EFFECTIVE DATE: See the **OVERVIEW**.

ANALYSIS: The act establishes a new property tax classification for property used for wildlife conservation and values that property at its value as agricultural land rather than its fair market value. It clarifies the present-use valuation of property subject to a conservation easement, and it exempts from property tax a leasehold interest in certain property used to provide affordable housing.

Wildlife Conservation Land. – Since 1973, the General Assembly has provided special property tax treatment for farmland that is classified and used for agricultural, horticultural, or forest purposes. If the farmland meets certain ownership and size requirements and is engaged in commercial production under a sound management program, the land may be appraised and taxed at its present-use value (PUV) as opposed to its fair market value. Agricultural land and horticultural land must also meet an income requirement: the land must have one tract that produced at least $1,000 average gross income over the three preceding years. The difference between the taxes due on the PUV and the taxes that would have been payable in the absence of the special tax treatment are known as deferred taxes. When the land becomes disqualified for PUV, the land is taxed at its fair market value for the year in which it loses its classification and the deferred taxes for the three previous years become due and payable, with interest.

During the 2007 session, the General Assembly extended PUV treatment and classification to land used as an aquatic species farm[105] and to working waterfront property.[106] This act extends PUV treatment to property used for wildlife conservation. To be eligible for this classification, the property must meet the following size, ownership, and use requirements:

- **Size.** – The land must consist of at least 20 contiguous acres. An owner may not classify more than 100 acres of land as wildlife conservation land within a county.
- **Ownership.** – The land must be owned by an individual, a family business entity[107] or a family trust[108] and it must have been owned by the same owner for the previous five years. Land owned by a business entity[109] is not eligible for PUV classification if

[105] Part III, S.L. 2007-497.
[106] Part I, S.L. 2007-485.
[107] A family business entity is defined as a business entity whose members are, directly or indirectly, individuals and relatives. An individual is indirectly a member of a business entity if the individual is a member of a business entity or a beneficiary of a trust that is part of the ownership structure of a business entity.
[108] A family trust is defined as a trust that was created by an individual and whose beneficiaries are, directly or indirectly, individuals who are the creator of the trust or a relative of the creator. An individual is indirectly a beneficiary of a trust if the individual is a beneficiary of another trust or a member of a business entity that has a beneficial interest in the trust.
[109] A business entity is defined as a corporation, a general partnership, a limited partnership, or a limited liability company.

the business entity is a corporation whose shares are publicly traded or one of its members is a corporation whose shares are publicly traded. The act provides these exceptions to the ownership requirements:

- The 5-year time period is considered met if the land has been owned by a member of the family business for five years or if owned by a beneficiary of the family trust for five years.[110]
- The 5-year time period is waived if the property acquired was classified as wildlife conservation land in the hands of the previous owner and the current owner continues to use the land as wildlife conservation land. To classify property under this exception, the new owner must file an application for PUV and must sign the wildlife habitat conservation agreement in effect for the property within 60 days after acquiring it.

- **Use.** – The land must meet both of the following use requirements:
  - The land is managed under a wildlife habitat conservation agreement[111] with the North Carolina Wildlife Resources Commission and the agreement is in effect as of January 1 of the year for which the benefit is claimed. The agreement must require the owner to manage the land to protect an animal species that lives on the land and is on a North Carolina protected animal list published by the Commission[112] or to conserve one of the following priority animal wildlife habitats: longleaf pine forest, early successional habitat, small wetland community, stream and riparian zone, rock outcrop, or bat cave.
  - The land must have been classified as either agricultural, horticultural, or forest land under the PUV classification when the wildlife conservation agreement was signed. This requirement may be waived if the owner can demonstrate to both the Wildlife Resources Commission and the county tax assessor that the owner used the land for a purpose specified in the signed wildlife conservation agreement for three years preceding the year for which the benefit of this special tax treatment is desired.

Property classified as wildlife conservation property under the PUV system loses its eligibility for the special tax treatment whenever it fails to meet one or more of the size, ownership, and use requirements. The owner of property classified as wildlife conservation

[110] These are the PUV ownership changes enacted in S.L. 2008-146. The members of a business entity would no longer be restricted to individuals but would include trusts and other business entities as long as a member was not a corporation whose shares are publicly traded and none of its members are corporations whose shares are publicly traded.

[111] The North Carolina Wildlife Resources Commission does not currently have a wildlife habitat conservation agreement. It will develop this agreement.

[112] The North Carolina Wildlife Action Plan, developed in compliance with a Congressional mandate, was submitted in 2005 to provide a conservation blueprint to advance the sound management of fish and wildlife resources in the future. The Plan identifies fish and wildlife resources and priority conservation needs associated with those resources. There are currently about 12 identified priority wildlife habitats in the State. There are a number of federally-listed threatened or endangered animal species and State listed animal species. There are also State and federal natural resource management plans for which wildlife habitat is its primary objective, such as Forest Stewardship, Cooperative Upland Habitat Restoration and Enhancement Program (CURE), and Wildlife Habitat Incentives Program. Link to North Carolina State and Federally listed wildlife species: www.ncwildlife.org/fs_index_07_conservation.htm

property must notify the county assessor whenever there is a change in the size, ownership, or use of the property that necessitates a review of the exclusion. An owner who fails to do so is subject to a penalty equal to 10% of the amount of the deferred taxes and interest for each listing period that the owner fails to report.[113]

As with other property in the PUV classification, property that loses its eligibility for the classification will be taxed at its fair market value for the year in which it loses its eligibility and the deferred taxes for the three previous years will become due and payable, with interest. The act provides several exceptions to this rule:

- No deferred taxes are due, and the lien for deferred taxes is extinguished, when the owner conveys the property by gift to a nonprofit organization for educational and scientific purposes as a protected natural area or for nonprofit historic preservation purposes; or to the State, a political subdivision of the State, or the United States.
- No deferred taxes are due, but the deferred taxes remain a lien on the property, when the property reverts back to its original farmland use under the PUV program. This exception requires that the property was previously classified under the PUV program and that the ownership of the property does not change. Similarly, no deferred taxes are due on property originally classified as farmland if the property is reclassified as wildlife conservation land.[114]
- No deferred taxes are due, but the deferred taxes remain a lien on the property, when the property is transferred to an owner who signs the wildlife habitat conservation agreement in effect for the land at the time of the transfer and the land remains classified as wildlife conservation property.[115]

The issue of classifying wildlife conservation property as a special class of property whose value may be partially excluded from taxation has been discussed for several years. This part of the act represents the collaborative work of representatives from the North Carolina Association of County Commissioners, various conservation groups, county tax assessors, the Forestry Association, the Wildlife Resources Commission, and the North Carolina Farm Bureau. The act directs the Revenue Laws Study Committee to study the three-year impact of the wildlife conservation land classification and its fiscal impact on local governments. The Committee is to report its findings to the 2015 General Assembly.

Land Subject to a Conservation Eeasement. – North Carolina provides an income tax credit to individual and corporate taxpayers who donate an interest in real property for conservation purposes to the State, a local government, or a body that is organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions.[116] The property tax value determination of property subject to a conservation

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[113]G.S. 105-282.1 requires an owner of any property eligible to be exempted or excluded from property tax to notify the county tax assessor of any change in the property's value or property's eligibility for the exemption or exclusion.

[114] See Section 5 of the act.

[115] This exception to the payment of the deferred taxes coincides with the waiver of the 5-year ownership requirement when the property acquired was classified as wildlife conservation land in the hands of the previous owner and the current owner continues to use the land as wildlife conservation land.

[116] The property interest must be donated in perpetuity and be useful for public beach access or use, public access to public waters or trails, fish and wildlife conservation, forestland or farmland conservation, watershed

easement must take into consideration the advantages and disadvantages of the conditions of the easement on the market value of the property. In some instances, the value of property subject to an easement is greater than the value that property would be if it was classified as farmland under the PUV program.

Prior to 2002, property classified within the PUV program that became subject to a conservation easement lost its PUV assessment because the property could no longer meet the use and income-producing requirements for PUV classification. Whenever property becomes ineligible for the program, the current year's taxes, as well as the three years of deferred taxes, become due and payable. In 2002, the General Assembly created an exception to the use and income-producing requirements for PUV by allowing property subject to a conservation easement to remain in the PUV program.

The Property Tax Division within the Department of Revenue interprets this exception to the PUV program narrowly to allow property to remain in the program only when the entire conservation easement is donated. In contrast, the Income Tax Division within the Department has allowed an income tax credit for any percentage of the easement value that is donated. For example, if a taxpayer donates an easement for conservation purposes to the State valued at $100,000 and receives $60,000 for the easement, the taxpayer has donated an easement worth $40,000. The taxpayer is then allowed an income tax credit equal to 25% of the donated value, or $10,000. However, because the taxpayer received some compensation for the easement, the property becomes ineligible for special property tax treatment under the PUV program. This act specifies that property may remain in the PUV program as long as it is subject to an enforceable conservation easement and the taxpayer received no more than 75% of the fair market value of the donated property interest in compensation. This part of the act becomes effective for taxable years beginning on or after July 1, 2010.

Property Tax Exemption of Certain Leasehold Interests. – This act exempts from property tax a leasehold interest in exempt property, effective for taxes imposed for taxable years beginning on or after July 1, 2008, if the following two conditions are met:

- The property itself is exempt from property tax because it is owned by a unit of government.
- The property is used to provide affordable housing for employees of the unit of government that owns the property.

An example of this property tax exemption is the leasehold interest of the Dare Education Foundation in property that is exempt in the hands of its owner, the Dare County Board of Education and used to provide affordable housing for teachers. An application for this exemption is timely if filed on or before September 1, 2008. Prior to this change, a leasehold interest in exempted property was subject to property tax.

protection, conservation of natural areas, conservation of natural or scenic rivers areas, conservation of predominantly natural parkland, or historic landscape conservation.

UNC Nonapp. Cap. Projects/Airport Authority.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-204	**SB 1925**	**Senator Kerr**

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS OF THE CONSTITUENT INSTITUTIONS OF THE UNIVERSITY OF NORTH CAROLINA; TO REVISE UNIVERSITY GENERAL OBLIGATION INDEBTEDNESS; TO ALLOW THE UNIVERSITY OF NORTH CAROLINA TO CREATE AIRPORT AUTHORITIES TO SUPPORT THE MISSION OF THE UNIVERSITY, ITS CONSTITUENT INSTITUTIONS, OR THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM; TO AUTHORIZE THE STATE EDUCATION ASSISTANCE AUTHORITY TO SET THE INTEREST RATE FOR THREE SCHOLARSHIP LOAN PROGRAMS AT A RATE NOT TO EXCEED TEN PERCENT PER ANNUM; AND TO MODIFY THE RESPONSIBILITIES OF THE NORTH CAROLINA FEDERAL TAX REFORM ALLOCATION COMMITTEE.

OVERVIEW: This act does the following:

- Authorizes the construction of numerous projects by The University of North Carolina using revenue bonds and special obligation bonds.
- Revises a UNC Bond Project from the 2000 Higher Education Bond Program by reducing a portion of the 2000 general obligation bond issuance for 'Berryhill Laboratory Building' at UNC-Chapel Hill by $8.6 million and using the money to fund a new project, 'Division of Laboratory Animal Medicine – Upfits'.
- Exempts the purchase, construction, and operation of capital facilities by Gateway University Research Park, Inc., a joint Millennial Campus in Greensboro, from the procurement provisions required for capital facilities financed through the State Capital Facilities Financing Act, except for the procurement provisions in Article 8 (Public Contracts) of the Act.
- Authorizes the Board of Governors to create one airport authority in Orange County for the sole purpose of resiting and operating the Horace Williams Airport. The authorized airport authority must support the mission of the University of North Carolina at Chapel Hill or the University of North Carolina Health Care System.
- Authorizes the State Education Assistance Authority to set the interest rate for three scholarship programs in an amount not to exceed 10% a year instead of the current fixed rate of 10%.

- Allows North Carolina to issue tax-exempt qualified educational facility bonds, the proceeds of which are used by a private for-profit corporation that has entered into a public-private partnership agreement with a local school administrative unit to construct, rehabilitate, refurbish, or equip an elementary or secondary public school.

FISCAL IMPACT: There is no impact on General Fund revenues. The self-liquidating projects are financed with funds available to the institutions from gifts, grants, receipts, self-liquidating indebtedness, or other funds or a combination of these funds, but not including funds received for tuition or appropriated from the General Fund.*(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2008 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except at otherwise specified, this act became effective when signed into law by the Governor on August 8, 2008.

ANALYSIS:

Part I: Self-Liquidating Projects

Each year the University of North Carolina requests legislative authorization for needed capital projects at its constituent or affiliated institutions. These projects are funded by two types of self-liquidating bonds that may be issued by the University's Board of Governors.[117] Section 1.2 of the act authorizes 31 projects on nine campuses.[118] The Chancellors and Boards of Trustees for the listed campuses, as well as the President and the Board of Governors have approved these projects. Construction of these projects is expected to begin before June 30, 2009. The maximum principal amount of bonds to be issued for the projects will not exceed the specified costs of the projects plus $25 million for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest. Section 1.3 of the act authorizes planning money for five projects on three campuses. Sections 1.6 and 1.9 of the act exempt the following projects from the statutory requirement regarding location of special obligation projects: UNC-Chapel Hill's Research Resource Facility – Phase III capital project, UNC-Chapel Hill's Cogeneration and Steam Infrastructure Improvement and Expansion capital project, ECU's Athletic Facilities Expansion and Improvement capital project, and NCSU's Avent Ferry Administration Center Renovation capital project. Sections 1.7 and 1.8 of the act authorize UNC-Chapel Hill and Appalachian State University to construct and finance the expansion and renovation of their football stadiums through lease arrangements to and from a third party. Once constructed and approved by the State reviewing agencies, these improvements would transfer to the State. Section 1.7 of the act also provides that after the property is transferred to the State, UNC-Chapel Hill may provide for the operation and maintenance of the facilty through a contractual or lease agreement with a third party.

Part II: Revise University General Obligation Indebtedness

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[117] Article 21 of Chapter 116 of the General Statutes authorizes the Board to issue revenue bonds for educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. These revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility but not from tax revenues. Article 3 of Chapter 116D of the General Statutes authorizes the Board to issue special obligation bonds payable with any sources of income or receipts of the Board or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund. These bond proceeds can be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions.

[118] These projects include academic, research, clinical and administrative space and improvements to student services, residential living, dining, recreation, and athletic facilities.

This part of the act modifies a UNC bond project authorized in the 2000 Higher Education Bond Program by transferring up to $8.6 million of the 2000 bond funding for the Berryhill Hall Laboratory Building to a related project called 'Division of Laboratory Animal Medicine – Upfits'. Berryhill Hall is the primary education building for the UNC School of Medicine. The Hall is not large enough to support the planned enrollment expansion in the medical program. UNC-Chapel Hill will recommend replacement of Berryhill Hall and seek needed funding in the future. The new project, Division of Laboratory Animal Medicine – Upfits, will use the balance of the Berryhill Hall renovation funds to renovate other related teaching and research support space in existing campus facilities. These renovated facilities will provide the necessary space for those displaced during the construction of the new medical education building and future projects.

Part III: Procurement Modifications

This part of the act removes the purchase, construction, and operation of capital facilities by Gateway University Research Park, Inc. (hereinafter Gateway) from all procurement provisions required for capital facilities financed through the State Capital Facilities Financing Act, except for those provisions in Article 8 of the Act.[119] Article 8 requires separate contract specifications, adherence to minority business participation goals, and bidding requirements. Gateway is a 501(c)(3) organization controlled by North Carolina A & T and UNC-G to manage construction projects at the Gateway University Research Park, a joint millennial campus created by the Board of Governors. This statutory change codifies Gateway's authority to manage construction projects in accordance with Gateway's Management Services and Development Agreement with North Carolina A & T and UNC-G and its Ground Lease Agreement with the State approved by the Council of State in 2007. The change to G.S. 142-94 allows Gateway to continue to follow its streamlined bidding and procurement process for construction of all facilities located on the Joint Millennial Campus. This process is explicitly described and included in the Ground Lease Agreement, which also incorporates substantial oversight protections. Currently, this statutory change affects two projects.

Part IV: Allow the University of North Carolina to Create an Airport Authority

This part of the act establishes a new article in Chapter 116 of the General Statutes authorizing the Board of Governors to create one airport authority in Orange County for the sole purpose of resiting and operating the Horace Williams Airport.[120] The airport authority must support the mission of UNC-Chapel Hill or the UNC Health Care System. Horace Williams Airport is a university-owned airport that opened in 1940. The Airport is the hub for planes serving the North Carolina Area Health Education Centers (AHEC) Program based in the UNC School of Medicine. AHEC transports UNC medical faculty across the State to provide specialty clinics and educational programs in underserved areas. The Airport also houses private planes. As early as 2002, the University announced plans to close the Airport and use the site for a planned satellite research campus, Carolina North. After much debate among the University, the Town of Chapel Hill, supporters of AHEC, and private pilots, the General Assembly authorized the Board of Governors to create the airport authority.

[119] G.S. 142-94 of Article 9, Chapter 142.
[120] Article 13 of Chapter 116 (Higher Education) of the General Statutes.

An airport authority authorized by the Article must consist of 15 appointed members and may be created to support the mission of UNC-Chapel Hill, one constituent institution and the UNC Health Care System, or the UNC Health Care system. In August, the Board of Governors decided to create an airport authority to support the mission of the constituent institution, UNC-Chapel Hill, and the University of North Carolina Health Care System. Pursuant to the Article, the 15 appointed members must consist of the following: one member appointed by the General Assembly upon the recommendation of the Speaker of the House, one member appointed by the General Assembly upon the recommendation of the President Pro Tempore of the Senate, eight members appointed by the Board of Governors (four members upon the recommendation of the UNC-Chapel Hill Board of Trustees and four members by the UNC Health Care System), three members appointed by the Orange County Board of Commissioners, and one member appointed by the Chapel Hill Town Council. No member of the General Assembly may serve on an airport authority created under the Article.

The general powers of an airport authority created under the Article include the following: powers that a city or county has over airports; powers regarding financing capital expenditures and operations that are delegated to or conferred upon constituent institutions or the UNC Health Care System; to sue and be sued; to establish, operate, and maintain an airport; to expend funds for these purposes; to lease property; to receive a sales tax refund; to borrow money; and to acquire property by eminent domain, except over property held on July 1, 2008 by a 501(c)(3) organization organized for educational purposes. If regulations adopted by the airport authority and development regulations adopted by Orange County or a municipality in the County apply to land owned by and the approaches to land owned by the airport authority, then the more restrictive regulations apply.

If the airport authority created under the Article ceases its operation, then the title to the authority's property shall vest in The University of North Carolina. The proceeds of the sale of the property must first be distributed pro rata to the constituent university member or to the UNC Health Care System for reimbursement purposes.

Part V: Interest Rate for Scholarship Loan Programs[121]

This part of the act authorizes the State Education Assistance Authority (SEAA) to set the interest rate for the following three scholarship programs at a rate not to exceed 10%: the Nursing Scholars Program, the Graduate Nurse Scholarship Program for Faculty Production, and Principal Fellows Program. A loan under each of these scholarship programs is a free grant if the student fulfills the service commitment, and the intent of the loan is for the recipient to serve the State as opposed to repaying in cash. This part of the act becomes effective January 1, 2009, and applies to loans issued on or after July 1, 2009.

The responsibility for establishing the interest rate for the State scholarship loan programs differs according to the program. In some cases, the SEAA has the responsibility to set the rate, in others, such as these three programs, the interest rate is set by statute at 10%. According to the SEAA, the statutorily set 10% rate has been a promotional obstacle for these scholarship programs because it is significantly higher than federal loan rates, such as

[121] Part V of the act was initially introduced in Senate Bill 1070, which passed the Senate. The substance of SB 1070 was put in Part V of the act, because it did not appear that the bill was eligible for consideration during the Short Session.

the Stafford Loan, which has a rate of 6.8%. The SEAA requested this change to encourage students to apply for the programs. Below are descriptions of the three programs:

- **Nursing Scholars Program** - This program offers scholarship loans of up to $6,500 per year with a maximum of four years per recipient to North Carolina residents interested in preparing to become registered nurses through an associate or baccalaureate degree program. If also offers up to $6,500 per year per recipient for two years of study leading to a master of science in nursing. The loan is forgiven if, within seven years after graduation, the recipient practices nursing in North Carolina for one year for each year of aid received. While the statutory maximum was increased to $6,500 in 2006, the current award amounts actually offered are $3,000 per year for applicants pursuing an associates degree or hospital diploma in nursing and $5,000 per year for applicants pursing a bachelor of science degree in nursing.
- **Graduate Nurse Scholarship Program for Faculty Production** – This program offers scholarship loans in the amount of $15,000 per year per recipient for the following: (1) students enrolled in a masters program in nursing education; (2) students enrolled in a doctoral degree program in nursing education; and (3) nursing faculty in the North Carolina Community College System enrolled in a masters degree program in nursing education. The loan is forgiven if, within seven years after graduation, the recipient teaches in a public or private nursing education program in a public or private educational institution in North Carolina for one year for every year of aid received. If the recipient was a nursing faculty member of a community college, the loan will be forgiven if the recipient teaches in a community college nursing education program in North Carolina one year for each year of aid received.
- **Principal Fellow Program** – This program requires, within six years after graduation, a four-year commitment to serve as a school administrator in a North Carolina public school to receive the $30,000 first-year stipend and the second-year loan in the amount of 60% of the beginning salary for an assistant principal plus $4,100 for tuition, fees, and books.[122]

Part VI: Modify TRAC Responsibilities[123]

This part of the act enables North Carolina to issue tax-exempt qualified educational facility bonds, the proceeds of which may be used by a private for-profit corporation that has entered into a public-private partnership agreement with a local school administrative unit to construct, rehabilitate, refurbish, or equip an elementary or secondary public school.

Qualified private activity bonds are tax-exempt bonds[124] issued by a state or local government, the proceeds of which are used for a defined qualified purpose by an entity other than the government issuing the bonds. A qualified private activity bond is secured by the financed project's revenues rather than the full faith and credit of the governmental unit. Qualified private activity bonds enable the private sector to access tax-exempt capital

[122] These amounts may be adjusted to take into account increases in tuition, fees, and the cost of books; increases in the State principal assistant salary schedule; and changes in the stipend paid to participants in the program during the second-year internship.
[123] Part VI of the act was initially introduced in Senate Bill 1902, which passed the Senate, and House Bill 2724. The substance of these bills was put in Part VI of the act, because it did not appear that these bills were eligible for consideration during the Short Session.
[124] The interest paid to the bondholder is not includable in their taxable income.

markets, thereby reducing a project's financing costs. Federal law limits the aggregate amount of private activity bonds that may be issued by a state.

In the Economic Growth and Reconciliation Act of 2001, Congress expanded the purpose for which qualified private activity bonds could be issued to include qualified public educational facilities. A qualified educational facility is a public elementary or secondary school owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency. The expansion of a qualified purpose to include educational facilities allows more tax-exempt financing of public school construction. In 2006, the General Assembly enacted legislation to facilitate the building of public school facilities through public-private partnerships.[125] The authorization allowing local school administrative units to use capital lease financing expires July 1, 2011. To date, no school facilities have been financed through this authority.

North Carolina cannot currently avail itself of the use of qualified educational facility bonds because the statutes do not authorize their allocation or issuance. The General Assembly created the North Carolina Federal Tax Reform Allocation Committee in 1987 to manage the allocation of tax exempt private activity bonds and low-income housing credits. This act expands the authority of the Committee to include the allocation and issuance of qualified public educational facility bonds. This legislation, together with the legislation enacted in 2006, provides another financing alternative for public school construction.

Federal law limits an issuing authority to a maximum amount of tax-exempt bonds that may be issued to finance a qualified educational facility to the greater of $5 million or $10 multiplied by a state's population. Based upon North Carolina's population, its 2008 allocation is $90.6 million and its 2007 allocation was $88 million. A state may elect to carry forward the unused bond volume cap for any calendar year for three years following the calendar year in which the unused volume cap arose. This election is made by filing IRS Form 8328. The Treasurer's Office filed a carryforward for 2007. On the effective date of the act, North Carolina had two years of allocation, or approximately $178 million, to allocate for qualified educational facility bonds.

Home Inspector Privilege License.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-206	**HB 2558**	**Representative Ross**

AN ACT TO REQUIRE LICENSED HOME INSPECTORS TO OBTAIN A PRIVILEGE LICENSE.

OVERVIEW: This act imposes a $50 State privilege license tax on individuals licensed under the Home Inspector Licensure Act.

FISCAL IMPACT: The act increases General Fund revenues by $77,000.

[125] S.L. 2006-232, as amended by S.L. 2006-259

EFFECTIVE DATE: This act became effective when signed into law by the Governor, August 9, 2008, and applies to taxable years beginning on or after July 1, 2008.

ANALYSIS: This act imposes an annual State privilege license tax of $50 on an individual licensed under the Home Inspector Licensure Act.[126] The State's privilege license tax is imposed on a fiscal year basis and is due by July 1 of each year. The full amount of the tax applies to a person who, during the fiscal year, begins to engage in an activity for which a privilege license is required. Since the act became effective after July 1, 2008, it includes a provision extending the time in which a person engaged in the business of home inspection has to obtain the required State license for fiscal year 2008-2009, from July 1, 2008, until October 1, 2008.

By imposing a State license tax on this profession, the act repeals the authority of cities to impose a local license tax on this profession.[127] Under the general authority of G.S. 160A-211, several cities impose a privilege license tax on home inspectors. Since many of these cities have already collected the tax for fiscal year 2008-2009, the act specifically authorizes its imposition and collection by those cities for this fiscal year. A city cannot impose a license tax on this profession for fiscal years beginning on or after July 1, 2009.

An individual required to have a State privilege license may not engage in the licensed activity until a license is obtained. To obtain a license, an individual must file a completed application with the Department of Revenue and pay the required tax. An application for a license is considered a return. The license does not of itself authorize the practice of a profession, business, or trade for which a State qualification license is required.

Solid Waste Tax Changes/Unsalable OTP Refund.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-207	**HB 2530**	**Rep. Harrison, T. Harrell, Luebke, Thomas**

AN ACT TO MAKE ADMINISTRATIVE CHANGES TO THE SOLID WASTE DISPOSAL TAX AND TO ALLOW A REFUND FOR ALL UNSALABLE OTHER TOBACCO PRODUCTS.

OVERVIEW: This act does two things:

- It makes changes the Solid Waste Disposal Tax that became effective July 1, 2008.
- It allows a refund of the tax paid on unsalable tobacco products other than cigarettes (OTP).

FISCAL IMPACT: This act is expected to reduce General Fund Revenues by approximately $9,000 annually.

[126] Article 9F of Chapter 143 requires home inspectors and associate home inspectors to be licensed. The state privilege license tax imposed under this act applies to both types of licenses.
[127] G.S. 105-42(h).

EFFECTIVE DATE: The provisions allowing a refund of the tax paid on unsalable OTP became effective October 1, 2008, and apply to products returned on or after that date. The remainder of the act became effective when signed into law by the Governor on August 9, 2008.

ANALYSIS: The act makes certain administrative changes to the solid waste disposal tax. First, it clarifies that the tax and the return are due on a quarterly basis. Second, if a third party fails to pay the amount charged for the disposal of waste tonnage and an owner or operator has deducted that amount from gross income as a bad debt, then the owner or operator may deduct the amount of that tonnage if the tax was paid on the tonnage. If the owner or operator is not subject to income tax, the owner or operator may take the deduction when it is determined that the charges are not collectible. Finally, the act excludes a city or county from receiving proceeds if it does not provide solid waste management programs and services and is not responsible by contract for payment, unless the city or county is served by a regional solid waste management authority. If the city or county is served by the authority, then the city or county must forward the amount of proceeds it receives to that authority. To assist the Department with distribution, the Department of Environment and Natural Resources must provide the Department with a list of cities and counties that are excluded by May 15 of each year.

In S.L. 2007-323, the General Assembly increased the excise tax levied on OTP from 3% to 10%, effective October 1, 2007, with the Secretary of Revenue remitting the additional tax to the University Cancer Research Fund. This act permits wholesale and retail dealers who possess unsalable OTPs to return them to the manufacturer and apply for a refund of the excise tax paid on them. A similar provision already exists for cigarettes and cigars. The act also conforms the discount and refund provisions for OTPs and cigarettes.

Toll Enforcement Authority Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2008-225	**SB 1697**	**Senator Jenkins**

AN ACT TO PROVIDE FOR THE ENFORCEMENT OF TOLLS ON TURNPIKE PROJECTS OF THE NORTH CAROLINA TURNPIKE AUTHORITY, TO MODIFY LAWS APPLICABLE TO THE NORTH CAROLINA TURNPIKE AUTHORITY, AND TO CLARIFY THE AUTHORIZATION MADE IN A PRIOR LAW TO TOLL AN EXISTING SEGMENT OF N.C. 540.

OVERVIEW: This act provides for the enforcement of tolls at toll facilities operated by the North Carolina Turnpike Authority and clarifies the authorization made in a prior law to toll an existing segment of NC 540.

FISCAL IMPACT: No estimate available.

EFFECTIVE DATE: The majority of the provisions of the act became effective when the act was signed into law by the Governor on July 18, 2008.

ANALYSIS: This act addresses four areas pertaining to the North Carolina Turnpike Authority. First, it clarifies the authority to toll the specific segment of NC 540 for which the prohibition on tolling was lifted in 2006. Second, it establishes the procedure for the collection and enforcement of tolls by the Authority. Third, it treats documents and bids on contracts for a toll road the same as those for other roads with respect to confidentiality, registration of maps, and resolution of construction claims. Fourth, it exempts the Authority from the purchase and contract statutes that apply to other State agencies and from rulemaking, except as provided for contesting liability for unpaid tolls.

In 2002, the General Assembly established the North Carolina Turnpike Authority as an independent agency responsible for toll roads and designated the toll road projects. Current law enables the Turnpike Authority to set and collect tolls on Turnpike projects, but it does not establish any procedures for the collection or enforcement of the tolls.

The method by which the Authority plans to impose tolls is through an 'open road' tolling system. Under this system, there are no toll booths and drivers do not have to stop to pay the toll. Vehicles are identified electronically by means of transponders[128] and cameras. Tolls are collected by debiting a prearranged account, by payment by the driver at a facility off the tolled roadway, or by sending the driver a bill for the unpaid toll. The act requires the Authority to post signage notifying drivers that they are approaching a highway for which a toll is required and indicating the methods by which the toll must be paid. The Authority must also operate a facility within the immediate vicinity of the Turnpike project that accepts cash payment of the toll.

The act requires tolls for the same class of vehicle to be the same, but allows a discount of up to 35% of the amount of the toll for vehicles that have transponders. The person who is the registered owner of a vehicle is responsible for a toll unless the owner can establish that the vehicle was in the care, custody, or control of another when the vehicle incurred the toll.

If a toll is not paid within 15 days of when it is incurred, the Authority sends the owner of the vehicle a bill for the toll. The owner has 30 days to pay the bill. If the bill is not paid within 30 days, a processing fee is added to the amount the person owes. The Authority must set the processing fee at an amount that does not exceed the costs of identifying the owner of a motor vehicle that is subject to an unpaid toll and billing the owner for the unpaid toll. The maximum processing fee for a billing period may not exceed $6. A person may not be charged more than $48 in processing fees in a calendar year. A person who receives one or more bills for unpaid tolls during a six-month period and who has not paid the amount due on those bills within 30 days after the end of the six-month period is subject to a civil penalty of $25. Only one civil penalty may be assessed for a six-month period.

If the amount of unpaid tolls remains unpaid after 30 days, the Authority will notify the Division of Motor Vehicles that the toll, fee, and penalty have not been paid and the Division will block the renewal registration of the vehicle until the amount is paid. A person whose motor vehicle registration renewal is blocked due to unpaid tolls, processing fee, or civil penalties may pay the amount due to the Division when renewing the vehicle's

[128] An automatic device that transmits a predetermined message or generates a signal in response to a predefined signal.

registration so that the block may be removed. The Division must remit the revenue received to the Authority. The Division's costs of collecting the tolls, fees, and penalties are considered a necessary expense of the operation of the Authority and the Authority must reimburse the Division for these costs.

The act establishes an administrative review process for contested tolls. A person who disputes liability for a toll may, within 30 days after receiving the bill, request a review by the Authority. If after the informal review process, the Authority determines the person is liable for the toll, the person may contest this determination by filing a petition for an administrative hearing at the Office of Administrative Hearings (OAH). Judicial review of an administrative decision by OAH is on the record.

Under current law, it is an infraction for the operator of a motor vehicle to willfully cover or conceal the numbers on a registration plate for the purpose of interfering with the taking of a clear photograph by a traffic control system, such as the 'red-light cameras'. This act adds toll collection systems to this offense, effective December 1, 2008.

In 2006, the General Assembly removed the prohibition on tolling existing roads with respect to a segment of existing NC 540. The 2006 change, however, did not include the identified segment of NC 540 in the group of 'Turnpike Projects' for which a toll can be imposed. Therefore, this act also clarifies the authority of the Turnpike Authority to toll a segment of NC 540 in Wake County that has already been constructed.

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