2009

FINANCE LAW CHANGES

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2009 Finance Law Changes

Modify Corporate Apportionment Formula.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-54	**SB 575**	**Senator Hoyle**

AN ACT TO ENCOURAGE THE LOCATION AND EXPANSION OF CAPITAL INTENSIVE COMPANIES IN THIS STATE BY PROVIDING FOR APPORTIONMENT OF CORPORATE INCOME BASED SOLELY ON THE SALES FACTOR FOR COMPANIES THAT MEET CERTAIN INVESTMENT AND QUALITY JOBS CRITERIA.

OVERVIEW: This act changes the corporate income tax apportionment formula used by a capital intensive multistate corporation meeting specific investment criterion from a three-factor formula based upon property, payroll, and double-weighted sales to a single sales factor formula. The apportionment formula determines the amount of a multistate corporation's income that may be taxable by North Carolina. A single sales factor formula reduces the income tax liability of a corporation with relatively large shares of its nationwide property in North Carolina but a relatively small share of its nationwide sales in North Carolina.

FISCAL IMPACT: The act reduces General Fund revenues by approximately $3 million annually beginning in fiscal year 2011-2012. The loss could become as great as $12.5 million a year by fiscal year 2018-2019. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2010.

ANALYSIS: A corporation that does business in more than one state must pay income tax to each of the states in which it has nexus. The U.S. Supreme Court cases have upheld the right of states to tax the income of multistate corporations so long as the income is fairly sourced to the taxing state. The conventional method used by states to source income has been the apportionment formula, which is used to derive an apportionment percentage. Generally speaking, a taxpayer multiplies its taxable income by its apportionment percentage to determine the amount of its income sourced to a state. The state's corporate income tax rate is applied to the corporation's income apportionable to that state.

Most states use an apportionment formula based on or substantially similar to the Uniform Division of Income for Tax Purposes Act (UDITPA).[1] The UDITPA formula is a composite of three factors: a property factor, a payroll factor, and a sales factor. The property factor represents the ratio of the taxpayer's real and tangible personal property in the taxing state to its real and tangible personal property everywhere. Likewise, the payroll

[1] UDITPA dates back to 1957.

factor and the sales factor represent a ratio of the taxpayer's payroll and sales in the taxing state to its payroll and sales everywhere. Under UDITPA, the sum of the three factors is divided by three, resulting in a taxpayer's apportionment percentage.

North Carolina shifted to a double-weighted sales factor apportionment formula in 1988 at the request of RJR Nabisco.[2] A double-weighted sales factor tends to favor home-state industries that have a concentration of their total facilities in a state but sell their products all over the country. Under North Carolina's current apportionment formula, the payroll and property factors are each weighted 25% and the sales factor is weighted at 50%; the sum of the four factors is divided by four.

This act creates a single sales factor apportionment formula at the request of Apple, who plans to build a major East Coast data center in Maiden, NC.[3] Apple will invest at least $1 billion in the infrastructure hub and it is expected to employ 50 full-time employees.4 Under the single sales factor formula, the total allocation of a corporation's nationwide profits to North Carolina is solely based on where the corporation's sales occur. This method of apportionment provides a tax reduction to a corporation with relatively large shares of its nationwide property and payroll in North Carolina but a relatively small share of its nationwide sales in North Carolina.

The act limits the single sales factor apportionment formula to a 'qualified capital intensive corporation'. The act defines a 'qualified capital intensive corporation' as one that meets all of the requirements listed below. At the time the General Assembly considered this legislation, no taxpayer met these requirements. However, it is anticipated that Apple will meet these requirements. The act provides that if no corporation has met these requirements by January 1, 2019, the single sales factor provision is repealed.

- The corporation's property factor must meet one of the following conditions:
    - The property factor as a percentage of the sum of the factors in North Carolina's double weighted sales factor apportionment formula must exceed 75%.
    - The average property factor for the preceding three years as a percentage of the average sum of the double weighted sales factor apportionment formula must exceed 75%.
- The Secretary of Commerce makes a written determination that the corporation has invested or is expected to invest at least $1 billion in private funds to construct a facility in this State within nine years of the time that construction begins.
- With respect to the facility that meets the $1 billion investment threshold, it must:

[2] RJR Nabisco had plans for a large automated bakery in the Garner area. After the change was adopted, RJR Nabisco was bought out and forced to cut back on capital expenditures. The company never built the plant.

[3] Although the identity of the company was not made public during the legislative deliberations, Governor Perdue issued a press release on June 3, 2009, the same day she signed Senate Bill 575 into law, announcing that Apple selected North Carolina as the location for a new data center. Apple announced in July that it would locate the data center in Catawba County, in the town of Maiden. It had also considered locating the facility in Cleveland County.

[4] The Department of Commerce projects that a data center investment of $1 billion will create more than 3,000 jobs in the regional economy over the next 10 years.

- Be located in a county designated as a tier one or tier two area at the time construction began.[5]
- Maintain the average number of employees it has at the facility during the first two years after the facility is placed in service for the remainder of time in which the corporation must complete the required $1 billion investment.
- Meet the weekly wage standard set out in Article 3J.[6] The applicable weekly wage standard for Catawba County in 2009 is $592.
- Provide health insurance for all full-time jobs at the facility.[7]

The act provides that a qualified capital intensive corporation must forfeit the benefit of the single sales factor apportionment formula prospectively if it fails to make the required investment in capital facilities within nine years. It does not require the recapture of any benefits already received. The act also provides that a qualified capital intensive corporation is ineligible for Article 3J tax credits[8] a grant from the Job Development Investment Grant Program[9] or a grant from the One NC Fund[10] with respect to a facility that met the $1 billion investment threshold. Lastly, the act encourages qualified capital intensive corporations to utilize the Employment Security Commission and cooperating local agencies as a first source for recruitment of employees.

In 2006 and 2007, the General Assembly enacted exemptions from the sales and use tax for data centers that meet certain conditions[11] In January of 2007, Google announced its decision to invest $600 million in a new facility in Caldwell County in Lenoir, North Carolina.[12] G.S. 105-164.13(55) exempts an eligible Internet data center from sales tax on electricity and on certain business property located and used at the data center. G.S. 105-187.51C imposes a privilege tax, in lieu of a sales tax, on certain equipment and machinery purchased by an eligible data center. The rate of tax is 1% of the sales price of the equipment and machinery, capped at $80 per article. To be an eligible Internet data center under G.S. 105-164.13 or an eligible data center under G.S. 105-187.51C, a facility must meet certain use, location, wage, employee insurance benefits, and investment conditions. If Apple meets the conditions of these exemptions, it would be eligible for them as well as the modified corporate apportionment formula.

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[5] Catawba County is designated as a tier 2 area in 2009.

[6] G.S. 105-129.83 provides that a job in a tier two area satisfies the wage standard if it pays an average weekly wage that is at least equal to the lesser of one hundred ten percent (110%) of the average wage for all insured private employers in the State and ninety percent (90%) of the average wage for all insured private employers in the county.

[7] Under G.S. 105-129.83, a taxpayer provides health insurance if it pays at least fifty percent (50%) of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee pursuant to G.S. 58-50-125.

[8] See Article 3J of Chapter 105 of the North Carolina General Statutes.

[9] See Part 2G of Article 10 of Chapter 143B of the North Carolina General Statutes.

[10] See Part 2H of Article 10 of Chapter 143B of the North Carolina General Statutes.

[11] Section 24.17 of S.L. 2006-66 and Section 31.22 of S.L. 2007-323.

[12] North Carolina also provided a grant to Google under the Job Development Investment Grant Program. The grant required the company to create 200 jobs in four years. In December 2008, Google withdrew its application for the grant incentive because it could not meet the job creation criteria. As of December 2008, the company had approximately 50 employees at the data center located in Lenoir, NC.

Add Division of LESS to CCPS.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-81, as amended by S.L. 2009-550	**HB 201 HB 274**	**Rep. Spear, R. Warren**

AN ACT TO FACILITATE THE TRANSFER OF MOTOR VEHICLES FROM THE UNITED STATES DEPARTMENT OF DEFENSE TO LOCAL GOVERNMENT UNITS, VOLUNTEER FIRE DEPARTMENTS, AND VOLUNTEER RESCUE SQUADS AND TO CLARIFY THAT THE DIVISION OF LAW ENFORCEMENT SUPPORT SERVICES IS A DIVISION OF THE DEPARTMENT OF CRIME CONTROL AND PUBLIC SAFETY.

OVERVIEW: This act provides exemptions from the highway use tax for State agencies acting as a pass-through for vehicles received through a United States Department of Defense program that are subsequently transferred to an emergency response unit, a law enforcement agency, or fire department. S.L. 2009-550 establishes the retail value of a vehicle transferred through this program for purposes of the highway use tax as the price paid by the purchaser of the vehicle rather than the market value of the vehicle.[13] The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 11, 2009. The clarifying change in S.L. 2009-550 became effective when the Governor signed it into law on August 23, 2009.

ANALYSIS: Federal law provides programs through which vehicles are disbursed from the Department of Defense to emergency response units, local law enforcement, and fire departments.[14] The Federal programs require a state agency to facilitate the transfer of these vehicles. The Department of Crime Control and Public Safety (DCCPS) has been operating one of these programs for over 15 years. Last year, the DCCPS facilitated the transfer of over $1 million in vehicles to local law enforcement through this program.[15] A similar program facilitated by the Department of Environment and Natural Resources (DENR) has been in operation for the past two years and has facilitated the transfer of approximately 90 vehicles.

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[13] Section 2.(e) of S.L. 2009-550, AN ACT TO MAKE VARIOUS CLARIFYING CHANGES TO THE GENERAL STATUTES AND SESSION LAWS.

[14] 10 U.S.C. §381 establishes procedures under which states and units of local government may purchase law enforcement equipment for counter-drug activities through the Department of Defense. 10 U.S.C. § 2576b establishes procedures under which states may purchase personal property to assist firefighting agencies.

[15] Section 17.5 of S.L. 2009-451 established a fee that a local law enforcement agency must pay to the Department of Crime Control and Public Safety for equipment it receives through the Department from the United States Department of Defense. The fee amount is set by the DCCPS. (see G.S. 143B-475.2)

When vehicles under this program are initially transferred, the department facilitating the program does not take title to the vehicle. The ultimate recipient, which is either an emergency response unit, local law enforcement, or a fire department, takes title to the vehicle and pays the highway use tax. If the recipient decides the vehicle is no longer needed, the vehicle is transferred to the department facilitating the program for transfer to another emergency response unit, local law enforcement, or fire department in the State. During this subsequent transfer, the department may take title, at which point the department would be required to pay highway use tax.

The highway use tax is payable when a person applies for a certificate of title for a motor vehicle. The rate of tax is 3% of the retail value of the vehicle. The retail value of a vehicle is its sales price if the vehicle is sold by a retailer. Otherwise, the retail value of a vehicle is its market value, which is presumed to be the value of the vehicle as set in a schedule of values adopted by the Commissioner of Motor Vehicles.

The program operated by DCCPS was momentarily halted this year after the Division of Motor Vehicles raised concerns about whether the facilitating agency should obtain title to the vehicles when initially transferred, and if so, whether the facilitating agency should pay the highway use tax. The question also arose as to the retail value of the vehicle, for purposes of the highway use tax, since the price paid for the vehicle may be less than its market value. This act, and S.L. 2009-550, resolve these issues.

Section 1 of this act and Section 2(b) of S.L. 2009-550 exempt the facilitating department from the requirement under G.S. 20-73 to apply for a certificate of title within 28 days of the transfer of the vehicle.[16] This exemption will allow both DCCPS and DENR to transfer vehicles under the federal programs without first obtaining title to the vehicle. If the agency does not have to obtain a title, it does not have to pay the highway use tax. Sections 2(a), (b), and (d) of S.L. 2009-550 also exempt the facilitating agency from the mileage and damage disclosure requirements of Chapter 20 of the North Carolina General Statutes.

Section 2 of this act exempts the facilitating agency from paying highway use tax when it obtains title to a vehicle from a unit of local government, volunteer fire department, or volunteer rescue squad for the purpose of transferring the vehicle to another unit of local government, volunteer fire department, or volunteer rescue squad. Section 2(e) of S.L. 2009-550 sets the retail value of a vehicle transferred under this federal program as the price paid for the vehicle rather than its market value.

State Treasurer Investments.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-98	**SB 703**	**Senator Rand**

AN ACT CONCERNING INVESTMENTS OF THE STATE TREASURER.

[16] A person who fails to apply for a certificate of title within the required time frame is subject to a $15 civil penalty and is guilty of a Class 2 misdemeanor.

<u>OVERVIEW:</u> This act, requested by the Office of the State Treasurer, gives the State Treasurer more flexibility to invest special funds[17] held by the State Treasurer, with the goal of increasing portfolio return and better managing risk.

<u>FISCAL IMPACT:</u> No impact.

<u>EFFECTIVE DATE:</u> This act became effective when it was signed into law by the Governor on June 11, 2009.

<u>ANALYSIS:</u> The State Treasurer has statutory authority to invest certain special funds held by the Treasurer in excess of the amount required to meet the current needs and demands of these funds. Authorized investments are outlined by statute in G.S. 147-69.1(c)(1)-(7) and G.S. 147-69.2(b). This act provides the Treasurer with more flexibility and tools to invest these funds as follows:

- Authorizes the investment of funds in obligations that are convertible into equity securities. These are non-investment grade securities. These newly authorized investments, as well as the currently authorized investment in obligations, must bear one of the four highest ratings of at least one nationally recognized rating service when acquired. The act deletes the requirement that the obligations must not bear a rating below the four highest by any nationally recognized rating service that rates the particular security. (See G.S. 147-69.2(b)(4)).

- Permits investment in asset-backed securities that bear a rating below the four highest by any nationally recognized rating service that rates the particular securities. (See G.S. 147-69.2(b)(6)).

- Requires the Treasurer to invest assets of the Retirement Systems[18] so that no less than 20% of these assets are at all times invested in investments authorized by G.S. 147-69.2(b)(1)-(6). This liquidity requirement is designed to ensure that funds are available to meet the cash needs of the Retirement Systems. (See G.S. 147-69.2(b)(6a)).

- Authorizes the Treasurer to make investments pursuant to G.S. 147-69.2(b)(1)-(6) directly, or indirectly through contractual arrangements as long as the indirect investment is managed by an investment manager that has assets under management of at least $100,000,000. (See G.S. 147-69.2(b)(6b)).

- Authorizes the Treasurer to invest the assets of the Retirement Systems in obligations and other debt securities, including debt securities convertible into other securities, that do not meet the investment requirements of G.S. 147-69.2(b)(1)-(6) and (7) as long as these investments in credit opportunities meet all of the following requirements:

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[17] These special funds are listed in G.S. 147-69.2 and include, among others, the various State and local governmental employee retirement systems. The employee retirement systems are supported by investment returns, employee contributions, and employer contributions.

[18] The following systems are referred to collectively as the Retirement Systems: the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, the Firemen's and Rescue Workers' Pension Fund, the Local Governmental Employees' Retirement System, the Legislative Retirement System, and the North Carolina National Guard Pension Fund.

  - The investments must be made through the following investment entities or vehicles: investment companies registered under the Investment Company Act of 1940, individual, common collective trust funds of banks and trust companies, group trusts and limited partnerships, limited liability companies or other limited liability investment vehicles that invest primarily in investments authorized by G.S. 147-69.2(b)(6c) and through contractual arrangements. If the investment is through a contractual arrangement, the investment manager for each investment must have assets under management of at least $100,000,000.
  - The investments may not exceed 5% of the market value of all invested assets of the Retirement Systems.

  (See G.S. 147-69.2(b)(6c)).

- Authorizes the investment of Retirement Systems' assets in equity securities traded on a public securities exchange or market organized and regulated under the laws of the jurisdiction of the exchange or market. Prior law permitted investment only in preferred or common stock. These investments are still capped at 65% of the market value of all invested assets of the Retirement Systems, but the act removes the 5% cap on assets that may be invested in the stocks or shares of a diversified investment company registered under the Investment Company Act of 1940. So long as each investment manager manages assets of at least $100,000,000 (was $50,000,000), Retirement Systems assets may be invested through the following:
  - Investment companies registered under the Investment Company Act of 1940.
  - Individual, common, or collective trust funds of banks and trust companies.
  - Group trusts.

  The act adds the following investments to this list:
  - Contractual arrangements in which investment managers have full and complete discretion and authority to invest assets specified in such contractual arrangements.

  (See G.S. 147-69.2(b)(8)).

- Authorizes the Treasurer to directly invest Retirement Systems' assets in any equity securities represented in the S&P 500 Index or that have been publicly announced to be included in the S&P 500 Index. The act eliminates certain statutory limitations on the investments of Retirement Systems' assets. The act, however, maintains the requirement that no more than 1½% of the market value of the Retirement Systems' assets be invested directly in the stock of a single corporation, and the total number of shares in that corporation not exceed 8% of the issued and outstanding stock of the corporation. Prior to this legislation, all stock management was outsourced. The Treasurer will still outsource most stock management, but the direct management of some funds should allow the Treasurer greater access to market data and savings in fees. (See G.S. 147-69.2(b)(8)).
- Authorizes the Retirement Systems' assets to be invested in inflation resistant assets such as commodities, timberlands, real estate, and treasury inflation protected

securities.[19] As some of the other investments authorized by this act, these investments must be made through investment companies registered under the Investment Company Act of 1940, individual, common or collective trust funds of banks and trust companies, group trusts and limited liability investment vehicles and through contractual agreements in which the investment manager has full discretion and authority to invest Retirement Systems assets in these investments. For each investment allowed under G.S. 147-69.2(b)(9a), the investment manager must manage assets of at least $100,000,000, and the investments authorized under subdivision (9a) must not exceed 5% of the market value of all invested assets of the Retirement Systems. (See G.S. 147-69.2(b)(9a)).

The act permits the Treasurer to use fees assessed under G.S. 147-69.2((b2) and (b3) to defray the cost of administering these investments. Subsection (b2) applies to the investment of public hospital funds deposited with the Treasurer, and subsection (b3) applies to the investment of UNC Hospitals at Chapel Hill funds deposited with the Treasurer.

The remaining changes to G.S. 147-69.2 are conforming and technical.

Temporary Floor for Motor Fuels Tax Rate.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-108	**SB 200**	**Senator Jenkins**

AN ACT TO ESTABLISH A MINIMUM MOTOR FUELS TAX RATE FOR TWO YEARS.

OVERVIEW: This act establishes a minimum variable rate of 12.4¢ a gallon for calculation of the motor fuel tax rate, applicable for the period July 1, 2009, through June 30, 2011. With a minimum variable rate of 12.4¢, the motor fuel tax rate may be greater than 29.9¢ per gallon but it may not be less.

FISCAL IMPACT: The act increases revenue $50 million for fiscal year 2009-2010 and it is expected to increase revenue $17.5 million for fiscal year 2010-2011. Three-fourths of the revenue derived from the excise tax on motor fuel is allocated to the Highway Fund and the remaining quarter is allocated to the Highway Trust Fund.[20] *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 15, 2009.

ANALYSIS: This act establishes a minimum motor fuel tax rate of 29.9¢ a gallon for the period July 1, 2009, through June 30, 2011, by providing that the variable component of the rate may not be less than 12.4¢ a gallon. The motor fuel tax rate consists of a flat rate of

[19] The cash flows from treasury inflation protected securities are based on inflation; as inflation sets in periodic interest payments increase.

[20] One-half cent per gallon of the excise tax is allocated to various environmental funds. The remaining revenue is allocated to the Highway Fund or the Highway Trust Fund.

17.5¢ per gallon plus a variable rate based upon the average wholesale price of motor fuel. With a minimum variable rate of 12.4¢, the rate may be greater than 29.9¢ per gallon, but it may not be less.

The variable component of the motor fuel tax rate is equal to the greater of 7% of the average wholesale price of motor fuel during a base six-month period or 3.5¢ per gallon. The base six-month period for the motor fuel rate applicable on and after July 1 ends March 31. The base six-month period for the motor fuel rate applicable on and after January 1 ends September 30. Based upon the average wholesale price of motor fuel for the base period April 1, 2008, through September 30, 2008, the motor fuel rate effective on and after July 1, 2009, would have been 27.8¢ a gallon.

In 2006, the General Assembly capped the variable wholesale component of the motor fuels tax at 12.4¢ per gallon, the wholesale rate for the period of January 1, 2006, through June 30, 2006.[21] The General Assembly extended the cap in 2007 from July 1, 2007, through June 30, 2009.[22] With the cap, the rate could be less than 29.9¢ per gallon, but it could not be greater. During this period, the rate fell to 29.7¢ per gallon for the period July through December 2007. Otherwise, it stayed at 29.9¢ per gallon.

Changes for Bonds Authorized Under ARRTA.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-140	**SB 754**	**Senator Clodfelter**

AN ACT TO AMEND THE NORTH CAROLINA GENERAL STATUTES TO ALLOW THE STATE TO TAKE FULL ADVANTAGE OF THE EXPANSION OF EXISTING BOND PROGRAMS AND THE CREATION OF NEW BOND PROGRAMS UNDER THE AMERICAN RECOVERY AND REINVESTMENT TAX ACT OF 2009 (ARRTA).

OVERVIEW: This act does two things:

- It authorizes local governments to issue several types of government bonds established under the American Recovery and Reinvestment Tax Act of 2009 (ARRTA).
- It authorizes the private sale of general obligation bonds that have a credit rating below "AA" or that are unrated and that are issued prior to December 31, 2010.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 19, 2009.

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[21] Section 24.3 of S.L. 2006-66. Section 2.2(g) of S.L. 2006-66 provided a reserve in the General Fund for the purpose of holding harmless the Highway Fund and the Highway Trust Fund in the event that the variable wholesale component of the tax would have exceeded 12.4¢ per gallon.
[22] Section 31.15 of S.L. 2007-323.

ANALYSIS:

Authorize new bonds. – This act authorizes local governments to issue several types of government bonds[23] established under ARRTA. Bonds under these programs are either tax-exempt[24] bonds or tax credit bonds. Tax credit bonds are a recent alternative to traditional tax-exempt bonds. They are not interest-bearing obligations; instead, a taxpayer holding a tax credit bond is allowed a credit against federal income tax equivalent to the interest that the bond would otherwise pay. The bondholder must include the amount of the credit in gross income and treat it as interest income. The credit effectively replaces the interest that would be paid on an exempt bond, allowing the issuer to borrow interest-free. The types of bonds authorized under ARRTA are:

- **Build America bonds.** – Unlike tax credit bonds, which provide a tax credit in lieu of interest payments, build America bonds pay interest to the bondholders and also provide a tax credit. The bondholder must include the interest in gross income, but is allowed a credit against federal income tax liability for a portion of the interest payments received. The tax credit is equal to 35% of the interest payable on the interest payment date of the bond. These bonds must be issued before January 1, 2011. State and local governments may elect to receive a direct payment in the form of a refundable credit in lieu of the credit to the bondholder.

- **Qualified school construction bonds.** – ARRTA provides bond authority to states and local governments for school infrastructure through two primary tax credit bond programs: a new qualified school construction bond program and the extension of the qualified zone academy bond (QZAB) program.

  North Carolina's QZAB program is currently administered by the State Board of Education. The national volume cap for these bonds is $11 billion for 2009 and another $11 billion for 2010. There is also an annual cap allocated among the states based on their respective populations of individuals below the poverty line. North Carolina's QZAB allocation for 2009 is $44.1 million.

  The State Board of Education will also administer the statewide allocation of qualified school construction bonds, which are to be issued in the same manner and under the same guidelines as the QZABs. The statewide allocation to North Carolina under ARRTA for these bonds is approximately $187.2 million.[25] A bond is a qualified school construction bond if all of the following conditions are met:

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[23] State and local bonds are classified as either governmental bonds or private activity bonds. Governmental bonds are primarily used to finance governmental functions and are repaid with governmental funds. Interest on these bonds is generally exempt from federal and State income tax. Private activity bonds are bonds that allow the state or local government to serve as a conduit for providing financing to nongovernmental entities. Interest on private activity bonds is not excluded from gross income for federal income tax purposes unless the bonds fall within certain defined categories.

[24] Federal law limits the amount of certain types of tax-exempt bonds that may be issued each year in the State. North Carolina has established the North Carolina Federal Tax Reform Allocation Committee (Committee) to manage the federal allocation and to decide which of the local bonds may be issued if the demand exceeds the supply. The Committee consists of the Secretary of the Department of Commerce, the Executive Assistant to the Governor for Budget Management, and the Treasurer.

[25] ARRTA provided that the 100 largest school districts in the United States are to receive a percentage of the total amount of bonds authorized. The following counties will receive a part of this special allocation:

- Mecklenburg - $25.96 million

- 100% of the available project proceeds of the issue of which it is a part are to be used for the construction, rehabilitation, or repair of a public school facility or to acquire land on which a facility funded by the same issue is to be built.
- The bond is issued by a state or local government within the jurisdiction of which the school is located.
- The issuer designates the bond as a qualified school construction bond under section 54F of the Internal Revenue Code.

- **Recovery zone facility bonds.** – Recovery zone facility bonds are a type of qualified private activity bond, the interest income of which is tax-exempt. The national limitation on the amount of these bonds that may be issued before January 1, 2011 is $15 billion. The IRS will allocate the national amount to the states based on an amount that bears the same ratio to the total limitation that its employment decline for 2008 bears to the aggregate of the 2008 employment declines for all of the states.

  A recovery zone facility bond is any bond issued before January 1, 2011 and where 95% or more of the net proceeds of the issue are to be used for recovery zone property. Recovery zone property is depreciable property constructed, reconstructed, renovated, or acquired by purchase by the taxpayer after the date on which the recovery zone designation took effect where substantially all of the use of the property is in a recovery zone and is in the active conduct of a qualified business by the taxpayer in the zone. A recovery zone is (1) any area designated as having significant poverty, unemployment, rate of home foreclosures, or general distress; (2) any area designated by the issuer as economically distressed by reason of the closure or realignment of a military installation; or (3) any area for which a designation as an empowerment zone or renewal community is in effect.

- **Recovery zone economic development bonds.** – Recovery zone economic development bonds are a type of qualified bond, which entitles the county or municipal issuer to elect to receive a 45% tax credit for the interest paid on the bond. Up to $10 billion in these bonds may be issued nationally before January 1, 2011. It is estimated that $351.7 million will be allocated to North Carolina. The proceeds of the bonds are to be used for qualified economic development purposes defined as expenditures for promoting development or other economic activity in a recovery zone.

- **Qualified energy conservation bonds.** – Qualified energy conservation bonds are a new type of tax credit bond authorized under the Emergency Economic Stabilization Act of 2008. These bonds provide a federal subsidy to assist state and local governments in financing energy conservation projects with respect to capital expenditures, research expenditures, expenses for mass commuting facilities, demonstration projects that promote green building technology, and other

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- Cumberland - $15.95 million
- Forsyth - $12.24 million
- Guilford - $17.15 million
- Wake - $17.30 million

technologies that promote energy efficiency. ARRTA expands the program by increasing the national cap from $800 million to $3.2 billion. North Carolina's allocation is $95.7 million.

Conform Federal Tax Reform Allocation Committee. – This act also amends the Article governing the Federal Tax Reform Allocation Committee (Committee) to reflect the addition of recovery zone facility bonds, recovery zone economic development bonds, and qualified energy conservation bonds under ARRTA. With this change, the Committee is authorized to manage the allocation of these new bonds and to study the ways in which these bonds can be utilized.

Authorize private sale of certain general obligation bonds. – Bonds issued by units of local government must be sold by the Local Government Commission (LGC) after advertisement and upon sealed bids, unless they meet one of the statutory exceptions. Under prior law, the following types of bonds could be sold at private sale:

- Bonds that a state or federal agency has previously agreed to purchase.
- Any bonds for which no legal bid is received within the time allowed for submission of bids.
- Revenue bonds and special obligation bonds issued pursuant to Chapter 159I of the General Statutes.
- Special obligation refunding bonds.
- Refunding bonds issued pursuant to G.S. 159-72, if the LGC determines that a private sale is in the best interest of the issuing unit.
- Bonds designated as qualified zone academy bonds pursuant to G.S. 115C-489.6, if the LGC determines that a private sale is in the best interest of the issuing unit.
- Project development financing debt instruments.

This act adds to the above list general obligation bonds issued pursuant to the Local Government Bond Act that have been rated by a nationally recognized credit rating agency at a credit rating below "AA" or that are unrated if they are sold prior to December 31, 2010.

The act also authorizes the private sale of bonds that are part of an issue in which the interest payments on some or all of the bonds are intended to be subsidized by payments from the federal government under federal tax laws, if the LGC determines that a private sale is in the best interest of the issuing unit. The purpose of this language is to permit the use of build America bonds, in which the interest subsidy is paid directly by the U.S. Treasury to the issuer of the obligations.

Conform Industrial and Pollution Control Facilities Financing Act. – The act makes conforming changes to the Industrial and Pollution Control Facilities Financing Act to take into account the recovery zone facility bonds authorized under ARRTA.

The Industrial and Pollution Control Facilities Financing Act authorizes the issuance of tax-exempt industrial development and pollution control bonds. Under this Act, a local political subdivision issues bonds, the proceeds of which are used to finance the acquisition and construction of industrial, pollution control, or other capital facilities to be used by a private company. The bonds are secured by and are sold exclusively on the basis of the company's obligation to make payments under a financing agreement entered into between the company and the political subdivision. Because the interest on the bonds is exempt from North Carolina and federal income taxes, the interest payments (made indirectly by the private company) are considerably lower than would be required in an ordinary taxable financing. The type and size of facilities that may be financed by industrial development and pollution control bonds are limited by both federal and state law.

The act authorizes a county or city to designate an Industrial Facilities and Pollution Control Financing Authority as a governmental entity authorized to issue recovery zone facility bonds. It allows facilities that qualify as recovery zone property in connection with the issuance of recovery zone facility bonds to qualify as "special purpose projects" under the Act. Finally, it allows facilities used in the production of tangible or intangible personal property to qualify as "industrial projects" under the Act.

Conform North Carolina Capital Facilities Financing Act. – The act also makes changes similar to those made to the Industrial and Pollution Control Facilities Financing Act, to the North Carolina Capital Facilities Financing Act. It allows facilities used in the production of tangible or intangible personal property to qualify as "projects" under the North Carolina Capital Facilities Financing Act.

Rescind Advanced Property Tax Appraisal.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-180	**HB 1530**	**Rep. Cole, Holloway, Burr, Starnes**

AN ACT TO VALIDATE THE SCHEDULE OF VALUES USED TO APPRAISE REAL PROPERTY FOR THE TAXABLE YEAR BEGINNING JULY 1, 2009, BY A COUNTY THAT ADOPTED A RESOLUTION TO POSTPONE A 2009 REAPPRAISAL BETWEEN JANUARY 1, 2009, AND JUNE 30, 2009.

OVERVIEW: This act validates a resolution adopted by a board of county commissioners between January 1, 2009, and June 30, 2009, to postpone a 2009 property tax reappraisal. The effect of the validated resolution is that the schedule of values adopted by the board of county commissioners and used to appraise real property in the county for its last reappraisal will remain the schedule of values for property tax appraisal purposes until the county reappraises real property in accordance with the statutory time schedule.[26]

FISCAL IMPACT: No General Fund impact.

[26] G.S. 105-286 requires counties to reappraise real property at least every eight years. The purpose of a reappraisal is to help a county fairly and equitably distribute the tax burden between the different classes of property. To accomplish this purpose, a county may voluntarily advance its reappraisal schedule to a shorter cycle by passing a resolution setting a different reappraisal cycle. A county that has advanced its reappraisal cycle may also pass a resolution to go back to a longer cycle, so long as the octennial requirement continues to be met.

EFFECTIVE DATE: This act became effective when it was signed into law by the Governor on June 26, 2009.

ANALYSIS: This past year's economic condition, in which the national median sales price for existing homes dropped by roughly 25%, the stock market began sliding, and North Carolina's unemployment rate increased, was an impetus for counties to postpone their 2009 property tax reappraisals.[27] In 2009, six counties voted to repeal or postpone their 2009 revaluations. Four of the counties that had advanced their property tax appraisals and had already conducted reappraisals for the 2009 taxable year, chose to postpone the 2009 appraisals after January 1, 2009.[28] In April, 2009, the North Carolina Attorney General issued an advisory memorandum confirming the earlier opinions of the Department of Revenue and the School of Government that North Carolina law does not permit a county to rescind a revaluation once the schedule of values becomes effective on January 1. The advisory memorandum pointed out that under North Carolina law a board of county commissioners must review and approve a schedule of values before January 1 of the year they are applied, and that the value of real property is determined as of January 1 of the year in which the valuation is fixed. Because the statutes do not expressly authorize a county to repeal a schedule of values once it takes effect, such authority may not be read into the statutes. A county must therefore proceed with the schedule of values approved by the county commissioners. The memorandum also emphasized that if a county were allowed to rescind previous approval of an advanced reappraisal and the new schedule of values at any time during the year, then the tax rate determined by the county might not meet its financial needs.[29]

The act validates the resolutions adopted by Caldwell, Stanley, and Rockingham Counties, as well as that of any other county, to repeal or postpone the 2009 revaluations so long as the boards of county commissioners voted to do so by June 30, 2009.

Two-Thirds Bonds Act of 2008.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-209	**HB 1508**	**Rep. Owens, Goforth, Womble**

AN ACT TO MAKE TECHNICAL CORRECTIONS TO THE TWO-THIRDS BONDS ACT OF 2008 AND TO PROVIDE FOR THE ISSUANCE OF GENERAL OBLIGATION BONDS TO FINANCE

[27] See Christopher B. McLaughlin, "The Revaluation Revolt of 2009", *Local Government Law Bulletin* No. 121 (September2009), available at www.sog.unc.edu/bulletins/lglb for a detailed discussion of the history of this legislation.
[28] Caldwell County passed a resolution on January 5, 2009, to delay its revaluation until 2011; Stanly County passed a resolution on January 20, 2009;Rockingham County passed its resolution on March 9, 2009; and Swain County abandoned its 2009 revaluation in June, 2009.
[29] A county must submit a tax rate to the governing board by June 1, and the rate must be approved by July 1. The tax rate, necessary to meet the financial needs of the county, is based upon the value of the taxable property.

THE COSTS OF THE BIOMEDICAL RESEARCH IMAGING CENTER.

OVERVIEW: This act modifies the Two-Thirds Bonds Act of 2008[30] in the following two ways:

- It changes the way the term 'biennium' is used for purposes of calculating the two-thirds bonds availability. The effect of this change is to extend the authorization for the sale of bonds for the Green Square Project into the 2009-2011 biennium.
- It adds as an authorized special indebtedness project the Biomedical Research Imaging Center at the University of North Carolina at Chapel Hill. The act authorizes the issuance of $223 million of non-voted general obligation bond indebtedness to finance the capital costs of this facility.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 29, 2009.

ANALYSIS: Last year, the General Assembly, in its continuation budget, authorized the issuance of $107 million of non-voted general obligation bond indebtedness to finance the Green Square Project. 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, Section 3(f)[31] of the North Carolina Constitution, the State may issue non-voted general obligation bonds in an amount not to exceed two-thirds of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. The term 'biennium' is not specifically defined in the Constitution. The Two-Thirds Bonds Act of 2008 used the term 'biennium' to refer to any consecutive two-year period. Specifically, it referred to the two-year period ending June 30, 2008. Based upon this formula, the State could have issued up to $125 million of non-voted general obligation bonds for fiscal year 2008-2009. No bonds have been issued under this authorization yet.

The current bond counsel for the State of North Carolina interprets the term 'biennium' as used in Article V, Section 3(f) of the North Carolina Constitution to refer to the traditional State biennium beginning on July 1 of odd-numbered years and ending on June 30 of the second following year. Thus, two-thirds bonds may be issued during the biennium ending June 30, 2011 based on the amount of net debt reductions for the biennium ending June 30, 2009. This interpretation is consistent with the way the State applied the two-thirds provision for bonds authorized by legislation enacted in 1988 (S.L. 1987-1048) and in 1991

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[30] Section 27.9 of S.L. 2008-107, as amended by Section 2.7(c) and (d) of S.L. 2008-118.

[31] **"Sec. 3. Limitations upon the increase of State debt.**

(1) Authorized purposes; two-thirds limitation. The General Assembly shall have no power to contract debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State who vote thereon, except for the following purposes:

…

(f) for any other lawful purpose, to the extent of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the next preceding biennium."

(S.L. 1991-760). With this change, the issuance of the two-thirds bonds authorized last session for the Green Square Project would be moved to the 2009-2011 biennium.

The Green Square Project consists of an office building for the North Carolina 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 million. The General Assembly appropriated $25 million 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 $27.5 million towards the cost of the Nature Research Center and $15.5 million toward the cost of the exhibits.

This act also adds as a project to the Two-Thirds Bonds Act of 2008, the Biomedical Research Imaging Center at the University of North Carolina at Chapel Hill (BRIC). The act authorizes the issuance of $223 million of non-voted general obligation bond indebtedness to finance the capital costs of this facility.

Under the constitutional two-thirds limitation, the State may issue up to $486.8 million of non-voted general obligation bonds this coming biennium. Under the Debt Affordability Study, dated February 2009, the State's recommended debt affordability capacity for each of the next five years is $50.2 million. In conducting its analysis, the Treasurer's Office included anticipated debt of the Green Square Project. The addition of the BRIC project to the act would cause the State to exceed the recommended debt capacity. Therefore, the act also adjusts the indebtedness for several projects financed through special indebtedness to provide enough debt capacity, under the Debt Affordability Study, to add BRIC to the Two-Thirds Bonds Act of 2008.

EMS/Fire Dept. Sales Tax Refund.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-233	**HB 511**	**Rep. Williams, Goforth, Lucas, E. Warren**

AN ACT TO REENACT THE SALES TAX REFUND FOR CERTAIN VOLUNTEER EMERGENCY RESPONSE PERSONNEL.

OVERVIEW: This act allows a volunteer fire department and a volunteer EMS squad that is exempt from income tax under the Internal Revenue Code (Code) a sales and use tax refund, regardless of how the nonprofit is organized.

FISCAL IMPACT: The act will reduce General Fund revenues by $2.4 million in fiscal year 2009-2010 and $2.5 million in fiscal year 2010-2011. The act will also reduce local revenues by $1.0 million in fiscal years 2009-2010 and approximately $1.0 million in each year thereafter. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective July 1, 2008, and applies to purchases made on or after that date. The retroactive effective date refers to the date that the 2008 clarifying legislation became effective. The change made by this bill effectively reinstates the semiannual sales and use tax refund for volunteer fire departments and voluntary EMS squads.

ANALYSIS: During the 2008 Session, the General Assembly clarified the types of nonprofits that may receive a semiannual refund of State and local sales and use taxes paid by the nonprofit on direct purchases of tangible personal property and services[32] for use in carrying on the work of the nonprofit entity. Prior to the clarification, the Department of Revenue had to determine whether an entity requesting a refund was a 'charitable institution.' To make its determination, the Department relied upon past determinations and court decisions. In May 2008, the North Carolina Court of Appeals appeared to expand what could be considered a 'charitable institution.'[33] The intent of the 2008 legislation was neither to expand nor limit the prior law's application but to clarify it.

The clarification provided a bright line test that used as its starting point nonprofits exempt from income tax under section 501(c)(3) of the Code. The clarification became effective July 1, 2008. After the passage of the legislation, some volunteer fire departments learned they no longer qualified for the sales and use tax refund because they were not organized as a section 501(c)(3) organization. Many of the volunteer fire departments organized prior to the mid-1970s organized as a section 501(c)(4) organization[34] because that is how, at the time, the IRS recommended they organize.

This act allows a volunteer fire department or a volunteer EMS squad that is exempt from income tax under the Code a sales and use tax refund, regardless of how the nonprofit is organized. A request for a refund for the first six months of a calendar year is due the following October 15, and a request for a refund for the second six months of a calendar year is due the following April 15. However, under G.S. 105-164.14(d), a refund is not barred unless it is applied for more than three years after its due date.

Tax Info Disclosure to State Treasurer.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-283	**SB 691**	**Senator Dorsett**

AN ACT TO PERMIT DISCLOSURE OF CERTAIN TAX INFORMATION OF LOCAL GOVERNMENTS TO THE DEPARTMENT OF STATE TREASURER AND TO ENACT THE

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[32] The refund does not apply to direct purchases of electricity, telecommunications service, or ancillary service.
[33] *The Lynnwood Foundation v. N.C. Department of Revenue.* 660 S.E.2d 611 (2008).
[34] Section 501(c)(4) refers to civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

TREASURER'S GOVERNANCE AND TRANSPARENCY ACT OF 2009.

OVERVIEW: This act makes the following changes related to the authority of the State Treasurer:

- Permits the Department of Revenue to disclose certain tax information concerning local governments to the Treasurer's Office.
- Increases the membership of the State Treasurer's Investment Advisory Committee from five to seven members by adding two public members and changes the experience requirements of the public members.
- Codifies the fiduciary standard to be applied to the Treasurer with respect to the discharge of his or her duties in connection with the retirement systems administered by the Treasurer's Office.
- Requires the Treasurer to make annual reports to the General Assembly on investments made under new grants of authority.[35]

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 10, 2009.

ANALYSIS: This act was requested by the Office of the State Treasurer and makes several changes related to the Treasurer's authority.

Disclosure of tax information. – The act creates a new exception in the tax secrecy statute by authorizing the Department of Revenue to release tax information to the Treasurer's Office concerning whether a local government has timely filed a withholding report, has charged a penalty, or has paid a penalty for failure to file the report. This information may be used by the Treasurer to determine compliance with the Local Government Finance Act.

Current law provides that the disclosure of tax information is prohibited unless the disclosure is for one of the purposes enumerated by statute. There are currently over 35 purposes for which disclosure is permitted. Individuals who disclose tax information in violation of the statute are guilty of a Class 1 misdemeanor. Public officials and employees who disclose tax information in violation of the statute are dismissed from office or employment and may not hold public office or public employment for five years after the violation.

Increased Investment Advisory Committee membership. **–** The State Treasurer is authorized to appoint an Investment Advisory Committee (Committee). Under prior law, the Committee consisted of five members: the State Treasurer, two members from the board of trustees of the Retirement Systems, and two public members. The public members were required to have experience in one or more of the following areas: investment management, real estate investment trusts, real estate development, venture capital investment, or absolute return strategies. The Committee has only advisory powers.

[35] The last three bullets were originally the contents of Senate Bill 632.

This act increases the membership of the Committee from five to seven members, with the two additional members to be appointed by the Treasurer as public members. The act also changes the experience requirements for the public members by removing the requirement for experience in real estate investment trusts and venture capital investments, and substituting experience in securities law.

Codification of fiduciary standard. – The State Treasurer is authorized to invest the assets of all the State-administered retirement systems. There are several limitations on the amount and types of investments that can be made with these funds. This act codifies the fiduciary standard applicable to the Treasurer with regard to the administration of the retirement systems. The standard was modeled on the Model Uniform Management of Public Employee Retirement Systems Act, which was approved by the National Conference of Commissioners on Uniform State Laws. Specifically, the Treasurer must discharge his or her duties as follows:

- Solely in the interest of participants and beneficiaries.
- For the exclusive purpose of providing benefits and paying reasonable administrative expenses.
- With the care, skill, and caution under the circumstances that a prudent person who was familiar with the matters would use in a like situation.
- Impartially, taking into account the differing interests of participants and beneficiaries.
- Incurring only appropriate and reasonable costs.
- In accordance with a good-faith interpretation of the law governing the Retirement Systems.

The act also sets standards to be used by the Treasurer in investing and managing the assets of the retirement systems, including that the Treasurer:

- Must consider the following circumstances:
    - General economic conditions.
    - The possible effects of inflation or deflation.
    - The role of each investment in the overall portfolio.
    - The expected total return and the appreciation of capital.
    - Needs for liquidity, regular income, and preservation or appreciation of capital.
    - The adequacy of funding based on reasonable actuarial factors.
- Must diversify the investments unless the Treasurer determines it is clearly not prudent to do so.
- Must make reasonable efforts to verify relevant facts.
- May invest in any kind of real property which the State is authorized to acquire under Article 6 of Chapter 146 of the General Statutes.
- May consider other benefits created by an investment in addition to return on the investment, only if the investment would be prudent even without the collateral benefit.

The Treasurer's compliance with this standard must be determined based on the facts and circumstances at the time the decision was made, not using hindsight. In addition, the Treasurer's investment and management decisions must be evaluated in light of the portfolio as a whole and as part of an overall investment strategy.

<u>Reporting requirement.</u> – The act also provides that when the Treasurer is granted broadened investment authority by the General Assembly regarding certain funds, the Treasurer must report in detail to the General Assembly regarding the investments. The report must be made for four years after the new authority is granted, and include the return on those investments, earnings, changes to value, and gains and losses in the disposition of the investments. The funds are:

- The General Fund.
- The Teachers' and State Employees' Retirement System.
- The Consolidated Judicial Retirement System.
- The Firemen's and Rescue Workers' Pension Fund.
- The Local Government Employees' Retirement System.
- The Legislative Retirement System.
- The North Carolina National Guard Pension Fund.
- Any idle fund.

<u>Defer Tax on Builders' Inventory.</u>

Session Law	*Bill #*	*Sponsor*
S.L. 2009-308	**HB 852**	**Rep. Dickson, Brubaker, Holliman, Wainwright**

AN ACT TO DEFER A PORTION OF THE PROPERTY TAX DUE ON REAL PROPERTY HELD FOR SALE BY A BUILDER.

<u>OVERVIEW:</u> This act creates a property tax deferral program to defer for a maximum of three years the portion of taxes on an unoccupied, unsold residence attributable to the construction of the residence by a builder.

<u>FISCAL IMPACT:</u> This act is estimated to result in a deferral of local property tax revenues in the amount of $30-$35 million in FY 2010-11 and $7-$12 million in FY 2011-12. Minimal or positive impact in subsequent years as program sunsets and deferred taxes are paid.

<u>EFFECTIVE DATE:</u> This act is effective for taxes imposed for taxable years beginning on or after July 1, 2010, and is repealed for taxes imposed for taxable years beginning on or after July 1, 2013.

<u>ANALYSIS:</u> North Carolina currently has six property tax deferral programs: (i) historic district property held as future site of historic structures , (ii) the circuit breaker tax deferral program , (iii) nonprofit property held as future site of low or moderate income housing ,

(iv) present use value (PUV) property , (v) working waterfront property , and (vi) historic property. Uniform tax provisions for all deferral programs include the following:

- Taxes that are deferred under one of these programs become a lien on the property, which is extinguished when the taxes are paid.
- The deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event.
- Interest accrues during the deferral period as of the date the taxes would have originally become due without the deferral program.
- Upon disqualification, the tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program.

This act adds a seventh property tax deferral program for an occupant-ready residence constructed[36] and owned by a general contractor for resale on a parcel of real property. The amount of property tax liability that can be deferred is the portion of tax that represents the increase in the property value resulting from the construction of the residence on the property. For example, if the land value of unimproved real estate was $100,000, and the value of the property, as improved by the construction of a residence, was $400,000, the builder must pay the property tax on the land value ($100,000) but may defer the property tax liability for the value of the improvement ($300,000).

The deferred taxes are carried forward in the records of the county and, if applicable, the city in which the property is located until the occurrence of one of the following disqualifying events: (1) the builder transfers the residence; (2) the residence is occupied by the builder or another with the builder's consent; (3) five years from the time the improved property was first subject to being listed for taxation by the builder, or (4) three years from the date the improved property first received the property tax benefit provided by this deferral program. The uniform provisions for deferral programs apply to this inventory tax deferral program. Applications should be filed within the regular listing period and may be filed later if the board of equalization and review determines there is good cause for the lack of timely filing.

Energy Savings Contracts' Cap/Program Admin.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-375	**SB 304**	**Senator Clodfelter**

AN ACT TO INCREASE THE AMOUNT THE STATE MAY FINANCE UNDER GUARANTEED ENERGY SAVINGS CONTRACTS AND TO MODIFY THE REPORTING REQUIREMENTS.

[36] Construction activities limited to renovating, refinishing, rehabilitating, or remodeling do not qualify.

<u>OVERVIEW:</u> This act increases the cap on guaranteed energy savings contracts and modifies the reporting requirements of the program.

<u>FISCAL IMPACT:</u> There is no net impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: <u>Fiscal and Budgetary Actions</u>, 2009 Session. Available in the Legislative Library.)*

<u>EFFECTIVE DATE:</u> This act became effective when signed into law by the Governor on July 20, 2009.

<u>ANALYSIS:</u> State agencies and local governments have the authority to enter into financing contracts to finance the cost of energy conservation measures. Prior to this act, the aggregate principal amount payable by the State under these contracts was limited to $100 million. An energy conservation measure is a facility or meter alteration, training, or services that will provide anticipated energy savings with respect to a facility. The financing contracts are known as guaranteed energy savings contracts. Under the contract to implement energy conservation measures, all payments, except obligations on early termination, are to be made over time, and energy cost savings are guaranteed to exceed the cost of the contract.

The law provides that a guaranteed energy savings contract is not a pledge of the government's taxing power. The debt is secured by a lien on, or a security interest in, any part of the property with respect to which an energy conservation measure is undertaken and/or the land upon which the property is or will be located. It is anticipated that the energy savings will generate enough money to pay the debt service on the contract. This is a method of funding repair and renovation projects without impacting the State's debt capacity.

State agencies that enter into guaranteed energy savings contracts are required to report to the State Energy Office which, in turn, reports annually to the Joint Legislative Commission on Governmental Operations. State energy conservation measures are subject to inspection and compliance by the State Construction Office or the local building inspector. The cost of the evaluation of the contract by either an independent architect or engineer, or by the State Construction Office, and the costs of the necessary building inspections are included in the cost of the contract.

Before a guaranteed energy savings contract can be entered into, the Office of State Budget and Management must certify that resources are expected to be available to pay the amounts due under the contract. Next, the Council of State must approve the contract by resolution that sets out the maximum maturity and the maximum interest rates. The maximum maturity may not exceed 20 years. The State Treasurer also must approve the financing, finding that the amount to be borrowed is adequate and not excessive, that it 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.

This act increases the limit on the contracts from $100 million to $500 million, and clarifies that the limit is a revolving limit based on the amount of contracts at any given time rather than a limit on the aggregate amount of all savings contracts entered into. The act requires a qualified provider to conduct a life-cycle cost analysis of each conservation measure in a final proposal. A life-cycle cost analysis considers certain costs of owning and using property over its economic life, including the initial costs, system repair and replacement costs, maintenance costs, operating costs, and salvage value. The act also requires local governments that enter into energy savings contracts to report the contracts and the terms of the contracts to the State Energy Office. Previously, local governments that entered into energy savings contracts were required to report the contracts to the Local Government Commission.

JDIG Technical Modifications.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-394	**HB 1516**	**Rep. Crawford, Dickson, Gibson**

AN ACT TO MAKE CERTAIN MODIFICATIONS TO AND EXTEND THE SUNSET OF THE JOB DEVELOPMENT INVESTMENT GRANT PROGRAM.

OVERVIEW: This act makes clarifying and technical changes to the Jobs Development Investment Grant program and extends the sunset of the program from 2010 to 2016.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 31, 2009.

ANALYSIS: In 2002, the General Assembly created a new economic development tool for new and expanding businesses in North Carolina, the Job Development Investment Grant (JDIG) Program. JDIG is used to attract businesses to the State by allowing a five-member Economic Investment Committee[37] to award grants to businesses. The grants may be awarded over as many as 12 years, and the amounts of the grants are based on income tax withholdings from new jobs created by the businesses. The Committee may enter into no more than 25 agreements per calendar year and may commit no more than $15 million in any fiscal year under all agreements entered into during a single calendar year. When the General Assembly created the program, it imposed a two-year sunset on the authority of the Committee to enter into new grant agreements. The General Assembly has voted to extend this sunset three times since its enactment.[38] This act extends the program a fourth time, from January 1, 2010 to January 1, 2016.

The act also makes the following clarifying and technical changes to the program, upon the recommendation of the Department of Commerce.

- Section 1 removes the reference to 'negotiated' agreements because the form of the basic agreement is standard for all grantees. The term 'negotiated' has led some grantees to believe they may negotiate the terms required by the State.
- The act clarifies that the JDIG program awards grants, and that the program may enter into agreements with businesses to provide grants.

[37] The members of the Committee are the Secretary of Commerce, the Secretary of Revenue, The Director of the Office of State Budget and Management, and two public members appointed by the General Assembly, one upon the recommendation of the President Pro Tempore of the Senate and the other upon the recommendation of the Speaker of the House of Representatives. G.S. 143B-437.54.

[38] S. L. 2004-124, S.L. 2005-241, and S.L. 2006-168.

- Section 1 removes language that refers to the cap on annual grants for the year 2006.
- Section 2 clarifies that a business may apply for grants that include performance by related members of the business. The purpose of this change is to make it clear that the grantee is not the legal representative of the related member and that the related member has no legal right to grant payments. Current law provides that a business may not include performance by related members in its application for a grant unless the related members assign to the business any claim of right the related members may have to apply for grants individually.
- Section 2 changes the annual reporting requirements of the JDIG program as follows:
  - The report must include the annual maximum State liability under each grant awarded as well as the maximum total lifetime State liability under the grant.
  - The report may list the wage levels of jobs created by projects that received grants in increments of $10,000 as opposed to $5,000.
  - The report must identify any changes in criteria developed by the Economic Investment Committee to implement the program.
  - The report must indicate separately the number of awards made to new businesses and those made to existing, expanding businesses.
- Sections 3 and 5 change the method for reducing grants whenever a grantee defaults upon one or more of the provisions in the agreement. Previously, the Economic Investment Committee had to must formally approve an amendment to the grant agreement to implement the grant reduction. Under the act, the Committee and its staff may reduce the amount or term of grant if a grantee fails to comply with the terms of the agreement. A grant agreement must include provisions providing the Committee with this authority. It also provides for a reduced payment due to default in the payment for the year in which the default occurred, rather than the following year.
- Section 4 clarifies that the grantees must provide annual reports showing withholding as well as identifying positions created during the year that remained filled at the end of the year.

Continue School Construction Funding.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-395	**HB 311**	**Rep. Yongue, Glazier, Johnson, Wainwright**

AN ACT TO CONTINUE THE CONSTRUCTION FUNDING OF SCHOOLS THROUGH THE FIRST AND THE SECOND ONE-HALF CENT SALES AND USE TAXES.

<u>OVERVIEW:</u> This act makes permanent the designation of a certain percentage of local sales and use taxes for public school capital outlay purposes or related debt retirement by eliminating the sunsets on those requirements.

<u>FISCAL IMPACT:</u> This act has no impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: <u>Fiscal and Budgetary Actions</u>, 2009 Session. Available in the Legislative Library.)*

<u>EFFECTIVE DATE:</u> This act is effective January 1, 2010, and applies to sales made on or after that date.

<u>ANALYSIS:</u> A percentage of the first ½ cent and second ½ cent sales and use tax levied by counties must be used for public school capital outlays. Under both the first ½ cent and second ½ cent sales and use tax, the amount designated for public school capital outlay may be used to retire indebtedness incurred for public school capital outlay. However, if a county can demonstrate that it does not need the earmarked revenue to meet its public school capital needs, it may petition the Local Government Commission to authorize it to use the money for any public purposes. In making its decision, the Commission must consider not only the public school capital needs but also the other capital needs of the county.

<u>First ½ Percent Sales and Use Tax.</u> – Article 40 of Chapter 105 of the General Statutes provides counties that levy a one percent (1%) sales and use tax the authority to levy an additional one-half percent (1/2%) sales and use tax. For the first five years of the tax, 40% of the revenue must be used for public school capital outlay; for the next 23 years of the tax, 30% of the revenue must be used for public school capital outlay. This act amends G.S. 105-487 to require that after the first five years that the first one-half percent (1/2%) sales tax is in effect, 30% of the revenue must always be used for public school capital outlay or indebtedness.

<u>Second ½ Percent Sales and Use Tax.</u> – Article 42 of Chapter 105 provides counties that levy the one percent (1%) sales tax and the additional first one-half percent (1/2%) sales and use tax the authority to levy a second one-half percent (1/2%) sales and use tax. For the first 25 years of the tax, 60% of the revenue must be used for public school capital outlay, unless the amount allocated to the county under the first one-half percent (1/2%) is greater than the amount allocated under the second one-half percent (1/2%) sales tax, the difference between the two amounts. This act amends G.S. 105-502 to require that 60% of the revenue from the second one-half percent (1/2%) sales tax, as designated in that section, must always be used for public school outlay purposes or to retire indebtedness incurred for that purpose during the five years before the indebtedness took effect.

<u>Sales Tax: Reliance on Written Advice by DOR.</u>

Session Law	*Bill #*	*Sponsor*
S.L. 2009-413	**SB 909**	**Senator Clodfelter**

AN ACT EXTINGUISHING THE LIABILITY OF RETAILERS FOR SALES TAX OVERCOLLECTIONS MADE IN RELIANCE ON WRITTEN ADVICE OF THE SECRETARY OF REVENUE.

<u>OVERVIEW:</u> This act provides that if a retailer collects sales tax from a customer in excess of the amount that should have been collected, based on specific written advice it received from the Secretary of Revenue, the retailer is not liable to the customer for the overcollected amount. The act also clarifies that there is no change to the current requirement that a retailer must issue a refund to the customer prior to the retailer obtaining a refund from the Department.

<u>FISCAL IMPACT:</u> No fiscal impact.

<u>EFFECTIVE DATE:</u> This act became effective when the Governor signed it into law on August 5, 2009.

<u>ANALYSIS:</u> This act provides that a seller is not liable to a purchaser if the seller collected and remitted sales and use tax in accordance with written advice it received from the Department.

All sales taxes, including over-collections, must be remitted to the Department. In the case of an overcollection, a purchaser's first course of remedy is to seek a refund from the seller who, in turn, may obtain a refund from the Department. A cause of action against the seller does not accrue until a purchaser has provided written notice to a seller, and the seller has had sixty days to respond. If the seller issues a refund or credit to the purchaser, the seller may then apply to the Department for the amount of the refund or credit. A seller is not entitled to a refund or credit unless the purchaser has been refunded or received a credit for the amount of tax erroneously charged.

A taxpayer may request specific advice from the Department. If the Department furnishes erroneous advice and the taxpayer reasonably relies on that advice, the taxpayer is not liable to the Department for any penalty or additional assessment attributable to the erroneous advice to the extent the following conditions are satisfied:

- The advice was reasonably relied upon by the taxpayer.
- The penalty or additional assessment did not result from the taxpayer's failure to provide adequate or accurate information.
- The Department provided the advice in writing or the Department's records establish that the Department provided erroneous verbal advice.

Current law already provides that a taxpayer (in this case, the seller) is not liable to the Department for any penalty or additional assessment if the advice it received from the Department was wrong. Under this act, a seller is immunized from liability with respect to a purchaser from whom it overcollected sales and use tax based on advice the seller relied upon from the Department.

Franchise Tax-Overbilling Out of Capital Base.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-422	**SB 367**	**Senator Jenkins**

AN ACT TO REMOVE BILLINGS IN EXCESS OF COSTS FROM THE FRANCHISE TAX CAPITAL BASE FOR TAXPAYERS USING THE PERCENTAGE OF COMPLETION METHOD OF REVENUE RECOGNITION.

OVERVIEW: This act excludes from a corporation's franchise tax base all billings in excess of costs, effective for taxable years beginning on or after January 1, 2010.

FISCAL IMPACT: This act has the potential to impact General Fund revenues. However, according to the Department of Revenue a specific determination was not possible. Currently, the account is either incorrectly included in the liabilities total as definite and accrued, or properly excluded from this amount. Because the exclusion is not specifically reported on the return, it is not possible to quantify the number of taxpayers in compliance with current law or not in compliance. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective for taxable years beginning on or after January 1, 2010.

ANALYSIS: This act exempts billings in excess of costs from surplus and undivided profits, thus excluding them from the franchise tax capital base.

The State imposes a franchise tax on C-corporations and S-corporations. The tax rate is $1.50 per $1,000[39] and is applied to a company's capital stock, surplus, and undivided profits.[40] The term "surplus" for franchise tax purposes has a broader and more inclusive meaning than the generally accepted accounting definition. G.S. 105-122(b) provides that surplus and undivided profits includes all liabilities, reserves, and deferred credits unless those items are specifically exempt. One of the exemptions from surplus and undivided profits is "definite and accrued legal liabilities." The Department of Revenue defines a definite and accrued legal liability as one that meets both of the following conditions:

- The liability is definite in amount, meaning it is exactly determined and not merely accurately estimated.
- The liability will be incurred before the end of the taxable year.

Generally accepted accounting principles require that revenue be recorded in the period it is earned regardless of when it is billed or when cash is received. In long-term construction contracts, there is often a mismatch between actual billed revenue and earned revenue. Sometimes elements of a contract are billed in advance and sometimes they are delayed. The accounting solution to this problem is the percentage of completion method of revenue recognition. Under this method of accounting, where the costs can be reasonably estimated,

[39] The minimum tax is $35.
[40] A corporation's capital base may not be less than 55% of the appraised value of tangible property in NC, nor less than its actual investment in tangible property in the State.

revenue is recognized as production takes place. This method of accounting may result in "billings in excess of costs" or "cost in excess of billings." Billings in excess of costs is a balance sheet liability because it represents unearned income. Cost in excess of billings is a balance sheet asset. For purposes of the State's franchise tax, the balance sheet liability of "billings in excess of costs" is not considered a definite and accrued legal liability because it is based on estimates; therefore, it is included in a corporation's capital base.

The construction industry sought to change this interpretation because it resulted in contractors having to pay taxes on liabilities and for revenue they had not actually received. The act incorporates the industry position by providing that billings in excess of costs that are determinable using the percentage of completion principles are exempted from surplus and divided profits, and therefore, excluded from the franchise tax base.

Rev Laws Tech, Clarifying, & Admin. Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-445	**SB 509**	**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 following taxes and related laws: privilege license, income, excise and insurance taxes; sales and use taxes and highway use taxes; property taxes; occupancy taxes; and motor fuel taxes.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: Except as otherwise specified, this act became effective when signed into law by the Governor on August 7. 2009.

ANALYSIS:

Section	Explanation
Privilege License, Income, Excise, and Insurance Tax Changes	
1	Clarifies the privilege license tax on home inspectors applies to an individual licensed under the Home Inspector Licensure Act so that associate home inspectors will be taxed similarly. S.L. 2008-206 imposed an annual State privilege license tax of $50 on a licensed home inspector but it failed to mention associate home inspectors. Without this change, an associate home inspector would be subject to local privilege license tax in each city that levies the tax.[41]
2	Moves the definitions from subsection (b) to a newly created subsection (b1).

[41] S.L. 2009-509 sunset the associate home inspector license. That legislation provides that the Home Inspector Licensure Board may not accept applications for associate home inspector licensees after April 1, 2011, and it may not renew an associate home inspector license after October 1, 2013.

	The current subsection (b) contains two different subdivision lists. This change puts the defined terms, listed by subdivisions, into a new subsection.
3	Clarifies that a recycling facility[42] that is eligible for the tax credit for investing in large or major recycling facility is not also eligible for the Article 3J tax credit for investing in business property. This section becomes for taxable years beginning on or after January 1, 2007, the year the Article 3J tax credits became effective.
4	Changes the term 'nonbusiness activities' to 'activities producing nonapportionable income', which is a defined term in the statute that sets out the manner in which corporations must allocate and apportion their income to North Carolina for income tax purposes. In 2002, the terms 'business income' and 'nonbusiness income' were replaced by apportionable and nonapportionable. This subsection was missed when those changes were made.
5	Clarifies that a corporate taxpayer may not use an alternative apportionment method unless it receives a written decision from the Secretary authorizing it to do so. A return that is not filed in accordance with the statutes is an improper return. This section specifically states that return prepared using an alternative apportionment formula without the permission of the Secretary is an unlawful return.
6	Corrects an effective date relating to changes made to the statute designating who may sign an income tax return. These changes were originally part of the major rewrite of the tax appeals procedure in 2007 (SB 242).
7	Repeals an unnecessary statute in the corporate and personal income tax laws. The Department of Revenue does not ask taxpayers to file a 'supplemental' return. A taxpayer files either an original return or an amended return. If the Department determines additional tax is due, it proposes an assessment.
8	Clarifies the reporting requirements for the film industry credit. The term 'claimed' may have several different meanings. The Department of Revenue requested clarity as to the meaning of the term.
9	Clarifies the application of the dollar cap amounts under the qualified business investment credit and the credit for certain real property donations in light of the 2009 Court of Appeals decision in the *North Carolina Department of Revenue v. Hudson* case. In that case, the court held that the statutory cap of $50,000 limits the amount a taxpayer may claim in a single tax year and allowed the taxpayer to carry forward amounts in excess of the cap. The change makes clear that an individual may only carry forward unused amounts of the credit up to the cap rather than being able to carry forward amounts in excess of the cap.
10	Changes the date by which the State Treasurer must make a transfer from the General Fund to the North Carolina Health Insurance Risk Pool Fund. The

[42] The General Assembly enacted the credit as a tax incentive for Nucor in 1985.

	statute provided that *within 75 days after the end of each fiscal year*, the Treasurer must transfer to the Fund an amount equal to the growth in net revenue from the gross premiums tax on insurance companies. Insurance tax returns are due by March 15. Insurance companies are also required to prepay their tax in installments. The first installment of the fiscal year is due by October 15. Therefore, until those installments are remitted, little or no funds are available for transfer. This section changes the date from within 75 days after the end of the fiscal year, or September 14, to November 1, as recommended by the Department of Revenue.
Sales and Use Tax and Highway Use Tax Changes	
11	Updates the reference to the Streamlined Agreement from June 23, 2007 to May 12, 2009. North Carolina does not need to amend its sales and use tax laws to conform to the changes made in the Agreement since June 23, 2007. A copy of the Agreement, as well as a document summarizing the changes made to the Agreement since June 23, 2007, may be found on the Streamlined Sales Tax Project's website: www.streamlinedsalestax.org
12	Makes two conforming changes to the general sales tax sourcing principles. It provides that direct mail is sourced to the location where the property is delivered, and if that is unknown, it is sourced to the location from which the direct mail was shipped. This change ensures compliance with the Streamlined Agreement. This section also codifies the long-standing sourcing method used for florist wire sales: the sale is sourced to the business location of the florist that takes the order for the sale.
13	Reorganizes the statutory subsection without making any substantive changes.
14	Replaces the word 'energy' with the word 'electricity' for consistency. This term appears in the statute enacted last year authorizing a sales tax refund for materials used to build a facility that manufactures solar electricity generating materials. This section is effective July 1, 2008, the effective date of the original provision.
15	Provides a new distribution methodology for the allocation of sales tax collected o modular homes to local governments. The methodology currently references the distribution under the third ½ cent local sales and use tax; but this tax is repealed effective October 1, 2009. A 2.5% State sales tax applies to the sale of a modular home. Twenty percent of the tax collected is distributed to the counties. This amounts to approximately $1 million annually. This section provides that 20% of the sales tax collected on modular homes will be allocated to the counties on a per capita basis, and distributed to the county and its municipalities as provided in the first ½ cent local sales tax.
16	Repeals an unnecessary highway use tax exemption. A transfer of a motor vehicle to a handicapped person from the Department of Health and Human Services after the vehicle is equipped by the Department for use by the handicapped is exempt from highway use tax. The exemption is not needed

	because the Department never takes title to the vehicle.
17	Corrects two incorrect statutory references.
18	Clarifies how a bundled transaction that includes food is taxed under the local option ¼ cent county sales tax article. *See GS 105-164.4D.*
19	Simplifies the Mecklenburg local sales tax in Chapter 1096 of the 1967 Session Laws without making any substantive changes. Currently, the administration of the sales and use tax under the Mecklenburg local act and Article 39 of Chapter 105 are the same with the exception of the distribution formula. Under the local act, proceeds are divided between the county and the cities on an ad valorem basis; Article 39 gives counties a choice between ad valorem and per capita.
Property Tax Changes	
20	Reinserts the word 'shares', which was inadvertently deleted from the definition of 'corporation' when changes were made in 2008 to the property tax homestead circuit breaker.
21	Modernizes the language.
22.(a)	Clarifies that the homestead exclusion applies uniformly to a husband and wife, regardless of how they hold title to the property.
22.(b)	Makes the following clarifying and technical changes to the homestead circuit breaker: • Clarifies that property owned by a qualifying owner must have been the owner's permanent residence for at least five consecutive years but that the owner's five-year occupancy does not have to be consecutive. • Clarifies that the occupancy and ownership requirement refers to 'length' of occupancy and ownership. • Clarifies that the homestead circuit breaker applies uniformly to a husband and wife, regardless of how they hold title to the property. • Removes an unnecessary word. • Clarifies that a person may defer the portion of the principal amount of tax that is imposed for the current tax year on the residence and exceeds the percentage of the qualifying owner's income. • Clarifies that only the deferred taxes for the last three years prior to the disqualifying event become due and payable. • Clarifies that notice of the sum of deferred taxes and interest that are due and payable must be sent annually to the mailing address of the residence subject to the circuit breaker benefit as opposed to mailing notice to each owner of the property.
22.(c)	Makes the following clarifying changes to the disabled veteran homestead

	exclusion: • Replaces the definition of 'owner' with a definition for 'qualifying owner'. • Provides that a disabled veteran must have 'separated' instead of 'been discharged' from a branch of the Armed Forces to reflect more clearly the language used by the Armed Forces. • Provides that the exclusion applies to a disabled veteran whose separation was also under honorable conditions. Prior law applied the exclusion only if the separation was honorable. • Clarifies that the surviving spouse of a disabled veteran is eligible for the exclusion as long as the spouse does not remarry. • Provides that the surviving spouse may also qualify for the exclusion if the Veterans Administration certifies that the veteran's death was the result of a service-connected condition. This new language would apply where the veteran died while on active duty and the death was the result of a service-connected condition or where the veteran died after discharge due to a service connected condition that did not rise to the level of total and permanent disability. • Clarifies that the exclusion is available to a disabled veteran who 'received' instead of 'receives' federal benefits to adapt the veteran's housing, since these benefits are generally a one-time payment. • Clarifies that the exclusion applies uniformly to a husband and wife, regardless of how they hold title to the property.
22.(d)	Section 22 of the act is effective for taxes imposed for taxable years beginning on or after July 1, 2009
23.(a)	Repeals a reference to an incorrect effective date for the wildlife conservation land tax benefit.
23.(b)	Repeals the provision in the working waterfront statute regarding application procedures because there is a general statute governing application procedures for property tax exemptions or exclusions.
23.(c)	Adds drug samples to the list of exempt property not requiring an application, effective for taxes imposed for taxable years beginning on or after July 1, 2008. Adds solar energy electric systems to the list of property excluded from taxation that must file a single application, effective for taxes imposed for taxable years beginning on or after July 1, 2008.
23.(d)	Adds working waterfront property to the list of property classified for taxation at reduced valuation that must file a single application, effective for taxes imposed for taxable years beginning on or after July 1, 2009.
23.(e)	Adds wildlife conservation to the list of property classified for taxation at

	reduced valuation that must file a single application, effective for taxes imposed for taxable years beginning on or after July 1, 2010.
23.(f)	Sets out the effective dates for section 23, as noted in the subsections above.
24.(a)	Makes the following changes to the combined motor vehicle registration and property tax system which provides for the collection of vehicle property taxes with the issuance and renewal of vehicle registrations. Adds the following definitions to G.S. 105-330: 'registered classified motor vehicle', 'unregistered classified motor vehicle', and 'registration fees'. • Amends G.S. 105-330.1 to add the following to the list of motor vehicles that are exempt from classification under the combined system: motor vehicles issued permanent registration plates and self-propelled property-carrying vehicles issued three-month registration plates at the farmer rate. • Amends G.S. 105-330.2(a) and (a1) to clarify the period in which the value of a classified motor vehicle is determined so that the date of valuation will continue to be January 1. If the value cannot be determined on January 1, then the value will be the most currently available January 1 retail value of the vehicle. Subsection (a) also clarifies that the situs of a vehicle is determined on the date registration is applied for or renewed and may not be changed until the next registration date. • Amends G.S. 105-330.2(b) to add language that the initial appraised value of a vehicle purchased from a dealer is the sales price, including all accessories attached to the vehicle. • Amends G.S. 105-330.2(b1) to clarify the right to appeal the appraised value or taxability of a vehicle as follows: require that the right to appeal must be set out in the combined tax and registration notice or the tax receipt, and require that the lessee of a motor vehicle be given the right to appeal the value if the lessee is required to pay the tax on the vehicle under the terms of the lease. • Amends G.S. 105-330.3 to add subsection (d) setting out the penalty for willfully attempting or aiding or abetting any person to evade or defeat the taxes imposed under the combined system, and to make technical and stylistic changes. • Amends G.S. 105-330.4 as follows: subsection (a) removes unnecessary language and adds language clarifying when taxes are due on an unregistered classified motor vehicle, a classified motor vehicle registered under the staggered system, a classified motor vehicle registered under the annual system, and a classified motor vehicle that has a temporary registration plate or a limited registration plate; subsection (b) deletes unnecessary language; subsection (c) clarifies that the enforcement remedies for unpaid property taxes apply only

	to unpaid taxes on an unregistered classified motor vehicle. • Amends G.S. 105-330.5 by deleting unnecessary language, making stylistic changes, and adding the following clarifications: subsection (a) authorizes the Department to select a third party contractor to prepare and mail combined tax and registration notices, clarifies the contents of the combined notice, clarifies that if there is a pre-payment of taxes then the tax rate will be the rate in effect on the date the taxes are computed, and provides that the combined notice serves as the registration certificate for a vehicle issued a limited registration plate; subsection (b) clarifies that a lessee of a vehicle would receive a combined notice since the definition of 'owner' includes the lessee of a vehicle; subsection (d) clarifies that taxes on motor vehicles be included in the tax levy for the fiscal year in which the taxes are collected; and new subsection (e) describes the method for handling small underpayments and overpayments of taxes. • Amends G.S. 105-330.8 to add the following property tax statutes to the statutes that do not apply to the combined motor vehicle registration and property tax system: G.S. 105-321(f) (governing the collection of minimal taxes charged) and G.S. 105-360 (governing the due date of property taxes, interest for nonpayment of taxes, and discounts for prepayment of taxes). • Amends G.S. 105-330.9 to add subdivision headings. Amends G.S. 105-330.11 by making stylistic changes. Except for changes to G.S. 105-330.9 and G.S. 1-5-330.11, the above changes become effective July 1, 2011, and apply to combined tax and registration notice issued on or after that date, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first.
24.(b)	Amends G.S. 20-79.1A to clarify issuance of a limited registration plate as follows: (1) the limited registration plate is issuable to a person who applies for a title to a motor vehicle and a registration plate if the person submits the title and registration fees but does not submit municipal corporation property taxes due on the vehicle; (2) if the municipal corporation property taxes are paid, then the person receives an annual registration plate; (3) a limited registration plate may only be used on the vehicle for which issued and if lost or stolen, a replacement plate must be received and attached to the vehicle before it may be driven. Subsection (b) becomes effective July 1, 2011, and applies to combined tax and registration notices issued on or after that date, or when the Division of Motor Vehicles and the Department of Revenue certify that the integrated computer system for registration renewal and property tax collection for motor vehicles is in operation, whichever occurs first.

24.(b1)	Amends G.S. 20-63(h) to clarify that a contract agent with the Division of Motor Vehicles receives compensation for issuing a vehicle registration card only when property taxes on the vehicle are not paid at the same time.
24.(c)	Sets out the effective dates for section 24 of this act.
25	Moves the effective date of the combined motor vehicle registration and property tax system from July 1, 2010 to July 1 2011, and clarifies that it applies to combined tax and registration notices issued on or after that date, or when the DMV and the Department of Revenue certify that the system is in operation, whichever occurs first.
26	Amends G.S. 105-361(a) to make stylistic changes and to clarify that the amount of taxes that a tax collector must report on a tax certificate includes any deferred taxes that would become due if a disqualifying event occurs.
27	Makes the following clarifying changes to G.S. 160A-215.2 (Heavy equipment gross receipts tax in lieu of property tax): • Changes the word 'resolution' to 'ordinance' to reflect that cities adopt ordinances while counties adopt resolutions. • Provides that a tax levied prior to the effective date of this act remains valid and in effect until amended or repealed, regardless of whether the city called the action a resolution or an ordinance. • Removes the reference to 'city finance officer', because the city may contract with the county to collect the gross receipts tax.
Occupancy Tax Changes	
28	Adds a Session Law reference that was inadvertently omitted when the Cherokee County local occupancy tax act was amended last year. In 2007, a number of local occupancy tax local acts were amended to change the due date for remitting occupancy tax proceeds and filing returns from the 15^{th} to the 20^{th} of the month to conform to current sales tax statutes. The Cherokee County local occupancy tax act was one of the acts so amended. However, when the rest of the local act was amended in 2008, the 2007 change was not incorporated. To make this technical change, the entire local act must be set out under drafting convention. However, no substantive change is being made.
29	Corrects an incorrect Session Law reference.
30	Adds to S.L. 2005-68, a Session Law reference to the 2007 act referenced above that made changes to a number of local occupancy tax acts related to the due date of the tax and return. S.L. 2005-68 is the act that authorized the additional occupancy tax to finance the NASCAR Hall of Fame Museum.
Motor Fuel Tax Changes	
31	Provides the Secretary with the ability to mandate electronic filing of motor carrier tax returns. The Secretary may currently mandate electronic filing of motor fuel tax returns. The Department developed an online filing system

	for motor carrier returns six years ago. To date, voluntary compliance is around 19%. This section becomes effective January 1, 2010.
32	Inserts a missing word.
33	Provides an exception to the requirement that a distributor, importer, or motor fuel transporter must obtain a bond or irrevocable letter of credit when the person is supplying motor fuel into the State because the market for motor fuel has been disrupted and emergency supplies are needed, as identified by an executive order of the Governor. The bonding requirement became an issue during the recent motor fuel supply shortages in the western part of the State.
34	Specifies that the tax on fuel grade ethanol is payable by the refiner or fuel alcohol provider. The difference between a refiner and a fuel alcohol provider is the amount of fuel the person produces. A refiner is a person who produces an average of more than 500,000 gallons a month; a person who produces less than this amount is a fuel alcohol provider. This section changes the law enacted last year in S.L. 2008-134 that specified when fuel grade ethanol was subject to tax. Effective January 1, 2009, the fuel is taxable when it was removed from a terminal or when it is produced in the State or imported to the State and not delivered to a terminal. However, the Department has had difficulty administering this provision. Ethanol is primarily shipped by railroad tank car and once imported into the State the ethanol may not be off-loaded for weeks. Since the tax is imposed upon importation, this delay in off-loading creates a loop-hole for filers. This section provides that the ethanol produced in this State is taxable when it is removed from the storage facility at the production location; ethanol produced outside the State is taxable when it is imported to the State. Prior to 2009, fuel grade ethanol was first subject to tax when it was blended. This section becomes effective January 1, 2010.
35	Changes the hold harmless refund from a quarterly one the Department calculates and administers to a monthly one the taxpayer requests. This section becomes effective January 1, 2010, and applies to motor fuel purchased on or after that date.
36	Requires a shipping document to transport fuel grade ethanol since the ethanol is now subject to tax before it is blended. This section accomplishes this change by expanding the statute to include refiners and fuel alcohol providers. This section also recognizes that the content of a shipping document issued for motor fuel transported by railroad tank car differs from a one issued for fuel transported by transport trucks. This section becomes effective January 1, 2010.
37	Corrects a misspelled word.
38	Conforms the tax exemptions for alternative fuel to the tax exemptions for motor fuel.
Other Changes	

39	Amends the tax secrecy provisions to prohibits the disclosure of standards used or to be used for the selection of returns for examination and the disclosure of data used for determining those standards. The Department of Revenue requested this provision.
40	Corrects a statutory reference. The statute cited was repealed in 2006.
41	Repeals the session law that created the Economic Development Reserve and its exemption from rule-making. The Reserve had a one-time appropriation. The money in the fund has been drawn down. The Reserve has served its intended purpose and is no longer necessary.
42	Corrects the prefatory language of Section 28.19.(a) of S.L. 2008-107.
43	Corrects the prefatory language of Section 28.25.(c) of S.L. 2008-107.
44	Corrects an incorrect statutory reference.
45	Corrects the effective date sections in S.L. 2008-146 to refer to 'Parts' rather than 'sections'.
46	Corrects the effective date section in Section 5.4 of S.L. 2008-204 to refer to 'Part' rather than 'section'.

Appropriations Act of 2009.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-451, as amended by S.L. 2009-575	**SB 202**	**Senator Garrou**

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

OVERVIEW: This act updates the reference to the Internal Revenue Code to May 1, 2009, but decouples from the bonus depreciation provision and the new additional standard deductions for real property taxes and motor vehicle sales taxes. The act adopts the proposal recommended by the Revenue Laws Study Committee to apply the State and local general rate of sales and use tax to audio works (music and ringtones), audiovisual works (movies), books, and computer software that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium and to revise the mail order sale statute to specifically set out certain circumstances that constitute soliciting business in this State for purposes of requiring a remote retailer to collect sales tax. Lastly, the act generates revenue required to balance the 2009-2010 biennium budget by making the following tax law changes:

- Income tax surtax on individuals whose North Carolina taxable income is greater than $100,000[43] and on corporations, for taxable years 2009 and 2010.
- A State sales tax increase of 1%, effective September 1, 2009, until July 1, 2011.
- An increase in the excise taxes on beer, wine, liquor, cigarettes, and other tobacco products. All of the increased tax revenue is distributable to the State.
- Retention by the State of a portion of the distribution of the excise tax on beer and wine that would otherwise be distributable to counties and cities for one year.

The act also authorizes the Finance Committees of the Senate and the House of Representatives to meet during the interim to study and recommend legislation to reform North Carolina's sales and income tax structure in order to broaden the tax base and lower the State's tax rates.

FISCAL IMPACT: The act increases General Fund revenues by approximately $990 million for fiscal year 2009-2010 and $1.3 billion for fiscal year 2010-2011. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: With the exception of the provision related to the real property tax deduction for non-itemizers, which is effective for taxable years beginning on or after January 1, 2008, the remaining IRC conformity provisions are effective for taxable years beginning on or after January 1, 2009. The revision of the statutes relating to remote retailers became effective when signed into law by the Governor on August 7, 2009. The expansion of the sales tax base to digital products becomes effective January 1, 2010. The increase in the excise taxes on beer, wine, liquor, and tobacco products became effective September 1, 2009. The income tax surtax is effective for taxable years 2009 and 2010. The increase in the State sales tax rate became effective September 1, 2009, and expires July 1, 2011.

ANALYSIS: Part XXVIIA of the Current Operations and Capital Improvements Appropriations Act of 2009 made the following tax law changes:

Corporate and Individual Income Tax Surtax. – Section 27A.1 increases General Fund revenues by approximately $196 million in fiscal year 2009-2010 and $202 million in fiscal year 2010-2011, by imposing a temporary income tax surtax on corporate taxpayers and individual taxpayers whose North Carolina taxable income exceeds $100,000. The corporate income tax surtax is equal to 3% of the tax payable by the taxpayer for the taxable year. The individual income tax surtax is also equal to a percentage of the tax payable by the taxpayer.[44] The percentage amount varies depending upon the taxpayer's North Carolina taxable income[45] and the taxpayer's filing status. For married filing jointly, the surtax percentage is zero for taxable incomes up to $100,000; it is 2% for taxable incomes[46] over $100,000 and

[43] The $100,000 threshold applies to taxpayers filing as married filing jointly. The threshold for taxpayers filing as head of household is $80,000; the threshold is $60,000 for single taxpayers; and the threshold is $50,000 for married filing separately.
[44] North Carolina income tax is the amount recorded on line 14 of NC D-400 tax form.
[45] North Carolina taxable income is the amount recorded on line 13 of the NC D-400 tax form.
[46] The graduated NC income tax rates are 6%, 7%, and 7.75%. The effective tax rates in the respective tax brackets for taxpayers subject to the 2% surtax are 6.12%, 7.14%, and 7.91% respectively.

up to $250,000; and it is 3% for taxable incomes[47] over $250,000. For heads of households, the thresholds are $80,000 and $200,000 respectively; for single taxpayers the thresholds are $60,000 and $150,000 respectively; and for married filing separately the thresholds are $50,000 and $125,000.

The income tax surtaxes imposed by this section are in addition to the corporate income tax and individual income tax owed by the taxpayer. The surtaxes are due at the same time as the filing of the tax return itself. For a corporate taxpayer, the tax is due on or before the fifteenth day of the third month following the close of its income year. For an individual taxpayer, the tax is due on or before April 15th.

The General Assembly made similar income tax adjustments during the budget shortfalls of 1991, 2001, and 2003. During the budget shortfall in 1991, the General Assembly imposed a temporary surtax on corporations in an amount equal to a stated percentage of the corporation's income tax liability.[48] During the budget shortfall in 2001, the General Assembly created a temporary 8.25% individual income tax bracket for incomes that exceeded $200,000 for taxpayers filing as married filing jointly. Under the 2001 legislation, the upper income tax bracket would have expired for taxable years beginning on or after January 1, 2004. In 2003, the General Assembly extended the 2004 sunset until 2006 and in 2005 it extended the sunset until 2007. In 2006, the General Assembly reduced the upper income tax rate from 8.25% to 8% for taxable year 2007. The temporary bracket expired for taxable years beginning on or after January 1, 2008.[49]

Increase Sales and Use Tax By One Percent. – Section 27A.2 increases General Fund revenues by approximately $803 million in fiscal year 2009-2010 and $1.1 billion for fiscal year 2010-2011 by imposing a temporary State sales and use tax increase of one percent, from 4.5% to 5.5%, effective September 1, 2009. The combined State and local tax rate in North Carolina based upon the highest possible county tax rate is 8.25%.[50] As of October 1, 2009, only 11 states have a higher combined sales tax rate than North Carolina.[51]

Effective October 1, 2009, the combined State and local rate will remain the same, but the allocation of the rate between the State and the counties will change based upon legislation enacted in 2007.[52] Effective October 1, 2009, the State sales tax rate is 5.75%. Effective July 1, 2011, the State rate will return to 4.75%.

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[47] The effective graduated tax rates for taxpayers subject to the 3% surtax are 6.18%, 7.21%, and 7.98%. Only nine states have a higher individual income tax rate than 7.98%: Hawaii, Oregon, California, New Jersey, Vermont, Rhode Island, Iowa, New York, and Maine.

[48] The percentage rate of the surtax was 4% for taxable year 1991. The rate fell by 1% each taxable year thereafter until it expired in taxable year 1995. See Chapter 689 of the 1991 Session Laws.

[49] S.L. 2001-424, S.L. 2003-284, S.L. 2205-276, and S.L. 2006-66.

[50] The local tax rate in most counties is 2.25%, making the combined State and local rate 7.75%. In 2007 the General Assembly authorized counties to impose an additional ¼ cent sales tax. As of October 1, 2009, eight counties have done so. In those counties, the combined rate is 8%. (Alexander, Catawba, Cumberland, Haywood, Martin, Pitt, Sampson, and Surry) Mecklenburg County has an additional ½ cent sales tax for public transit. The combined rate in Mecklenburg County is 8.25%.

[51] Kansas, Arizona, New York, Oklahoma, Washington, Missouri, Tennessee, California, Illinois, Arkansas, and Idaho.

[52] Section 31.16 of S.L. 2007-323. The State assumed 100% of the nonfederal, non-administrative share of Medicaid costs over a three-year period beginning in 2007. To provide the financial resources to assume these costs, the legislation phased out the third one-half cent local sales tax and made a corresponding increase in the State sales tax rate. Effective July 1, 2009, the State assumed the entire non-administrative, nonfederal share of

A sale is complete when delivery is made to a customer. The new tax rate applies to taxable sales and purchases of property or services delivered on or after September 1, 2009, regardless of the date the order was placed, with the following exceptions:

- Gross receipts from the lease of tangible personal property that is delivered to a lessee prior to September 1, 2009, and leased for a definite stipulated period of time.
- Construction materials purchased or sold on and after September 1, 2009, to fulfill a lump-sum or unit-price contract entered into or awarded prior to September 1, 2009.

Section 22 of S.L. 2009-575 provides that a retailer is not liable for an over-collection or under-collection of sales tax for the period beginning September 1, 2009, and ending October 1, 2009, if the retailer made a good faith effort to comply with the law and collect the proper amount of tax and has, due to the increased State rate under this act, over-collected or under-collected the amount of sales tax due.

The General Assembly increased the State sales tax rate from 3% to 4% in 1991. In 2001, it enacted a temporary increase of ½ cent, making the State rate 4.5%. Under the 2001 legislation, the increased rate would sunset effective July 1, 2003. However the General Assembly extended the sunset date in 2003 and 2005, and it maintained ¼ cent of the increased rate in 2007 for a State tax rate of 4.25%.[53] The State rate changed from 4.25% to 4.5% as part of the Medicaid swap on October 1, 2008.[54]

Nexus Clarification and Click Throughs, Use Tax Line on Income Tax Return, Digital Products, Magazines Delivered by Mail. – Section 27A.3, which originated as a Revenue Laws Study Committee recommendation and was included in the House's version of the budget as well as in the proposed Senate tax plan, makes several changes related to the sales tax treatment of digital products and clarifies certain circumstances that satisfy the nexus requirement for purposes of requiring sales tax collection by a remote retailer. This section increases General Fund revenues by approximately $11.8 million in fiscal year 2009-2010 and $24.1 million in fiscal year 2010-2011.

- **Nexus Clarification and Click Throughs. –** This section provides that a remote retailer who enters into a 'click-through' contractual agreement with a North Carolina resident is soliciting business in this State for purposes of requiring a remote retailer to collect sales tax. This provision became effective when the act became law on August 7, 2009.

  G.S. 105-164.8 sets out the circumstances under which a remote retailer is required to collect sales tax on mail order sales. Generally speaking, a remote retailer is one that does not maintain a brick and mortar establishment in this State. This statute reflects principles promulgated in a series of cases that set out circumstances under which a retailer has sufficient nexus with a state to require it to collect sales tax. Several of these cases involved businesses that used independent contractors or other commissioned agents to solicit orders in a state in which the business was not physically located. One of the leading cases in this area is *Scripto v. Carson*, in which

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Medicaid costs. The counties retained responsibility for the costs associated with administering Medicaid at the county level. Effective October 1, 2009, the State sales tax rate increased .25% to 4.75% and the local rate decreased .25%.

[53] S.L. 2001-424, 2003-284, 2005-276, 2006-66, 2007-145, and 2007-323.

[54] S.L. 2007-323.

the United States Supreme Court held that a state could require tax collection by a remote retailer that had contracts with 10 in-state residents deemed independent contractors who solicited orders for products on its behalf. This principle has been codified in G.S. 105-164.8, which states, in part, that a retailer who makes a mail order sale must collect the sales tax if:

> "The retailer has representatives in this State who solicit business or transact business on behalf of the retailer, whether the mail order sales thus subject to taxation by this State result from or are related in any other way to such solicitation or transaction of business."

This case reflected a business model that was common at the time. In recent years, with the growth of the Internet, a new business model has emerged as a way for online retailers to solicit business. Amazon is a prime example of this business model. Under what is referred to as an "affiliate program," Amazon enters into contractual agreements with the owners of other websites and pays a commission for sales that result from a "click-through" to the Amazon website from the other website. Through the operation of this program, Amazon has established nexus in this State by maintaining compensated representatives in the State who solicit business for Amazon. This principle is consistent with the holding of the *Scripto* case.

This section of the act revises the mail order sales provision in two ways. First, it changes the term "mail order sale" to "remote sale," which covers all transactions that are not face-to-face but reflects more modern terminology and the prevalence of Internet sales. Second, it provides that a retailer is presumed to solicit or transact business in this State and is, therefore, required to collect sales tax if all of the following conditions are met:

- The retailer has entered into an agreement with a resident of this State.
- Under the agreement, the resident receives a commission or other consideration in exchange for directly or indirectly referring potential customers, whether by a link on an Internet website or otherwise, to the retailer.
- The cumulative gross receipts from sales by the retailer to purchasers in this State who are referred to the retailer by all residents with this type of agreement with the retailer is in excess of $10,000 during the preceding four quarterly periods.

This presumption may be rebutted by proof that the resident with whom the retailer has an agreement did not engage in any solicitation in the State on behalf of the retailer that would satisfy the nexus requirement of the United States Constitution.

In a recent New York Supreme Court[55] case, Amazon challenged an identical provision in the New York sales tax statutes alleging that it violates the Commerce Clause of the United States Constitution as well as both the Federal and State Constitutions' Due Process and Equal Protection Clauses. The court dismissed the complaint for failure to state a cause of action. The court disagreed with Amazon's assertion that the commissioned agents were mere advertisers concluding that the provision requires tax collection only when an out-of-state seller avails itself of the

[55] The New York Supreme Court is a trial-level court.

benefit of in-state contractors who are compensated for referrals and who generate actual business for the seller. Moreover, the court stated that "Amazon should not be permitted to escape tax collection indirectly, through use of an incentivized New York sales force to generate revenue, when it would not be able to achieve tax avoidance directly through the use of New York employees engaged in the very same activities."

Amazon is still in litigation in New York, but so far the courts have sided with the State and have found that this type of arrangement is sufficient to create nexus. Rhode Island enacted similar legislation during its recent legislative session. California and Hawaii did as well, but the measures were vetoed by their respective Governors. Several other states, such as Connecticut, Illinois, Minnesota, Tennessee, and Wisconsin, had similar legislation introduced but not enacted or are continuing to study the issue.

- **Digital Products. –** This section imposes the State and local general rate of sales and use tax on certain digital goods that are delivered or accessed electronically to the extent those items would be taxable if sold in a tangible medium. It also eliminates the general exemption for prewritten computer software that is delivered electronically with an exception for certain "enterprise" software.

  Under current law, the general rate of State and local sales and use tax applies to the sale, lease, or rental of tangible personal property and some services. Tangible personal property is defined as "personal property that may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses." Digital goods, such as downloaded music and movies, are not tangible personal property, and, therefore, are not taxed. Prewritten computer software is specifically included within the definition of tangible personal property, but it is exempt from sales tax when it is delivered electronically or by load and leave.[56]

  When the Revenue Laws Study Committee examined the existing sales tax treatment of digital goods, three primary findings emerged leading to the recommendation of this provision. First, the Committee recognized that the sales and use tax statutes are outdated in relation to today's modern retail economy. The sales and use tax statutes were originally enacted in the 1930s and were drafted to apply to sales of tangible personal property because those items constituted the bulk of consumer purchases at that time. Technology and the prevalence of the Internet have transformed society in a number of ways, including the way in which consumers make purchases. Over the last 15 years, more and more consumers shop online and download or stream media in digital format. When the sales tax statutes were enacted, intangible digital goods were not in existence and therefore not contemplated under the tax code. However, purchases of media in digital format are quickly becoming the norm, and many states have been revisiting their sales tax statutes in order to bring them into the 21st Century. Second, the Committee also found that the sales and use statutes are inequitable to the extent that similar, if not identical, items are treated differently based upon the method of delivery or the point of purchase. This unequal treatment impacts consumers as well as retailers. For example, a consumer who purchases a

[56] The term "load and leave" is defined as "delivery to the purchaser by use of a tangible storage media where the tangible storage media is not physically transferred to the purchaser."

CD in a brick and mortar retail establishment, such as Walmart, pays sales tax on that item. Likewise, a consumer who orders the CD from the Walmart website pays sales tax on that item. However, a consumer who downloads the exact same CD in MP3 format from the Walmart website would not pay any sales tax on the item. In these examples, the consumer purchases the same item, but the tax treatment differs. This differing tax treatment discriminates against consumers who either choose to purchase a tangible format or who do not have the technological capability to download or stream in digital format because they do not have a computer or high-speed Internet access. Moreover, the tax code should not drive consumer choice but it should be neutral as to industry, content, and delivery method. This unequal tax treatment also places brick and mortar retailers, or at least those without an Internet presence, at a competitive disadvantage with Internet retailers. A sound tax structure is one that is fair and neutral. Taxing digital goods in the same manner as their tangible counterparts promotes these principles. Third, the Committee concluded that the State will lose significant sales tax revenue that it is currently collecting as consumers continue to transition from purchases of tangible media to purchases of digital media.

In light of these findings, the General Assembly enacted this provision, which imposes the general rate of sales and use tax on audio works, audiovisual works, books, magazines, newspapers, newsletters, reports, photographs, and greeting cards that are delivered or accessed electronically and that would be taxable if purchased in a tangible format, effective January 1, 2010. The tax applies regardless of whether the purchaser has a right to use it permanently or to use it without making continued payments. The tax does not apply to a service that is already taxed or to an information service. The purchase of a digital code used to obtain one of these items is considered a sale of that item.

The terms "audio work" and "audiovisual work" are defined terms under the Streamlined Sales Tax Agreement. An audio work is a series of musical, spoken, or other sounds and includes items such as recorded or live songs, music, readings of books or other written materials, speeches or ringtones or other sound recordings. An audiovisual work is a series of related images and any sounds accompanying the images that impart an impression of motion when shown in succession and includes movies, music videos, news, and entertainment programs.

This section also eliminates the exemption for prewritten computer software when delivered electronically. Under current law, prewritten computer software purchased in a tangible format is subject to tax. However, prior to this act, there was a specific exemption for prewritten computer software[57] delivered by load and leave or delivered electronically. In an effort to equalize the treatment of goods that are similar in substance and differ only in format, the General Assembly chose to eliminate this exemption. In doing so, it carved out a "business-to-business" exception for enterprise software, which is software used by large businesses to run office operations, such as billing. Thus, computer software meeting any of the following descriptions is exempt from sales and use tax:

[57] This act does not change the treatment of custom computer software, whether in tangible or digital format, which is exempt from sales and use tax.

- It is designed to run on an enterprise server operating system.
- It is sold to a person who operates a datacenter and is used within the datacenter.
- It is sold to a person who provides cable service, telecommunications service, or video programming and is used to provide ancillary service, cable service, Internet access service, telecommunications service, or video programming.

- **Magazines Delivered by Mail**. – This section eliminates the sales tax exemption for magazines delivered by mail. Under current law, magazine publishers and other retailers who are engaged in business in this State are liable for State and local sales tax on their over the counter sales of magazines. However, sales of magazines by magazine vendors making door to door sales and retail sales of magazines by subscription delivered through the mail to subscribers inside or outside North Carolina are exempt from tax. In an effort to equalize the sales tax treatment of magazines, this section repeals the exemption for magazines delivered by mail. This section did not, however, change the current exemption for sales of newspapers by newspaper street vendors, by newspaper carriers making door to door deliveries, and by means of vending machines.

- **Use Tax Line on Income Tax Return. –** Finally, this section maintains the requirement that use tax be paid annually with the filing of an individual income tax return, which was set to expire on January 1, 2010. Had the provision expired, an individual still would have been required to pay use tax, but using a separate form and following the schedule for the remittance of sales taxes.

  An individual who purchases tangible personal property, other than boats and aircraft, outside the State for a non-business purpose is required to accrue and remit the use tax due on an annual basis. In 1999, in order to simplify and improve use tax collection, the General Assembly enacted legislation requiring that an individual who owes use tax and who is required to file an individual income tax return must pay the use tax with the individual income tax return. The Secretary is required to provide appropriate space and information on the individual income tax form for the reporting of use tax. By placing the use tax on the individual income tax return, as opposed to a separate return, the hope was to raise taxpayer awareness of the obligation to report and pay the tax.

  In 2000, the General Assembly repealed the requirement that the use tax line be included and paid with the individual income tax return, to become effective January 1, 2003. The rationale for the repeal was that once the Streamlined Sales Tax Project requiring out-of-state retailers to collect sales tax was fully implemented, there would be no need to report use tax. In 2003, the General Assembly delayed the repeal by two years. Then, in 2005, the repeal was delayed again until January 1, 2010, since Congress had not yet acted on this issue. This section of the budget eliminates the repeal set to take place in 2010, which means that the use tax will still be required to be paid annually on an individual's income tax return.

Alcohol Excise Tax Changes. – Section 27A.4 increases General Fund revenues by approximately $57.7 million for fiscal year 2009-2010 and $47 million in fiscal year 2010-2011, by increasing the excise tax rate on alcohol and by retaining part of the beer and wine revenues distributed to local governments. The State shares a percentage of the excise taxes collected on beer and wine with the counties or cities in which the retail sale of these beverages is authorized. The distribution is made annually for the preceding 12-month period ending March 31. Under this section, the State will retain approximately 70% of the revenues for the 12-month period ending March 31, 2010. This section also reduces the percentage of the revenues distributed in the future so that 100% of the revenues derived from the increased tax rates in this section will go to the State.

This section increases the excise tax rate on beer, wine, and liquor as follows:

- The excise tax rate on beer increased from 53.177¢ per gallon to 61.71¢ per gallon effective September 1, 2009. The rate increase means the tax on a can of beer changes from 5¢ a can to 5.8¢ a can, or about a 5¢ increase in the cost of a six-pack. The tax rate has not been increased since 1969. Four states have a higher tax rate on beer.[58] Beer is also subject to a federal excise tax of approximately 5¢ per can.

- The excise tax rate on unfortified wine[59] increased form 21¢ per liter to 26.34¢ per liter, effective September 1, 2009. The excise tax rate on fortified wine increased from 24¢ per liter to 29.34¢ per liter, effective September 1, 2009. The rate increase means the tax on a bottle of wine changes from approximately 16¢ a bottle to 20¢ a bottle. The tax rate does not appear to have been increased since 1969. Twelve states have a higher tax rate on wine.[60] Wine is also subject to a federal excise tax that ranges from 21¢ per bottle to 62¢ per bottle, depending upon the alcohol content.

- The excise tax rate on liquor sold in an ABC store increased from 25% of the taxable sale to 30% of the taxable sale, effective September 1, 2009. North Carolina last changed the taxation of liquor in 2001.[61] Five states have a higher tax rate on liquor.[62] Liquor is also subject to a federal excise tax of approximately $2.14 per bottle.

Tobacco Products Excise Tax Changes. – Section 27A.5 increases General Fund revenues by approximately $38 million for fiscal year 2009-2010 and $54.5 million for fiscal year 2010-2011, by increasing the excise tax rate on tobacco products as follows:

- The excise tax rate on cigarettes increased from 1.75¢ per cigarette to 2.25¢ per cigarette, effective September 1, 2009. This tax rate equates to a 10¢ increase in a pack of cigarettes, from 35¢ to 45¢. The General Assembly last increased the excise tax on cigarettes in 2005, when it increased the rate from 5¢ a pack to 35¢ a pack.[63]

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58 South Carolina, Hawaii, Alabama, and Alaska.

59 The difference between fortified and unfortified wine is the percentage of alcohol by volume that it contains. Unfortified wine is a wine that has 16% or less alcohol; fortified wine is a wine that has more than 16% but no more than 24% of alcohol.

60 West Virginia, Montana, Tennessee, Pennsylvania, Hawaii, Georgia, Virginia, Alabama, New Mexico, Iowa, Florida, and Alaska.

61 Prior to 2001, the excise tax on liquor was in lieu of the sales tax. In S.L. 2001-424, the State began imposing a State sales tax on liquor equal to the combined State and local sales tax rate. To recognize the change in taxation, the General Assembly reduced the excise tax on liquor from 28% to 25%.

62 Alaska, Virginia, Vermont, Oregon, and Washington.

63 S.L. 2005-276. The rate increased from 5¢ a pack to 30¢ a pack, effective September 1, 2005, and to 35¢ a pack, effective July 1, 2006.

Only five states have a tax rate lower than 45¢.[64] Cigarettes are also subject to a federal excise tax of $1.01 per pack.

- The excise tax rate on other tobacco products increased 2.8%, from 10% of the cost price of the product to 12.8%. The General Assembly increased the excise tax on other tobacco products from 2% to 3% in 2005.[65] In 2007, it increased the rate from 3% to 10% and earmarked the revenues derived from the increase to the University Cancer Research Fund.[66] The increase in revenues derived from the increase in this section will also be credited to the University Cancer Research Fund. However, the General Fund still benefits from the increased revenue since it will not have to appropriate this amount to the Cancer Research Fund from the State's General Fund.[67] Other tobacco products are also subject to a federal excise tax. The federal government taxes cigars the same as cigarettes. The federal excise tax on other tobacco products varies depending upon the product.

IRC Conformity. – Section 27A.6 updates from May 1, 2008 to May 1, 2009, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[68] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[69] Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law tracks federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made.

Changing the reference date to May 1, 2009, incorporates the majority of changes made by the five federal acts listed below, with several significant exceptions. This conformity will result in a loss to the General Fund of $116.1 million in fiscal year 2009-2010 and $80.9 million in fiscal year 2010-2011. The federal acts are:

- Heartland, Habitat, Harvest, and Horticulture Act of 2008 signed into law May 22, 2008 (P.L. 110-234).

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[64] South Carolina, Missouri, Kentucky, Louisiana, and Georgia.
[65] S.L. 2005-276.
[66] S.L. 2007-323.
[67] G.S. 116-29.1 establishes the University Cancer Research Fund and provides a minimum funding of $50 million for the Fund. Of this amount, $8 million is credited to the Fund from the Tobacco Trust Account. An amount equal to the difference between $50 million and the amounts credited to the Fund from the Tobacco Trust Account and the funds remitted from the OTP tax revenue is appropriated to the Fund from the General Fund.
[68] 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.
[69] 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."

- Heroes Earnings Assistance and Relief Tax Act of 2008 signed into law June 17, 2008 (P.L. 110-245).
- Emergency Economic Stabilization Act of 2008 (EESA) signed into law October 3, 2008 (P.L. 110-343).
- Worker, Retiree, and Employer Recovery Act of 2008 signed into law December 23, 2008 (P.L. 110-458).
- American Recovery and Reinvestment Tax Act of 2009 (ARRTA) signed into law February 17, 2009 (P.L. 111-5).

The following is a list of changes to which the General Assembly chose not to conform; below that list begins a description of the major federal tax changes under each of the above-referenced acts to which North Carolina is conforming. The provision related to the real property tax deduction for non-itemizers is effective for taxable years beginning on or after January 1, 2008. The remaining provisions are effective for taxable years beginning on or after January 1, 2009.

- Real property tax deduction for non-itemizers.[70]
- Income tax deduction for sales or excise taxes on new vehicle purchases.
- Extension of bonus depreciation.[71]
- For corporate filers only, the five-year carryback period for net operating losses attributable to a federally-declared disaster occurring during 2009[72] and for net operating losses of small businesses.
- Delayed recognition of certain cancellation of debt income.
- Suspension of applicable high-yield discount obligation rules for certain high-yield obligations.

Heartland, Habitat, Harvest, and Horticulture Act of 2008

- *Endangered species recovery expense.* – This act creates a new deduction for endangered species recovery expenditures for expenses incurred after December 31, 2008. Farmers may currently claim a deduction for qualifying soil and water conservation expenditures and land erosion prevention expenditures. The deduction is limited to 25% of gross income derived from farming during the tax year but can be carried forward indefinitely. This act adds endangered species recovery expenditures to the category of expenditures that qualify for the deduction. The expenditures must be paid or incurred by a farmer after December 31, 2008 for the purpose of site-specific management actions recommended in recovery plans approved pursuant to the Endangered Species Act of 1973. Depreciable structures, appliances, or facilities do not qualify for the deduction.

- *Charitable Contributions of Real Property for Conservation Purposes.* – This act extends the increased deduction for charitable contributions of real property for conservation purposes for tax years beginning before January 1, 2009. The deduction for capital gain appreciated real property is generally limited to 30% of the donor's adjusted

[70] This was included in the Housing Assistance Tax Act of 2008 signed into law July 30, 2008 (P.L. 110-289).
[71] See explanation below of modified conformity under *Business Tax Relief* in the section describing changes made by the **American Recovery and Reinvestment Tax Act of 2009**.
[72] This was included in the Emergency Economic Stabilization Act of 2008.

gross income if the donor uses the fair market value of the donated property. If the donor's basis is used as the value of the property, and the property is donated to a "maximum deduction" organization, the deduction is limited to 50% of the donor's adjusted gross income.[73] Deductions for donations to non-maximum donation organizations are limited to 20% of the donor's adjusted gross income. Contributions that exceed the deduction limit can be carried forward for five years. The Pension Protection Act of 2006 increased the deduction for donations of conservation easements. An individual may deduct the value of the easement, based on fair market value, up to 50% of adjusted gross income, with a 15-year carryforward for any excess. A "qualified farmer or rancher" may deduct the value of the gift up to 100% of adjusted gross income with a 15-year carryforward. A "qualified farmer or rancher" is an individual whose gross income from the trade or business of farming is greater than 50% of the taxpayer's gross income for the tax year. The land donated by a farmer or rancher also must "be available" for agricultural use, but it need not be used for that purpose. This act extends these provisions through December 31, 2009.

Heroes Earnings Assistance and Relief Tax Act of 2008

- *State or Local Bonuses for Combat Veterans.* – The act excludes state or local bonuses for combat veterans from gross income for income tax purposes. Generally all income is included in gross income unless the income is explicitly excluded. "Qualified military benefits" are excluded from gross income. These benefits generally include allowances or in-kind benefits provided to family members and former members of the armed services, or their dependents by reason of the member's service, including housing, moving, and travel allowances. This act expands the definition of "qualified military benefits" to include bonus payments by a state or local government to a member or former member of the armed services, or to a dependent of a member. To qualify for the exclusion, the payment must have been made for the member's service in a combat zone.[74]
- *Contributions of Military Death Gratuities to Roth IRAs and Coverdell ESAs.* – The act allows military death gratuities to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs. Upon notification of the death of military personnel on active duty or on inactive duty training, a death gratuity is paid to or for the person's survivor. The death gratuity is a qualified military benefit and excluded from income. Roth IRAs are subject to annual contribution limits equal to the lesser of the statutory dollar amount or 100% of taxable income. For 2008, the annual limit on contributions is $5,000 for individuals, with an additional catch up contribution of $1,000 allowed for individuals over age 50. Sums may be rolled-over from eligible

[73] Maximum deduction organizations include public charities, private operating foundations, private non-operating foundations that distribute contributions within two and one-half months of the year's end, and private non-operating foundations that maintain a common fund.
[74] A combat zone is defined as any area the President has by executive order designated an area in which the Armed Forces are or have engaged in combat.

retirement plans to Roth IRAs, subject to income-phase out limitations. For 2008, rollovers are allowed for individuals whose gross adjusted income does not exceed $100,000. A Coverdell Education Savings Account is a tax-exempt trust created for paying the education expenses of the trust's designated beneficiary. Annual contributions to Coverdell ESAs may not exceed $2,000. This act allows the gratuity to be contributed to a Roth IRA or Coverdell ESA regardless of contribution limits and income phase-out limits for Roth IRAs and Coverdell ESAs.

Emergency Economic Stabilization Act of 2008

The major provisions of this act that impact North Carolina revenues and to which North Carolina is conforming are as follows:

- *Extension of Income Exclusion for Discharged Indebtedness on Principal Residence.* – The act extends the exclusion from income for discharged indebtedness on principal residences for discharges occurring before January 1, 2013. When a lender forecloses on property, sells the home for less than the borrower's outstanding mortgage and forgives all or part of the unpaid mortgage debt, the canceled debt is considered income under the Code. There is no income limitation, but no more than $2 million in mortgage debt is eligible for exclusion. The exclusion from income for discharged indebtedness related to a principal residence is for the three-year period beginning January 1, 2007 and ending December 31, 2009. This act extends the exclusions for discharged indebtedness related to a principal residence for the period beginning January 1, 2007 and ending on December 31, 2012.

- *Charitable Contributions from IRAs Restored.* – The act extends the favorable treatment of qualified charitable distributions from IRAs for two years, for distributions made in 2008 and 2009. Generally, to make a charitable donation from an IRA, a distribution must be taken and the applicable rules regarding taxable income apply. The distribution is included in taxable income to the extent the distribution is not attributable to a return of a nondeductible contribution. The standard charitable deduction rules then apply to the donation. The Pension Protection Act of 2006 provided that individuals 70 ½ or older could distribute up to $100,000 per taxable year from their IRAs to charitable institutions without recognizing the income. The distribution must be made directly to the charitable organization from the trustee. This distribution counts towards the required minimum distribution. This provision was set to expire in 2007, but the act extends the provision through 2009.

EESA made several changes related to the Modified Accelerated Cost Recovery System (MACRS) as follows:

- *15-Year MACRS Recovery Period for Qualified Leasehold Improvements and Qualified Restaurant Improvements and Buildings.* – The act extends for two years the 15-year Modified Adjusted Cost Recovery System (MACRS) recovery period for qualified leasehold improvements and restaurant improvements and buildings. The 15-year recovery period applies to property placed in service before January 1, 2010. The act also creates a 15-year MACRS recovery period for qualified retail improvement property and applies to property placed in service after December 31, 2007 and before January 1, 2010. The building must be at least three years old when the improvement is placed in service. Before these provisions, the improvements would generally be considered a structural component of the building and would be depreciated over a 39-year period.

- *Seven-Year Depreciation Period for Motorsports Facilities.* – The act extends the 7-year MACRS recovery period for motorsports entertainment complexes to property placed in service in 2008 and 2009. Historically, race tracks and facilities were treated by the IRS the same as theme and amusement parks. The American Jobs Creation Act of 2004 codified this treatment. A "motorsports entertainment complex" is a racing track facility that is permanently situated on land, hosts at least one racing event for cars of any type, trucks, or motorcycles during the 36-month period following the first day of the month in which it is put in service, and is open to the public for an admission fee.

- *Certain Farming Equipment Business Machinery or Equipment Treated as Five-Year Property.* – The act provides that certain machinery or equipment used in a farming business is treated as five-year property for purposes of claiming MACRS depreciation. The equipment does not include grain bins, cotton ginning assets, fences, or land improvements. Property that is used in a farming business can be depreciated under the General Depreciation System (GDS) using the 150-percent declining-balance method. Farm machinery and equipment generally has a recovery period of 10 years and has a straight-line recovery method.

EESA also extended a number of deductions and an expensing election:

- *Deduction for Qualified Tuition and Related Expenses.* – The act extends the deduction for qualified tuition and related expenses for tax years beginning before January 1, 2010. The expenses eligible for the deduction include tuition and fees required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or dependent at an eligible institution of higher education. The maximum deduction is $4,000 for taxpayers whose AGI does not exceed $65,000 ($130,000 for joint filers) and $2,000 for taxpayers whose AGI does not exceed $80,000 ($160,000 for joint filers).

- *Above-the-Line Deduction for Certain Expenses of School Teachers.* – The act extends the above-the-line deduction for eligible educators for tax years beginning in 2008 and 2009. The $250 deduction is allowed for books, supplies, and computer equipment purchased by an eligible educator for use in the classroom.

- *Enhanced Deduction for Charitable Contributions of Computers.* – The act extends the enhanced deduction for charitable contributions of computers for tax years beginning in 2008 and 2009. C corporations that make qualified contributions of computer technology and equipment may claim an enhanced deduction equal to the corporation's basis in the donated property plus one-half of the ordinary income that would have been realized if the property had been sold. The enhanced deduction may not exceed twice the corporation's basis in the property.

- *Enhanced Deduction for Charitable Contributions of Food Inventory.* – The act extends the enhanced deduction for charitable contributions of food inventory for tax years beginning in 2008 and 2009. Taxpayers may take a deduction for donated food inventory equal to the lesser of (1) the donated item's basis plus one-half of the amount of gain that would be realized if the donated food item was sold at fair market value, or (2) two times the donated item's basis. The deduction is limited to 10% of the taxpayer's net income, however, the 10% limitation is suspended for contributions made by farmers or ranchers between October 3, 2008 and January 1, 2009.

- *Enhanced Deduction for Charitable Contributions of Book Donations.* – The act extends the enhanced deduction for charitable contributions of book donations for tax years beginning in 2008 or 2009. Any corporation, other than an S corporation, can take an enhanced deduction for contributions of book inventory equal to the lesser of (1) the donated inventory item's basis plus one-half of the item's appreciation, or (2) two times the donated inventory item's basis.

- *Deduction for Environmental Remediation Costs.* – The act extends the election to deduct environmental remediation costs to cover expenditures paid or incurred in 2008 and 2009. A taxpayer may elect to deduct certain environmental cleanup costs in the tax year paid or incurred, rather than capitalize them. The election only applies to costs that are incurred in connection with the abatement or control of hazardous substances at a "qualified containment site," also called a "brownfield site."

- *Deduction for Energy Efficient Commercial Buildings.* – The act extends the deduction for energy efficient commercial building property for five years and is available for qualified property placed into service after December 31, 2005 and before January 1, 2014. The deduction applies to "energy efficient commercial building property," which is defined as depreciable property that is installed as part of a building's interior lighting systems, HVAC and hot water systems, or building envelope systems, and is part of a certified plan to reduce the total annual energy and power costs of these systems by at least 50%. The deduction is limited to the product of $1.80 and the total square footage of the building, reduced by the aggregate amount deducted in any prior year.

- *Extend and Modify Treatment of Certain Qualified Film and Television Productions.* – The act extends the expensing election related to film and television productions for one year for productions that begin before January 1, 2010, and allows the election to be made, in part, for productions with aggregate costs over the dollar production limit. A taxpayer may deduct the production costs of a qualifying film or television production. To qualify for the election, the aggregate production cost may not exceed $15 million. This act modifies the provision so that the first $15 million of otherwise qualifying film or television productions may be treated as an expense even if the aggregate cost of production exceeds $15 million.

EESA made the following changes related to disaster relief:

- *Relief for Midwestern Disaster Areas.* – The act modifies and extends many of the tax benefits extended to the victims of Katrina, Wilma, and Rita hurricanes to the victims of storms that hit the Midwest in the summer of 2008. These include the extension of special expensing for qualified property, an enhanced low-income housing credit, and flexible tax-exempt bond financing rules.

- *Casualty Losses Attributable to Federally Declared Disasters.* – The act increases the deduction for casualty losses attributable to federally declared disasters for tax years beginning after December 31, 2007. Personal casualty losses are deductible to the extent the losses exceed $100 per casualty and the sum of the casualty losses exceed 10% of the taxpayer's AGI. For tax years beginning after December 31, 2007, the standard deduction is increased by the amount of any disaster loss amount for casualty losses attributable to a federally declared disaster occurring in 2008 and 2009. The losses are deductible without regard to whether the losses exceed 10% of a taxpayer's adjusted gross income. The deduction for any casualty attributable to a federally declared disaster occurring in 2009 is limited to the amount of the loss that exceeds $500.

- *Expensing of Qualified Disaster Costs.* – The act allows a taxpayer to elect to expense qualified disaster expenses after 2007 rather than capitalizing them. Qualified disaster expenses include any expenditure that is all of the following:
  (1) Paid or incurred in connection with a trade, business, or business-related property.
  (2) Otherwise chargeable to a capital account.
  (3) Made for any of the following:
    a. The abatement or control of hazardous substances that were released on account of a federally declared disaster.
    b. The removal of debris from, or the demolition of structures on, business-related property that is damaged as the result of a federally declared disaster.
    c. The repair of business-related property damaged as a result of a federally declared disaster.
- *Net Operating Losses Attributable to Federally Declared Disasters.* – The act creates a special five-year carryback period for net operating losses (NOLs) related to qualified disaster loss. In general, NOLs may be carried back and deducted against taxable income in the two tax years before the NOL year, and then carried forward and applied against taxable income for up to 20 years after the NOL year. The bill would allow a taxpayer to take the loss in three equal installments in taxable years 2010, 2011, and 2012.
- *Special Depreciation Allowance for Qualified Disaster Assistance Property.* – EESA allows an additional 50% depreciation allowance to be claimed for real and personal business property that is purchased to rehabilitate or replace similar property that is destroyed or condemned as a result of a residentially declared disaster for property placed in service after December 31, 2007, with respect to disasters declared after that date and occurring before January 1, 2010. North Carolina will conform to this provision in a modified way, just as it has with other bonus depreciation provisions enacted by Congress over the last decade. Like the bonus depreciation provision under ARRTA, a taxpayer will be required to add back 85% of the accelerated depreciation amount[75] in the year that it is claimed for federal purposes. Then, for tax years beginning on or after January 1, 2009, taxpayer may deduct from federal taxable income the total

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

amount of the add-back required for either the 2007 or 2008 tax year, divided into five equal installments.

- *Increased Expensing for Qualified Disaster Assistance Property.* – The act increases the maximum section 179 expense allowance and investment limitation amount for qualified section 179 disaster property placed in service after 2007. 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 Internal Revenue Code. To be eligible, the property must be tangible personal property which 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 expensing first and claim section 168(k) depreciation on any remaining basis. First year expensing and investment are increased for disaster property as follows:

  (1) The section 179 expense deduction ($250,000 for 2008) is increased by the lesser of $100,000 or the cost of the qualified section 170 disaster assistance property placed in service during the tax year.

  (2) The amount of the investment limitation ($250,000 for 2008) is increased by the lesser of $600,000 or the cost of qualified section 179 disaster assistance property placed in service during the tax year.

American Recovery and Reinvestment Tax Act of 2009 (ARRTA)

This massive stimulus package, with a total cost of $787 billion, included $300 billion in tax relief. Of the tax provisions that impact North Carolina revenues, this section, except where noted, conforms to the following changes:

INDIVIDUAL TAX RELIEF

- *Increase in EITC.* – Under federal law, a refundable earned income tax credit is available to certain low-income individuals. The amount of credit varies depending on the number of the taxpayer's qualifying children. ARRTA temporarily increases the credit from 40% to 45% of a family's first $12,570 of earned income for families with three or more children and increases the beginning point of the phase-out range for married couples filing a joint return by $1,880. North Carolina piggybacks this federal credit. A taxpayer who claims the federal EITC is allowed a refundable credit against North Carolina taxable income equal to 5% of the amount of credit the individual qualified for at the federal level.[76] Therefore, since the federal benefit is increasing, the State benefit will increase as well for the eligible individuals.

- *Temporary Suspension of Taxation of Unemployment Benefits.* – ARRTA allows an individual to exclude from gross income up to $2,400 of unemployment compensation received for 2009. Any unemployment benefits over $2,400 will be subject to federal income tax. Unemployment benefits include payments under federal or state law, disability payments received as a substitute for unemployment benefits, and payments under certain legislative acts and other benefit programs. Since the starting point for taxable

[76] G.S. 105-151.31

income in North Carolina is federal taxable income, this exclusion will flow through at the State level and the income will not be subject to State income tax.

- *Transit Benefits Parity.* – ARRTA temporarily increases the monthly income exclusion for certain transit benefits accepted by employees between February 17, 2009 and January 1, 2011. Under current law, employers may extend transit benefits to employees as fringe benefits to offset commuting costs. Although compensation for services is generally taxable, qualified transportation fringe benefits provided by an employer to an employee are excluded from an employee's gross income for income tax purposes and from wages for payroll tax purposes. With this new provision, employees may deduct $230 per month (increased from $120) for these expenses through 2010. This provision applies specifically to van pool benefits and transit benefits provided by an employer to an employee, so as to provide parity with an existing deduction for individual parking benefits.

BUSINESS TAX RELIEF

- *Expansion of the Work Opportunity Tax Credit.* – ARRTA extends the existing Work Opportunity Tax Credit to two new targeted groups of prospective employees: (1) unemployed veterans and (2) disconnected youth. Businesses hiring new employees from these targeted groups in 2009 and 2010 will be entitled to claim the credit in an amount equal to 40% of the first $6,000 of wages paid to those employees during the first year of employment. An "unemployed veteran" is one who was discharged or released from active duty from the Armed Forces during the five-year period prior to hiring and received unemployment compensation for more than four weeks during the years before being hired. A "disconnected youth" is one between the ages of 16 and 25 and has not been regularly employed or attended school in the past six months. North Carolina also piggybacks this federal credit. A taxpayer who is allowed the federal credit may take a State credit[77] in an amount equal to 6% of the amount of credit allowed under the Code for wages paid during the taxable year for positions located in this State. A position is located in this State if more than fifty percent (50%) of the employee's duties are performed in the State.

- *Extension of Bonus Depreciation.*[78] –The General Assembly decoupled from the extension of the bonus depreciation provisions in a manner similar to what it has done in the past by delaying the impact of the deduction. Taxpayers will be required to add back 85% of the accelerated depreciation amount[79] in the year that it is claimed for federal purposes. Then, for tax years beginning on or after January 1, 2009, taxpayer may deduct from federal taxable income the total amount of the addback 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

[77] G.S. 105-129.16G.

[78] 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%. There were bonus depreciation provisions in both the Emergency Economic Stabilization Act of 2009 and the American Recovery and Reinvestment Tax Act of 2009.

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

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. 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.

- *Extension of Enhanced Small Business Expensing.* – This section conforms to the increased expensing limits authorized under EESA and extended under ARRTA by one year. 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 EESA, 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[80] and increases the phase-out to $800,000. These limitations apply only to property purchased and placed in service in tax years beginning in 2008.

- *Five-Year Carryback of NOL for Small Businesses (for individual filers only).* – Taxpayers that sustain a net operating loss (NOL) for a tax year generally can take an NOL deduction to reduce income in another tax year. Under ARRTA, taxpayers can elect to carry back 2008 NOLs for three, four or five years, instead of the normal two years. An eligible business is defined as a corporation, partnership or sole proprietorship that had average annual gross receipts of no more than $15 million for the tax year of the NOL and the two immediately preceding tax years. A taxpayer may also elect to apply the extended carryback period to NOLs incurred in a tax year beginning in 2008, rather than in a tax year ending in 2008. This section allows individual filers who qualify to take advantage of the five-year carryback period at the State level. North Carolina did not, however, conform to this change for corporate filers. Under current State law, corporations must add back net operating losses. Therefore, nonconformity to this provision under EESA and ARRTA for corporate filers is consistent with current tax treatment.

- *Small Business Capital Relief.* – ARRTA temporarily increases from 50% to 75% the exclusion for qualified small business stock sold by an individual. The increased exclusion percentage is applicable to stock acquired after February 17, 2009 and before January 1, 2011. The percentage exclusion does not apply to the sale or exchange of certain empowerment zone stock. When the stock is issued, the gross assets of the issuing corporation may not exceed $50 million and the corporation must have at least 80% of the value of its assets used in the active conduct of one or more qualified trades or businesses.

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

- *Modification of § 382 Rules for Business Receiving TARP Funds.* – Under current law, when the ownership of a corporation changes, § 382 may be triggered to limit the use of the corporation's pre-change losses. ARRTA provides a narrow exception to the application of the § 382 limitation, which is normally triggered when ownership change occurs in a corporation that has a net operating loss, a NOL incurred in the year of the change, or a net unrealized built-in loss (NUBIL). ARRTA modifies the limitation so that it does not apply if the ownership change (1) occurs under a restructuring plan required under a loan agreement or a commitment for a line of credit entered into with the U.S. Treasury under EESA, and (2) is intended to result in a rationalization of the costs, capitalization, and capacity of the manufacturing workforce (and suppliers to) the taxpayer and its subsidiaries.

Study of North Carolina's Sales and Income Tax Structure. – Section 27A.7 authorizes the Finance Committees of the Senate and House of Representatives to meet during the interim to study and recommend legislation to reform North Carolina's tax structure. The Senate began this study during the legislative session. This study would be a joint effort by both legislative houses to reform North Carolina's tax system to reflect the current economy rather than the 1933 economy and to make the State's tax system more progressive and fairer so that individual taxpayers and business taxpayers who are in similar circumstances to one another are treated similarly by the tax system.

The State's experience with revenue shortfalls over the last 20 years has led to the creation of several study committees, both inside and outside the General Assembly, charged with the task of developing a 21st Century tax policy for the State. The last study committees to consider these issues include the Governor's Commission to Modernize State Finances, the Institute for Emerging Issues, the State and Local Fiscal Modernization Committee, and the Joint Select Committee on Economic Development Incentives. The Senate Finance Committee heard several presentations regarding the work of these committees.[81] The studies all proposed expanding the State's tax bases and eliminating tax exemptions, deductions, and credits. The Senate Finance Committee discussed a 21st Century Tax Modernization Plan based upon the recommendations of these study committees. The plan expands several of the State's tax bases and lowers tax rates. The intent of the plan is to provide the State with a more stable tax structure that balances the different types of taxes and the different groups of taxpayers and to avoid increasing revenues through temporary, expedient changes.

Real Property Sales Information.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-454	**SB 405**	**Senator Hartsell**

AN ACT TO ASSIST COUNTIES AND THE DEPARTMENT OF REVENUE IN OBTAINING ACCURATE REAL PROPERTY SALES INFORMATION NEEDED FOR PROPERTY TAX APPRAISALS.

[81] February 18, 2009; February 25, 2009; March 4, 2009; April 15, 2009; April 22, 2009; June 3, 2009; July 28, 2009.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, requires that a deed conveying real property and presented for registration before the register of deeds contain the following information:

- The name of each grantor and grantee and the mailing address of each grantor and grantee.
- A statement whether the property includes the primary residence of a grantor.

FISCAL IMPACT: No General Fund impact.

EFFECTIVE DATE: This act becomes effective January 1, 2010.

ANALYSIS: Beginning January 1, 2010, a deed[82] conveying real property and presented for registration with the register of deeds must include the following information on the deed:

- The name and mailing address of each grantor and grantee. This information will assist counties in collecting property taxes.
- A statement whether the property includes the primary residence of the grantor. This information will assist the Department of Revenue in determining whether income taxes are due such as on the sale of a vacation home or rental property.

Failure to provide this information on the deed will not affect the validity of a duly recorded deed. The act also reinstates the duty of the person presenting the instrument for registration to report the correct amount of tax due. An excise tax on conveyances is collected by the register of deeds when a deed is recorded. The rate is $1.00 for each $500 of the value of property conveyed. The correct amount of excise tax will assist the counties in determining accurate appraisals of real property for taxation purposes. This statutory duty was repealed in 2000 when legislation was enacted to eliminate the use of stamps on deeds.[83]

The Revenue Laws Study Committee had recommended to the 2009 General Assembly that a statewide sales information report be filed along with a deed and that this document also contain a brief description of the property conveyed, the total sales price, whether the transaction involved relatives or related businesses, whether personal property was conveyed with the transaction, and whether the transaction was the result of an auction or foreclosure sale. This sales information report was supported by tax assessors from large urban counties and smaller rural counties as well as the Property Tax Division within the Department of Revenue as a tool to assist the counties in meeting the statutory fair market appraisal standards. G.S. 105-283 requires that all property be appraised at its true value or market value for property tax purposes. To assist the counties in determining true value, the Department of Revenue conducts yearly sales assessment ratio studies for every county. These studies compare the appraised value of parcels with the sales price. The closer the comparison is to 100%, the closer the property's appraised value is to its fair market value. It was the opinion of this group that the information in the report would assist the Department

[82] The act does not apply to deeds of trust, deeds of release, or similar instruments.

[83] Prior to 2000, the registers of deeds affixed tax stamps on a deed to indicate that the excise tax on a conveyance had been paid. The use of these stamps was eliminated when metering machines and similar equipment became available.

in determining the true value of property in the counties while weeding out transfers of property that did not reflect payment of the property for fair market value. The Department of Revenue also noted that fifty counties currently send out letters requesting similar sales information and six counties require either transfer affidavits or copies of the sales contract.[84]

During the 2009 Session, the Revenue Laws Committee proposal was simplified by eliminating a separate report as well as disclosure of certain sales information. The General Assembly decided it was unnecessary to require parties to pay to record a separate document with the register of deeds as long as the required information was on the deed. The General Assembly also felt that a duty to report the correct amount of excise tax on the conveyance was sufficient notice of the sales price to assist the county in meeting the statutory fair market appraisal standards.

Withholding on Contractors Identified by ITIN.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-476	**SB 1006**	**Senator Hoyle**

AN ACT TO REQUIRE WITHHOLDING ON CONTRACTORS IDENTIFIED BY AN INDIVIDUAL TAXPAYER IDENTIFICATION NUMBER (ITIN).

OVERVIEW: This act, which was a request of the Department of Revenue, requires a person who pays an Individual Taxpayer Identification Number (ITIN) holder more than $1,500 a year in compensation other than wages to withhold 4% of the compensation.

FISCAL IMPACT: The act is estimated to generate $8 million in fiscal year 2009-2010, and potentially $18 million in subsequent fiscal years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2010.

ANALYSIS: Under current North Carolina law, an employer is required to deduct and withhold from an employee's wages the State income taxes payable by the employee on those wages and deposit the withheld taxes with the Department of Revenue. A person who pays more than $1,500 during a calendar year as compensation other than wages for personal services performed in this State by a nonresident individual or entity must withhold 4% of the payment and remit the withheld taxes to the Department.[85] This act applies the same withholding requirement to compensation other than wages paid to an ITIN holder. An ITIN is issued to a person who is required to have a taxpayer identification number but is

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[84] The following counties require transfer affidavits: Camden, Chowan, Currituck, Dare, Martin, and Pasquotank.

[85] The withheld taxes are credited to the employee or to the nonresident individual or entity from whom they were withheld. People from whom taxes have been withheld receive credit for the withheld taxes by filing a North Carolina income tax return, and any excess is refunded to the taxpayer.

not eligible to obtain a social security number. A person may obtain a social security number if the person has been lawfully admitted to the United States for permanent residence or under other immigration categories that authorize employment in the United States.

A payer required to withhold taxes from compensation paid to an ITIN holder must file a return and pay the withheld taxes to the Department. The withheld taxes are payable quarterly, monthly, or semiweekly depending upon the average amount withheld by a payer each month. If the amounts withheld average less than $250 a month, the payments are due quarterly. If the amounts withheld average at least $250 but less than $2,000, the payments are due monthly. All other payments are due by the date set under the Internal Revenue Code for payment of federal employment taxes attributable to the same wages. A payer who withholds taxes from compensation paid to an ITIN holder must give the person a written statement by January 31 following the end of the calendar year that sets out the total amount of compensation paid during the calendar year to the person and the total amount deducted and withheld.

The Department of Revenue requested this change in the law to better enable it to collect State income taxes on amounts paid to ITIN holders who are not employees. The Department reviewed 1099 Forms available through the Federal Data Exchange Program with the Internal Revenue Service. A review of the data indicated a number of North Carolina ITIN holders as the recipients of 1099 miscellaneous payments. Often, the ITIN holder receiving the compensation identified on the 1099 forms were illegal immigrants. Attempted collections of these amounts by the Department resulted in less than 10% of the amount of tax due. The Department believes that a withholding requirement on non-employee compensation paid to ITIN holders will insure the tax is properly paid on income earned in the State. The withholding requirement applies to an array of businesses, but one of the predominant ones is construction.

Community Land Trust Property Taxation.

Session Law	***Bill #***	***Sponsor***
S.L. 2009-481	**HB 1586**	**Rep. Luebke, Hall**

AN ACT TO CLARIFY THE VALUATION OF COMMUNITY LAND TRUST PROPERTY.

OVERVIEW: This act classifies community land trust (CLT) property as a special class of property and requires resale restrictions to be considered in determining the property tax value.

FISCAL IMPACT: This act will lower the value of land trust property for property tax purposes, potentially lowering the revenues of the cities and counties in which the properties reside. There are currently two qualifying community land trusts active in North Carolina: Durham Community Land Trust, and Orange Community Housing and Land Trust. The changes in this bill will result in a $6,885.15 revenue loss for Durham County beginning in FY 2009-10 and a $5,250.64 revenue loss for the City of Durham beginning in FY 2009-10.

The Orange Country Board of Equalization and Review is currently conducting a hearing regarding land trust property. Depending on how the Board rules, there could be an additional revenue loss to Orange County, the City of Carrboro, the City of Chapel Hill, and the Carrboro-Chapel Hill School District.

EFFECTIVE DATE: This act is effective for taxable years beginning on or after July 1, 2010.

ANALYSIS: CLT property is a model of home ownership for low- and moderate-income families where the underlying land is owned by a nonprofit and the homes located thereon are owned (or rented for sufficiently long periods that banks treat the leasehold interest as an ownership interest for loan purposes) by the low- or moderate-income individuals or families. Notably, CLT property is subject to restrictions on the sales price in order to ensure the properties are affordable for future, subsequent low- and moderate-income families.

Under North Carolina law, real property must be appraised at its true value, or the value a willing, able, and knowledgeable buyer would give to a willing, able, and knowledgeable seller for the property. In appraising true value, the assessor must "consider … any … factor that may affect its value." Anecdotal evidence suggested inconsistent treatment by counties of the resale restrictions on CLT property and whether those restrictions qualified as as a "factor that may affect [a property's] value" for purposes of establishing a property tax value. Accordingly, some CLT properties were appraised at market value for tax purposes despite resale restrictions that disallowed the homeowner to sell the property at market value.

This act classifies CLT property for special property tax valuation and establishes how resale restrictions should be used by an assessor in establishing property tax values for this type of property. [86] CLT property is an improvement to real property that meets all of the following requirements:

- It is developed by a non-profit 501(c)(3) tax-exempt entity, which retains an interest in the property according to one of the following two models:
    - The improvement is conveyed to the qualifying owner and the land on which the improvement is constructed is leased to the qualifying owner under a 99-year lease, renewable for an additional 99-year term.
    - The improvement and the land on which the improvement is constructed are leased to the qualifying owner under a 99-year lease, renewable for an additional 99-year term.
- An interest in the property is conveyed to a North Carolina resident who occupies the improvement, as owner or lessee, as a permanent residence and who is part of a household with an annual income, at the time of transfer and adjusted for family size, of not more than 100% of the local area median income.

[86] This act is not the only preferential tax treatment provided for low-income housing. Last session, the General Assembly enacted S.L. 2008-146, which classified certain low-income rental housing developments as a special class of property for which the value must be assessed by using the income approach to valuation. For such property, the tax assessor must take into account any applicable rent restrictions and may not include any federal tax credits for affordable housing in determining income. The property value determination is limited to actual rental income as opposed to the rental income similarly situated property not subject to rent restrictions would be able to generate as income.

- Its resale value is governed by restrictions contained in the ground lease to ensure low-priced housing to subsequent qualifying owners.

The tax value of CLT property when the property first qualifies for this classification is equal to the actual sales price of the house to the qualifying owner, minus any silent mortgage amount. In subsequent revaluations, the tax value of CLT property is capped at the original sales price plus the amount of capital gain the qualifying owner could realize from the sale.

Under G.S. 105-278.6(e), real property held by a nonprofit organization as a future site for housing for individuals or families with low or moderate incomes qualified for a deferral of property taxes. Those taxes become due and payable if homes for low or moderate income families are not built on the land within five years. In addition to classifying CLT property as a special class of property for property tax purposes, the act also modifies G.S. 105-278.6(e) in order to provide that eligibility for the tax deferral program does not end in situations such as bankruptcy or foreclosure, where the qualifying owner's interest is re-acquired by the CLT and the CLT owns the property, in toto, during the listing period.

Development Tier Designation Exception.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-505	**HB 1500**	**Representative Spear**

AN ACT TO CREATE A NEW DEVELOPMENT TIER DESIGNATION EXCEPTION FOR CERTAIN SEAFOOD INDUSTRIAL PARKS.

OVERVIEW: This act provides that any seafood industrial park has a development tier one designation for purposes of economic development programs, including certain tax credits.

FISCAL IMPACT: There is a potential fiscal impact depending on whether and how many new parks are established, but no estimate is currently available. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009, and expires on July 1, 2012.

ANALYSIS: This act provides that any seafood industrial park created under Article 23C of Chapter 113 of the General Statutes has a development tier one designation. The North Carolina Seafood Industrial Park Authority (Authority) is an eleven-member board with nine appointments by the Governor and two by the General Assembly. Among its purposes, the Authority is charged with creating jobs and economic growth in the seafood and other marine-related industries.

The tier designations assigned to counties each year by the Secretary of Commerce are designed to measure and rank how economically distressed each county is based on four factors:

- Average rate of unemployment
- Median household income
- Percentage growth in population
- Adjusted assessed property value per capita

Counties designated as tier one are the most economically distressed according to these factors, while counties designated as tier three are the least economically distressed. This tier system is incorporated into various economic development programs, including the Article 3J Tax Credits, to encourage economic activity in the less prosperous areas of the State. The thresholds and credit amounts are more favorable for tier one counties. Under current law, there are exceptions to the tier ranking system in which entities may be given a tier designation different from the county in which they are located. An exemption already exists for an industrial park located in multiple jurisdictions. This act creates a new exception for seafood industrial parks.

Currently, the only Seafood Industrial Park created under Article 23C of Chapter 113 of the General Statutes is located in Wanchese, Dare County,[87] North Carolina. However, since this facility is has no more room for expansion, the Authority is seeking new locations to accommodate future growth and to promote job creation. Of the 26 potential sites in 11 counties that were considered, Perquimans[88] was identified as the number one site. In 2008, Perquimans County and the Authority indicated their intent to enter into a partnership for the development of a 70-acre marine park. The County anticipates that when the park is fully developed it will have over 20 businesses, including six boat builders, boat repair and maintenance, marine engine sales and service, boat sales, upholstery, and cabinet making, with approximately 400 employees, and will be the major economic development initiative within the County. The Authority is also considering the establishment of another seafood industrial park in Hyde County. The lower tier designation may enable seafood industrial parks to obtain more generous tax incentives and federal money that they may not otherwise be able to obtain.

Sales Tax Incentives for Flight Simulators.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-511	**SB 1057**	**Senator Dorsett**

AN ACT TO EXPAND THE SALES TAX EXEMPTION FOR AIRCRAFT SIMULATORS.

OVERVIEW: This act extends the sales tax exemption for aircraft simulators to all aircraft simulators used for flight crew training and maintenance training.

[87] At the time of this publication, Dare County is a tier two county.
[88] At the time of this publication, Perquimans is a tier two county.

<u>FISCAL IMPACT:</u> The act will reduce General Fund revenues by $1.9 million in fiscal years 2009-2010 and 2010-2011. The act will also reduce local revenues by $0.8 million in fiscal years 2009-2010 and 2010-2011. *(For a more complete fiscal analysis, see Overview: <u>Fiscal and Budgetary Actions</u>, 2009 Session. Available in the Legislative Library.)*

<u>EFFECTIVE DATE:</u> This act is effective October 1, 2009, and applies to sales made on or after that date.

<u>ANALYSIS:</u> In 1999, a sales tax reduction from 6% to 1% with an $80 cap was given to passenger air carriers for purchases of aircraft simulators for flight crew training used at the air carrier's hub. The tax reduction also applied to interstate air couriers.

In 2005, the sales tax reduction was repealed and a sales tax exemption was provided for certain items, including aircraft simulators for flight crew training, for sales to an interstate passenger air carrier for use at its hub.

This act exempts from sales and use tax the sales of all flight simulators used for flight crew training and maintenance training. The changes to the sales tax exemption were requested as part of a development project for the Piedmont Triad International Airport. The Project seeks to promote creation of a flight training hub in the area by extending the credit to all flight simulators.

<u>JMAC Modifications.</u>

Session Law	*Bill #*	*Sponsor*
S.L. 2009-520	**HB 884**	**Representative Cole**

AN ACT TO MODIFY THE REQUIREMENTS FOR A GRANT FROM THE JOB MAINTENANCE AND CAPITAL DEVELOPMENT FUND.

<u>OVERVIEW:</u> This act does three things:

- It modifies the investment and employment requirements for a business to qualify for a grant from the Job Maintenance and Capital Development Fund.
- It increases the total aggregate cost of all agreements entered into under the Fund from $60 million to $69 million.
- It increases the total annual cost of any one agreement from $4 million to $6 million.

<u>FISCAL IMPACT:</u> The total impact is $9 million, because it increases the maximum payout from $60 million to $69 million from the Job Maintenance and Capital Development Fund. *(For a more complete fiscal analysis, see Overview: <u>Fiscal and Budgetary Actions</u>, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective July 1, 2010.[89]

ANALYSIS: The General Assembly created the Job Maintenance and Capital Development Fund in 2007 as a non-reverting account in the Department of Commerce.[90] The Fund is similar to the Job Development and Investment Grant Fund created by the General Assembly in 2002, except that the purpose of the Job Maintenance and Capital Development Fund is to maintain jobs while the purpose of the Job Development Grant Program is to create new jobs. In September 2008, two companies each received a 10-year grant from the Job Maintenance and Capital Development Fund for up to $30 million provided they meet job retention, investment, and other performance requirements: the Goodyear Tire and Rubber Company in Fayetteville and the Firestone North American Tire in Wilson.

The legislation enacted in 2007 set a minimum investment requirement of $200 million within five years and a minimum job retention requirement of 2,000 full-time employees or equivalent full-time contract employees.[91] Domtar[92] a company in Washington County in Plymouth, is a manufacturing company converting from paper production to fluff production.[93] The cost of the modernization project is expected to be $69 million. It is anticipated that the modernization project will ensure the future of the mill, but it will reduce the number of full-time equivalent employees from 520 to 320. This company could not meet the minimum investment and job retention requirements needed to receive a grant from the Job Maintenance and Capital Development Fund. This act creates a different level of investment and job retention for a manufacturing business that is converting its manufacturing process to change the product it produces:

- It reduces the minimum investment requirement from $200 million to $65 million. A business must make this investment with private funds and the investment must be made within three years of the time the investment commences.
- It reduces the minimum job retention requirement from 2,000 full-time employees or contract employees to 320 full-time employees. The business must maintain this level of employment for the full term of the grant.

The Department may not enter more than five agreements, and this act does not change that limitation. However, the act does increase the total aggregate cost of all agreements for grants from the Fund from $60 million to $69 million and it increases the annual cost of any one agreement from $4 million to $6 million. A grant agreement obligates the State to make a series of grant payments over a period of time, but it does not authorize the taxing power of the State to be pledged.

The act does not change any of the other following conditions a business must meet to qualify for a grant from the Job Maintenance and Capital Development Fund:

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[89] Senate Bill 825 initially contained the contents of this act. That bill failed third reading in the House on August 6, 2009. The contents of the bill were put into House Bill 884. House Bill 884 changed the effective date to July 1, 2010. Under Senate Bill 825, the bill would have become effective when it became law.

[90] S. L. 2007-552, G.S. 143B-437.11; S. L. 2008-187 recodified the statute as G.S. 143B-437.012.

[91] Under its agreements, Goodyear must retain 2, 398 workers and invest $200 million by 2012 at its Fayetteville facility and Firestone must retain 2,083 workers and invest $200 million by 2010 at its Wilson facility.

[92] Domtar was originally part of Weyerhauser.

[93] Fluff is created from loblolly pine and is used in disposable diapers for children and adults.

- The project must be located in a development tier one at the time the grant application is made.

- All newly hired employees of the business must be citizens of the United States or have proper identification and documentation of their authorization to reside and work in the United States.

- The business must pay an average weekly wage that is at least equal to 140% of the average wage for all insured private employers in the county.

- The business must make health insurance available for all full-time employees and equivalent full time contract employees of the project for which the grant application is made. This health insurance must pay at least 50% of the premiums for health care coverage that equals or exceeds the minimum provisions of the basic health care plan of coverage under G.S. 58-50-125. The business must provide a certification to the Department showing continuing compliance annually.

- The business, with respect to the location for which the grant is made, has no citations under OSHA that have become a final order within the past three years for willful serious violations or for failing to abate serious violations.

- The business, with respect to the location for which the grant is made, has no pending administrative, civil, or criminal enforcement action based on alleged significant violations of any program implemented by DENR, and has had no final determination of responsibility for any significant administrative, civil, or criminal violation of any program implemented by an agency of DENR within the past three years.

Any business meeting the requirements for a grant from the Job Maintenance and Capital Development Fund may apply for a grant. The Department of Commerce is charged with the responsibility of administering the selection of projects receiving a grant. The Department submits the project applications that it deems eligible and appropriate for a grant to the Economic Investment Committee. The Economic Investment Committee must make the following findings before it can recommend a project receive a grant from the Fund:

- The conditions for eligibility have been met.

- A grant from the Fund for the project is necessary to carry out the public purposes of the Fund.[94]

- The project is consistent with the economic development goals of the State and the area where the project is located.

- Affected local governments have participated in retaining the business and offered incentives appropriate to the project.

- A grant is necessary for the maintenance of the project within the State.

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[94] The public purposes include stimulating economic activity, maintaining high-paying jobs in the State, encouraging capital investment, reducing economic distress, enlarging the tax base, increasing revenue to the State's political subdivisions, and maintaining continued diversity in the State's industrial base.

The Economic Investment Committee must recommend the appropriate grant amount for each applicant to whom it believes a grant should be given. The Committee may consider the following factors in determining the amount of the grant:

- 95% of the privilege and sales and use taxes paid by the business on machinery and equipment installed at the project that is the subject of the agreement.
- 95% of the sales and use taxes paid by the business on building materials used to construct, renovate, or repair facilities at the project that is the subject of the agreement.
- 95% of the additional income and franchise taxes that are not offset by tax credits.
- 95% of the taxes paid on electricity, piped natural gas, and other fuel that is consumed at the project that is the subject of the agreement.
- 100% of worker training expenses associated with the project that is the subject of the agreement.
- 100% of any State permitting fees associated with the capital expansion at the project that is the subject of the agreement.

Absent a determination by the Secretary of Commerce that a project is no longer eligible or appropriate to receive a grant, the Department must enter into a binding and continuing contract, not to exceed 10 years, on behalf of the State with the business to provide a grant or series of grants for each project recommended by the Committee. The grant agreement must contain the following:

- All performance criteria, remedies, and other safeguards recommended by the Committee or required by the Department to secure the State's investment.
- A provision prohibiting a recipient business from receiving a payment or benefit under the agreement when it has received a notice of an overdue tax debt that has not been satisfied or resolved.

In order to ensure that public funds are used only for the Fund's public purposes, to protect the State's investment, and to ensure that the projected benefits of the project result, the Department must require each recipient business to agree to meet performance criteria, including maintenance of an appropriate level of employment at specific compensation levels, maintenance of health insurance for all full-time employees, investment of a specified amount over the agreement term, and any other criteria considered appropriate by the Department. In addition, the agreement must require the business to repay or reimburse an appropriate portion of the grant for any failure to meet the performance criteria.

The Department is charged with monitoring compliance by a recipient business with performance criteria and with administering repayment for failure by a recipient business to meet performance criteria. The Department pays for the administrative costs for these responsibilities from funds appropriated for that purpose or other economic development purposes. Within two months after the end of each calendar quarter, the Department must report to the Joint Legislative Commission on Governmental Operations regarding the Fund, including a listing of each grant awarded and each agreement entered into during the preceding quarter, and detailed information about any defaults and repayment during the preceding quarter. For each grant agreement in the report, the Department must include the name of the business, the cost-benefit analysis by the Committee, a project description, and the projected grant amount to be paid during the current fiscal year. The Department must publish its report on its website and make printed copies available upon request.

Revolving Loan Fund for Energy Improvements.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-522	**HB 1389**	**Rep. Fisher, Harrison, Rapp**

AN ACT TO AUTHORIZE CITIES AND COUNTIES TO ESTABLISH LOAN PROGRAMS TO FINANCE THE INSTALLATION OF DISTRIBUTED GENERATION RENEWABLE ENERGY SOURCES OR ENERGY EFFICIENCY IMPROVEMENTS THAT ARE PERMANENTLY AFFIXED TO REAL PROPERTY.

OVERVIEW: This act authorizes cities and counties to establish revolving loan programs to finance energy efficiency improvements and distributed generation renewable energy sources that are permanently affixed to real property.

FISCAL IMPACT: This act has no impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when signed into law by the Governor on August 26, 2009.

ANALYSIS: North Carolina cities and counties are eligible to obtain federal grant funds under the American Recovery and Reinvestment Act of 2009, P.L. 111-5 (ARRA), during the 2009-2011 biennium to finance certain energy-related programs. The Energy Efficiency Conservation Block Grants Program (EECBG) seeks to assist eligible entities to reduce fossil fuel emissions, to reduce total energy use, and to improve energy efficiency in transportation and buildings.

This act authorizes cities and counties to establish loan programs to finance energy efficiency improvements and the installation of distributed renewable energy sources that are permanently affixed to real property. Cities and counties may use EECBG funds and any other restricted funds the entity may have. The term of the loan may not be greater than 15 years, and the annual interest rate charged on the loan may not exceed 8%.

The term 'renewable energy source' has the same meaning as renewable energy resource as defined in G.S. 62-133.8. That definition does not include peat, a fossil fuel, or nuclear energy resource but does include all of the following:

- Solar electric.
- Solar thermal.
- Wind.

- Hydropower.
- Geothermal.
- Ocean current or wave energy resource.
- Biomass resource, including agricultural waste, animal waste, wood waste, spent pulping liquors, combustible residues, combustible liquids, combustible gases, energy crops, or landfill methane.
- Waste heat derived from a renewable energy resource and used to produce electricity or useful, measurable thermal energy at a retail electric customer's facility.
- Hydrogen derived from a renewable energy resource.

IDF Changes/Research & Prod. Serv. Districts.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-523	**HB 1514**	**Rep. Crawford, Dickson, Gibson**

AN ACT TO EXPAND ECONOMICALLY DISTRESSED COUNTIES TO INCLUDE ALL TIER ONE AND TIER TWO COUNTIES, TO INCREASE THE MAXIMUM EXPENDITURE OF FUNDS FROM THE INDUSTRIAL DEVELOPMENT FUND, TO EXEMPT FROM RULE MAKING THE CUSTOMIZED TRAINING PROGRAM UNDER THE COMMUNITY COLLEGE SYSTEM, AND TO AMEND THE COUNTY SERVICE DISTRICT ACT OF 1973 TO ALLOW ADDITIONAL COUNTY RESEARCH AND PRODUCTION SERVICE DISTRICTS.

OVERVIEW: This act expands the use of the Industrial Development Fund (IDF) and temporarily authorizes the establishment of additional county research and production service districts. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009. The modification of the qualification of counties for IDF benefits expires in three years on July 1, 2012.

ANALYSIS: The IDF provides funds to assist local governments of the most economically distressed counties in the State in creating jobs in eligible industries. An economically distressed county is a county that has one of the 65 highest rankings under the development tier designation. An 'eligible industry' is defined as a company or person engaged in the business of air courier services, information technology and services, manufacturing, or warehousing and wholesale trade. The IDF funds must be used for (i) installation of or purchases of equipment for eligible industries; (ii) structural repairs and renovations of buildings for expansion of eligible industries; or (iii) construction of or improvements to new or existing utility lines or equipment or transportation infrastructure for existing or new building for the eligible industries. The funds must be used by the city and county governments for projects that directly result in the creation of new jobs and must be expended at a maximum rate of $5,000 per new job created up to a maximum of $500,000 per project.

Within the IDF there is a special account entitled the Utility Account that provides funds to assist the local government units of economically distressed counties. The funds in the Utility Account may only be used for the construction of or improvements to new or existing water, sewer, gas, telecommunications, high-speed broadband, electrical utility distribution lines or equipment, or transportation infrastructure for existing or new or proposed industrial buildings to be used for eligible industrial operations. There is no maximum funding amount per new job to be created or per project under the Utility Account.

Under the development tier designation, the 40 most distressed counties are designated as tier one, the next 40 as tier two, and the 20 least distressed as tier three.

This act makes the following changes related to the IDF:

- Increases the maximum rate by which funds in the IDF are to be expended for jobs from $5,000 to $10,000.
- Authorizes funds from the IDF to be spent for job retention as well as job creation.
- Expands the definition of "economically distressed county" to a county that is a tier one or a tier two county, which consists of the top 80 counties. Prior law defined the term as a county that has one of the 65 highest rankings.
- Provides funds from the Utility Account to tier one or tier two counties instead of only to counties with one of the 65 highest rankings under the development tier designation.

This act also authorizes additional county research and production service districts. Under current law, a board of commissioners may, by resolution, establish a research and production district for any area of the county if it meets the standards listed below. A county may levy property taxes within the district in addition to those levied throughout the county with a cap of 10¢ on each $100 value of property.

This act modifies those standards to allow for the creation of such a district when all of the real property in the district is part of a multijurisdictional industrial park. The maximum property tax rate for a district meeting those criteria would be 15¢ on each $100 value of taxable property.

The current standards for a research and production service district are:

1. All real property in the district is being used for or is subject to covenants that limit its use to research or scientifically-oriented production or for associated commercial or institutional purposes.
2. The district contains at least 4,000 acres.

3. The district includes research and production facilities that in combination employ at least 5,000 persons.
4. All real property located in the district was at one time or is currently owned by a nonprofit corporation, which developed or is developing the property as a research and production park.
5. A petition requesting creation of the district signed by at least fifty percent (50%) of the owners of real property in the district who own at least fifty percent (50%) of total area of the real property in the district has been presented to the board of commissioners. In determining the total area of real property in the district and the number of owners of real property, there shall be excluded (1) real property exempted from taxation and real property classified and excluded from taxation and (2) the owners of such exempted or classified and excluded property.
6. The district has no more than 25 permanent residents.
7. There exists in the district an association of owners and tenants, to which at least seventy-five percent (75%) of the owners of real property belong, which association can make the recommendations provided for in G.S. 153A-313.
8. There exist deed-imposed conditions, covenants, restrictions, and reservations that apply to all real property in the district other than property owned by the federal government.
9. No part of the district lies within the boundaries of any incorporated city or town.

Development Tier Exception Modification.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-524	**SB 898**	**Senator Soles**

AN ACT TO MODIFY THE EXCEPTION FOR TWO-COUNTY INDUSTRIAL PARKS FOR DEVELOPMENT TIER DESIGNATION PURPOSES.

OVERVIEW: This act reduces the percentage of a two-county industrial park that must be located in the lower tier county to qualify the park for the lower development tier designation.

FISCAL IMPACT: There is a potential fiscal impact to the extent this act expands the scope of eligibility for certain tax credits and other incentives. However, since the Article 3J credits sunset January 1, 2011, it is not known whether any jobs or investment will take place in time for credits to be taken under the act. According to the Department of Commerce and the Columbus County Economic Development Commission, the process of purchasing the land, developing infrastructure and recruiting businesses for the proposed industrial park will take several years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009, and expires on July 1, 2012.

ANALYSIS: This act modifies in two ways the standards that must be met in order for a two-county industrial park to qualify for the tier designation of the lower-tiered county. First, it reduces from one-third to one-fifth, the percentage of property of an industrial park located in two counties that must be located in the lower-tiered county in order to be eligible for the lower tier designation. Second, the counties must have entered into an interlocal agreement providing that the incremental increase in property tax revenues within the park shall be shared equally by the counties.

The Department of Commerce annually ranks the State's 100 counties based on economic well-being and assigns a tier designation to each county. This tier system is incorporated into various State incentive programs to encourage economic activity in the less prosperous areas of the State. The 40 most distressed counties are designated tier one, the next 40 are designated tier two, and the remaining 20 counties are designated tier three. A development tier designation is effective only for the calendar year following the designation.

The ranking system is based upon a county's development factor[95] and statutorily mandated adjustments. One of the statutorily mandated adjustments[96] is for a two-county industrial park. An eligible two-county industrial park has the lower development tier designation of the two counties in which it is located. Prior to this act, an eligible two-county industrial park had to meet all of the following conditions:

- It is located in two contiguous counties.
- At least 1/3 of the park is located in the county with the lower tier designation.
- It is owned by the two counties or a joint agency of the counties, is under contractual control of designated agencies working on behalf of both counties, or is subject to a development agreement between both counties and third-party owners.
- The county with the lower tier designation contributed at least the lesser of one-half of the cost of developing the park or a proportion of the cost of developing the park equal to the proportion of land in the park located in the county with the lower tier designation.

Columbus and Brunswick Counties could benefit from this legislation. They are building a two-county industrial park and desire to take advantage of the lower tier designation of Columbus County. Columbus County is a tier one county and Brunswick County is a tier three county. The two counties are planning to develop the "International Logistics Park of North Carolina." This industrial park would be the first at-port distribution center in North Carolina. The 1000-acre park will be located along Highway 74 (future I-74) and within 16 miles of the Port of Wilmington. The park would house a series of large distribution centers from which goods coming into the State Port at Wilmington could be distributed to retail

[95] A county's development factor is the sum of the county's rank in the following areas: average rate of unemployment for the most recent 12-month period, median household income for the most recent 12-month period, percentage growth in population for the most recent 36 months, and adjusted assessed property value per capita for the most recent taxable year.

[96] Other statutorily mandated adjustments include those for small counties, development tier one areas, and multijurisdictional industrial parks.

outlets or regional distribution centers. The ports located in Charleston, SC, Norfolk, VA, and Savannah, GA all have at-port distribution centers located near them.

The International Logistics Park will straddle the Brunswick and Columbus County line with approximately 200 acres located in Columbus County and the remaining 800 acres or so located in Brunswick County. Prior to the act, the park could not exceed 600 acres to qualify for the adjustment, since at least one-third of the park (200 acres) would need to be in the lower tier area. Under the act, the entire 800 acres could qualify for the adjustment because more than one-fifth of the park (160 acres) would be located in the tier one county.

The counties anticipate that the park will create 4000 new jobs for the area and generate at least $300 million in private investments. The lower tier designation will allow businesses locating in the International Logistics Park to qualify for the larger tax credits available under Article 3J for tier one counties and other incentives available to tier one counties. Those incentives include:

- Credit for creating jobs. – The job threshold and the credit amount per job are determined by the tier designation of the county in which the jobs are created. For a tier one county, the minimum number of jobs that must be created is five and the credit amount per job is $12,500; for a tier two county, the minimum number of jobs is 10 and the credit amount per job is $5,000; for a tier three county, the minimum is 15 and the credit amount is $500.

- Credit for investing in business property. – The credit percentage and threshold are based on the tier designation of the county where the property is placed in service. For a tier one county, there is no threshold and the credit percentage is 7% of the cost of capitalized tangible personal property; for a tier two county, the threshold is $1 million and the credit percentage is 5%; for a tier three county, the threshold is $2 million and the credit percentage is 3.5%.

- Credit for investing in real property. – This credit is only available for an eligible establishment located in a tier one county. To be eligible, the taxpayer must invest at least $100 million in real property within a three-year period and create at least 200 new jobs within two years.

- Credit for research and development. – The credit for expenses for research performed in a tier one county is 3.25% of the expenses, regardless of the amount of expenses incurred. For research performed in a tier two or tier three county, the percentage varies depending upon the amount of expense occurred.

- Job development investment grant. – This discretionary incentive program provides a limited number of cash grants directly to new and expanding businesses. The grants are based on job creation and investment commitment. The minimum number of jobs that must be created to qualify for a grant varies depending upon the development tier designation of the county where the jobs are created: the minimum number of jobs that must be created in a tier one county is 10 and for all other counties the minimum number of jobs that must be created is 20.

- Industrial development fund. – This fund provides grants and loans for infrastructure development in the 66 most distressed counties. There is no local match requirement in the 26 most distressed counties.

Critical Infrastructure Assm't Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-525	**SB 97**	**Senator Hartsell**

AN ACT TO ALIGN THE AUTHORIZED PURPOSES FOR SPECIAL ASSESSMENTS FOR CRITICAL INFRASTRUCTURE NEEDS WITH THE PURPOSES OF PROJECT DEVELOPMENT FINANCING; TO ADD RENEWABLE ENERGY SOURCES AND ENERGY EFFICIENCY IMPROVEMENTS AS PURPOSES; TO CLARIFY THE LAW CONCERNING FINANCING A PROJECT FOR WHICH ASSESSMENTS MAY BE PLEDGED, TO EXEMPT PRIVATE ENTITIES THAT IMPLEMENT CERTAIN PROJECTS FOR WHICH ASSESSMENTS MAY BE PLEDGED FROM THE COMPETITIVE BIDDING REQUIREMENTS OF LOCAL GOVERNMENTS; AND TO PROVIDE GUIDANCE FOR LOCAL GOVERNMENTS WHEN ISSUING CERTAIN DEBT INSTRUMENTS AND ENTERING INTO CERTAIN AGREEMENTS.

OVERVIEW: This act does all of the following:

- Aligns the purposes for which cities and counties may issue bonds payable from special assessments with the purposes for which project development financing may be used and adds the financing of renewable energy sources and energy efficiency improvements as a purpose for which bonds payable from special assessments may be used.
- Allows a city or county to partner with a private entity to construct a project financed with assessment-based financing.
- Clarifies that a city or county may use one or more financing sources to pay the costs of a project for which a special assessment is imposed and provides that assessments may be used to secure revenue bonds or as additional security for a project development financing debt instrument.
- Provides budgeting guidance to local governments in meeting future project development debt obligations.

FISCAL IMPACT: No fiscal impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 26, 2009.

ANALYSIS: Cities and counties use project development financing and special assessments to help finance the cost of long-term capital projects related to economic development projects. The subject of the development typically bears the cost of these financing tools. In the case of project development financing, the source is new property tax revenues generated by the development and in the case of special assessments, the source is assessments imposed on the property by its owner to fund the costs of infrastructure that will benefit that property. These tools are relatively new in North Carolina.[97] In other areas of the country that have these financing tools, they are frequently used together.

This act modifies these two financing tools to make them more compatible. The act aligns the purposes for which cities and counties may issue bonds payable from special assessments with the purposes for which project development financing may be used under G.S. 159-103. Assessment-based financing may currently be used for water and sewer systems, stormwater systems, public transportation facilities, school facilities, and streets and sidewalks. This change effectively expands the purposes for which assessment-based financing may be used to include the following:

- Airport facilities
- Hospital facilities
- Art galleries, museums, and art centers
- Industrial parks
- Community college facilities
- Improving existing telephone systems
- Parks and recreation facilities
- Auditoriums, coliseums, arenas, stadiums, civic centers, and convention centers
- Parking facilities
- Preservation of railroad corridors
- Low and moderate income housing
- Gas systems
- Electric systems

The act also adds as a purpose for which assessment-based financing may be used the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to commercial, industrial, or other real property.[98]

The State Treasurer's office expressed concern about the use of assessments to finance traditional government functions, such as community college facilities and museums. Assessments may only be imposed on property that benefits from a project in some special way that is different from other property that is not assessed. Generally, these types of projects do not provide the kind of special benefit that warrants imposition of an assessment. There may be unusual circumstances where a special benefit could be substantiated, but these circumstances would be exceptional. Before assessment-based financing could be imposed for any of these purposes, the Local Government Commission must approve the proposed revenue bond issuance and one of the conditions that must be met before the Commission may approve such a debt issuance is that the proposed assessment is adequate and not excessive.

The act allows a city or county to implement a project financed in whole or in part by the imposition of assessment-based financing through contracts with public or private entities.

[97] S.L. 2003-403 authorized cities and counties to use project development financing, Article 6 of Chapter 159. S.L. 2008-165 authorized cities and counties to use special assessments, Article 9A of Chapter 153A (counties) and Article 10A Chapter 160A (cities).

[98] The House Judiciary Committee adopted an amendment to add this purpose.

The addition of this provision provides flexibility in procurement and greater conformity with project development financing projects. The provision recognizes that many of the local infrastructure projects associated with assessment-based financing are part of a unified and comprehensive development plan that makes it practical to construct a number of projects together.

The State Treasurer's office also expressed concern that the provision allows a local unit to partner with a private entity and bypass the bidding rules of Article 8 of Chapter 143 of the General Statutes. To address this concern, the act provides that private entities that undertake these projects are not subject to the competitive bidding requirements so long as no more than 25% of the estimated cost of the project is funded by general obligation bonds or general revenue. The act also provides that if the project is on public property and the bidding rules do not apply to the construction on this property, then the county must obtain certification from the private developer to ensure that claims for payment by contractors of the funds derived from the public financing will be met. The certification must be in the form and in an amount acceptable to the city or county. If the entity responsible for disbursing these funds receives notice of a claim from a person who would be entitled to a mechanic's or materialman's lien but for the fact that the claim relates to work performed on or supplies provided to publicly owned property, then either no disbursement of funds may be made until the claim is resolved or funds in an amount necessary to satisfy the claim must be set aside until the claim is resolved.

The act revises the financing provisions to address an interpretation issue raised by the School of Government and to provide that special assessments may be used to secure other obligations, including project development financing debt instruments. The act clarifies that the costs of these projects may be covered by using any combination of the following financing sources:

- Revenue bonds issued under G.S. 153A-210.6.
- Project development financing debt instruments issued under the North Carolina Project Development Financing Act, Article 6 of Chapter 159 of the General Statutes.
- General obligation bonds issued under the Local Government Bond Act, Article 4 of Chapter 159 of the General Statutes.
- General revenues.

The act also provides that special assessments may be pledged as additional security for project development financing debt instruments as well as revenue bond financing debt instruments. If the assessment is pledged to secure financing, the city or county must covenant to enforce the payment of assessments.

Lastly, the act provides three methods for a city or county to provide additional credit support to project development debt obligations. A city or county that issues project development financing debt instruments may agree in the proceedings relating to the issuance, and in the agreements it enters into with property owners in the development financing district,[99] that it will include in its budget an appropriation of the amount due on the debt instrument. A second method is to include in its appropriations the amount

[99] See G.S. 159-108.

necessary to restore the level of funding in a reserve fund to its required level. The third option available is to permit a city or county to use any excess revenues in its general fund to make the required payments.[100] A local unit of government that provides this agreement in its finance-related proceedings or in its increment agreement with property owners must expressly state that the agreement does not create an obligation on the governing board to make the appropriation; the appropriation continues to be subject to the annual budget making process.

Congestion Relief/Intermodal Transport Fund.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-527	**HB 148**	**Rep. Carney, Allen, Ross, McGee**

AN ACT TO ESTABLISH A CONGESTION RELIEF AND INTERMODAL TRANSPORTATION 21ST CENTURY FUND; TO PROVIDE FOR ALLOCATION OF THOSE FUNDS TO: (1) LOCAL GOVERNMENTS AND TRANSPORTATION AUTHORITIES FOR PUBLIC TRANSPORTATION PURPOSES, (2) SHORT-LINE RAILROADS, FOR ASSISTANCE IN MAINTAINING AND EXPANDING FREIGHT SERVICE STATEWIDE, (3) RAILROADS FOR INTERMODAL FACILITIES, MULTIMODAL FACILITIES, AND INLAND PORTS, (4) MAKE CAPITAL IMPROVEMENTS ON RAIL LINES TO ALLOW IMPROVED FREIGHT SERVICE TO THE PORTS AND MILITARY INSTALLATIONS, (5) EXPAND INTERCITY PASSENGER RAIL SERVICE; TO EXTEND LEVELS OF LOCAL TRANSIT FUNDING AUTHORIZATION TO THREE URBAN REGIONS; AND TO ALLOW OTHER LOCAL GOVERNMENTS OPTIONS FOR LOCAL TRANSIT FUNDING.

OVERVIEW: This act, which was a recommendation of the 21st Century Transportation Committee, does several things designed to provide funding options to improve public transportation and to relieve transportation-related congestion, including:

- Establish a fund to provide grants for public transportation, railroads for Intermodal and multimodal facilities and inland ports, State ports for terminal railroads and improved access to military facilities, and expansion of intercity passenger rail service.
- Authorize certain transportation authorities to levy, with voter approval, a ½% local sales tax to be used only for transportation systems.
- Authorize other counties that operate a public transportation system or have a municipality in the county that operates a public transportation system to levy, with

[100] See G.S. 159-107.

voter approval, a ¼% local sales tax to be used only for public transportation systems.

- Authorize an increase in local vehicle registration taxes.

FISCAL IMPACT: The additional ½% sales tax would generate an estimated $72.7 million for the Triangle Transit Authority, which includes Wake, Durham, and Orange Counties, and $46.6 million for the Piedmont Authority for Regional Transportation (PART), which includes Forsyth and Guilford Counties. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 11, 2009.

ANALYSIS:

State Grant Program for Intermodal Transit – Section 1 of this act creates the Congestion Relief and Intermodal Transportation 21st Century Fund (Fund) and authorizes the Secretary of Transportation, after consultation with the Board of Transportation, to make grants from the Fund to the entities listed below. The amount of grant funding will depend on the appropriations authorized for the Fund. The 2009 Appropriations Act did not include any appropriations for this Fund. In all cases except for the expansion of intercity rail service, the applicant must provide matching funds in an amount at least equal to the grant amount. The eligible recipient entities are:

- Local governments and transportation authorities for public transportation. The grant requires (i) approval of the application by the Metropolitan Planning Organizations covering the applicant; and (ii) a transit plan covering various planning policies and housing needs. A grant may not exceed 25% of the project cost.

- Short line railroads to assist in economic development and access to ports and military installations. A grant may not exceed 50% of the project cost. The total amount of annual grants for this purpose is limited to $5 million.

- Railroads to assist in rail improvements, intermodal or multimodal facilities or restorations to (i) serve ports, military installations, inland ports or (ii) improve rail infrastructure to reduce or mitigate truck traffic on the highway system. A grant may not exceed 50% of the project cost. The total amount of annual grants is limited to $10 million.

- State ports for terminal railroads and improved access to military facilities and Intermodal or multimodal facilities. A grant can not exceed 50% of project cost. The total amount of annual grants is limited to $10 million.

- Expansion of intercity passenger rail service.

Sales Tax Authorization. – Section 2 of this act authorizes transportation authorities and counties that operate a public transportation system or have a municipality in that county that operates a public transportation system to levy additional sales and use tax for public transportation purposes. The rate of tax varies as described below. This part also allows special districts that levy a sales tax to receive an annual refund of sales and use tax paid by the district.

- Mecklenburg – In 1997, Mecklenburg County was authorized to levy an additional ½% sales and use tax for the purpose of funding public transportation needs. Under this act, there is no change from current law, except that funds can be used for bicycle and pedestrian infrastructure that supports public transportation.
- Triangle and Triad – A ½% sales tax may be levied in one or more of Durham, Orange and Wake Counties, which operate the Triangle Transit Authority (TTA), or in one or more of Forsyth and Guilford Counties, which operate the Triad's Piedmont Authority for Regional Transportation (PART), to be used only for public transportation.

To authorize the tax, the board of the TTA or PART, and the county board(s) of commissioners of the counties where the tax is to be levied must jointly agree to establish a special tax district and conduct a referendum. The date of the referendum is to be agreed on jointly by the transit authority board, the county board(s) of elections, and the county board(s) of commissioners.

If the tax is approved in all of the counties voting, the tax will apply in all of those counties. If the tax is approved in less than all of the counties voting, the tax may be levied in any county that approves it. If a particular county votes no, the tax cannot be levied in that county. After a successful referendum, the transit authority board may levy the tax.

Prior to levy of the tax, (which could be before or after the referendum) a financial plan must be approved by (i) the transit authority board (ii) the board of commissioners of each county where the tax is to be levied, and (iii) all Metropolitan Planning Organizations whose jurisdiction includes any of the area of the special district.

The financial plan must provide for equitable use of the net proceeds within or to benefit the special district and consider (i) the identified needs of local public transportation systems in the district, (ii) human service transportation systems within the district, and (iii) expansion of public transportation systems to underserved areas of the district. The plan may be revised from time to time. An interlocal agreement between the transportation authority and all of the counties in the special district may require periodic review and approval of the financial plan.

The transit authority board will be the management agency for any multi-county district. The county board of commissioners is the management agency for any single county district, but may contract with the transit authority as needed for operation of the system.

If the district is approved in a referendum and does not consist of all three counties in the Triangle or both Triad counties, it may be expanded to include an additional county or counties by joint action of the transit authority and the board of commissioners of the county or counties to be added, with a favorable referendum in the county or counties to be added.

Repeal of the tax requires the approval of the transit authority and the county boards of commissioners of the counties involved and a referendum. A referendum on repeal can also be forced by a petition of 15% of the registered voters of the district.

- Remaining 94 counties – Section 2 authorizes the remaining 94 counties to levy a sales tax of ¼% with a referendum called by the county board of commissioners, but only if the county or a municipality within that county operates or contracts for the operation of a public transportation system and only if the county has levied the ¼-cent county sales tax authorized under Article 46 of Chapter 105 of the General Statutes. Funds may be used only for public transportation and are allocated between the county and the city under the same formula as for the increased vehicle registration fee set out in Section 4 of the act.

Local Vehicle Registration Charge Increase. – Since 1991, Triangle Transit has been authorized to levy a $5.00 vehicle registration tax, collected by DMV. This authorization was later extended to the Triad. The three Triangle counties are currently at the maximum. In the Triad, only Randolph County is levying the tax. Since legislative authorization in 1991, inflation brings the value of that $5.00 to $7.85. Section 3 of this act authorizes the tax to be increased to a maximum of $7.00, effective immediately and to $8.00, effective July 1, 2010. In the Triangle, a fee increase must be approved by the Triangle Transit Board, the boards of commissioners of all three counties, and by a special tax board consisting of two commissioners from each of the three counties, as provided by current law. In the Triad, the current fee authorization is on a county-by-county basis with the approval of the PART board and the board of commissioners of the county.

Additional Vehicle Registration Charge. – Section 4 of this act allows all counties in which there is a county or municipal transit system to levy a vehicle registration tax of up to $7.00. The tax will be collected by DMV, as is the current Triangle Transit registration fee. Within the levying county, the tax will be shared by the county and municipalities, with the county receiving funds based on the population in the unincorporated areas and the municipalities based on the population within the corporate limits. If the county does not operate a transit system, it does not get a share of the funds; likewise any municipality not operating a transit system does not get a share of the funds. Those funds will be reallocated to those entities within the county that do operate a transit system. The county or city does not have to operate the system directly. It may contract for operation with another county or city, regional transit agency, or private entity. Funding allocation for human services transportation operating countywide can be determined by interlocal agreement.

Vehicle Registration Tax Conformed to New Registration System Deadlines. – Section 5 of this act conforms the deadlines for changes to the regional authority registration taxes with the Division of Motor Vehicles combined registration/inspection renewal system by increasing the amount of notice the DMV receives before a change goes into effect.

Supplemental Property Tax. – Section 6 of the act authorizes a supplemental property tax in the Research Triangle Park special tax district. Under 1985 legislation, that district may levy a tax up to 10 cents on each $100 value of property for general municipal purposes. The act authorizes an additional 10 cents on each $100 value of property for public transportation with the RTP or to provide for public transportation from RTP to other public transportation systems or to other places outside RTP such as RDU airport. This language was agreed to by a special ballot of property owners in RTP prior to committee consideration of the legislation. Each one cent raises approximately $430,000 per year. The actual tax levy must be agreed upon each year by the special tax district advisory board and the Wake and Durham County Boards of Commissioners.

Expand Film Credit.

Session Law	Bill #	Sponsor
S.L. 2009-529	**SB 943**	**Senator Garrou**

AN ACT TO PROVIDE FOR AN ALTERNATIVE CREDIT FOR QUALIFYING EXPENSES OF A PRODUCTION COMPANY.

OVERVIEW: This act increases the income tax credit for a production company from 15% to 25% of the company's qualifying expenditures. However, in exchange for the higher credit amount, a taxpayer must subtract from the credit amount the difference between the amount of tax paid on purchases subject to the privilege tax on mill machinery under G.S. 105-187.51 and the amount of tax the company would have paid on those purchases if they had been subject to the combined general rate of sales tax under G.S. 105-164.4. A taxpayer may continue to claim the lower 15% credit amount without making this deduction.

FISCAL IMPACT: The act is expected to have minimal fiscal impact in fiscal year 2010-2011. The General Fund revenue loss in fiscal year 2011-2012 and future years is expected to be $40 to $60 million. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 2010, and applies to qualifying expenses incurred on or after that date.

ANALYSIS: In 2005, the General Assembly replaced the film industry development grant program with a refundable income tax credit equal to 15% of the qualifying expenses spent by a production company in connection with a production.[101] This act provides a production company with the choice of two different credit amounts. A taxpayer chooses which credit amount to claim when the taxpayer files the return claiming the credit. A taxpayer's election as to which credit amount to claim is binding. The two credit amounts are as follows:

- The current amount, which is equal to 15% of qualifying expenses. Qualifying expenses are the total amount spent in North Carolina on the following:
  - Goods and services leased or 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. An amount paid in excess of $1 million to an individual for compensation may not be included as a qualifying expense.
  - Cost of production-related insurance coverage obtained on the production. Expenses for insurance and coverage purchased from a related member may not be included as a qualifying expense.

[101] The incentive is targeted at feature films, episodic television series, and commercial advertising. The credit does not apply to the following: political advertising, television production of a news program or live sporting event, material that is obscene, or a radio production.

- An alternative amount, which is equal to 25% of qualifying expenses, less the difference between the amount of tax paid on purchases subject to the privilege tax on mill machinery under G.S. 105-187.51 and the amount of tax the company would have paid on those purchases if they had been subject to the combined general rate of sales tax under G.S. 105-164.4.[102]

The term 'mill machinery' is not defined. The Department of Revenue has long interpreted the term to include cameras, film, and props and building materials used in the construction of sets that are used in the actual filming of a movie for sale, lease, or rental.[103] Prior to 2006, the sales tax on mill machinery was 1% of the sales price of the machinery, up to a maximum tax of $80 per article. Effective January 1, 2006, this reduced sales tax rate on mill machinery was repealed and replaced by a privilege tax having the same rate.[104] The General Assembly changed the taxation of mill machinery in response to the requirement of the Streamlined Sales Tax Agreement that states simplify their sales tax laws by having a uniform sales tax rate with no caps or thresholds.

North Carolina's refundable film credit is capped at $7.5 million. In order to obtain the credit, the taxpayer's qualifying expenses must exceed $250,000. The credit may be claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit; therefore, it does not distribute the credit among its owners.

The North Carolina Film Office commissioned two studies funded in partnership with EUE Screen Gems Studios, IATSE Local 491, Premiere Entertainment Services, Charlotte Regional Film Commission, Piedmont Triad Film Commission, Wilmington Regional Film Commission, Cinelease, and Illumination Dynamics:

- "*Economic and Fiscal Impacts of the North Carolina Film Credit Program",* June 2009, prepared by Ernest & Young. This study presents estimates of the economic and tax impact of three components: film production activities; tourism related to NC films; and capital expenditures in NC film facilities.
- "*Economic Impact Study of the Production of a 'Mid-Major' Motion Picture on the Economy of Southeastern North Carolina",* Summer 2009, prepared by Dr. William Hall of the Cameron School of Business at the University of North Carolina at Wilmington. This study is a case study that identifies the spending impacts of a film on Brunswick, New Hanover, and Pender Counties.

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102 The 1st edition of the bill, as passed by the Senate, increased the credit from 15% to 25% and became effective for taxable years beginning on or after January 1, 2009. The House Finance Committee changed the effective date to 2010 and limited the tax credit increase. The bill was rewritten to make the increased credit amount as an alternate credit because the limitation on the credit would have made the bill roll call in the Senate when it went back to the Senate for concurrence. Since the Senate received the bill from the House on August 8, 2009, the same day it adjourned, the bill could not have been enacted if it had been a roll call bill.

103 North Carolina Department of Revenue Technical Bulletin, 20-4.

104 The 2001 General Assembly enacted Article 5F of Chapter 105 of the General Statutes, the article that imposes a 1%, $80 privilege tax on certain machinery and equipment. The 2001 legislation became effective January 1, 2006.

Both studies recognize the number of jobs generated by film production in the State, the direct and indirect spending stimulus on the region's economy, the capital investments made by production companies, the resulting film generated tourism, and the contribution of these activities to the State and local government's tax collections.

The Ernest & Young study estimated the State's return on investment (ROI) from the refundable income tax credit. In forming the ROI estimate, the study analyzed the impact of the credit at the rate of 15% in 2007 and, using projections from the NC Film Office, estimated the impact of the credit at the rate of 25% for 2010 and 2011. The study found that film productions qualifying for the credit in 2007 accrued an estimated net present value of $22 million of refundable tax credit cost to the State and $29 million of State and local tax revenue. In considering State tax ROI, the study estimated the State's ROI was $0.98 for each dollar of tax credit expenditure. This estimate assumes that the film productions qualifying for the credit would not have been produced in the State in absence of the credit. The study estimated that the total State and local tax impacts from film productions, tourism, and capital expenditures related to film production would be $48 million in 2010 and $57 million in 2011 under a 25% tax credit. Under this scenario, the State tax ROI from each dollar of tax credit expenditure would be $0.69 in 2010 and $0.67 in 2011.

Incentives for Energy Conservation.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-548	**HB 512**	**Rep. Holliman, Harrison, Luebke**

AN ACT TO EXTEND THE CREDIT FOR INVESTING IN RENEWABLE ENERGY PROPERTY TO GEOTHERMAL HEAT PUMPS AND EQUIPMENT, TO ALLOW THE CREDIT TO BE TAKEN AGAINST THE GROSS PREMIUMS TAX, AND TO EXTEND THE SUNSET FOR THE CREDIT.

OVERVIEW: This act expands the renewable energy tax credit to geothermal heat pumps and equipment, allows the credit to be taken against the gross premiums tax, and extends the sunset of the credit.

FISCAL IMPACT: The act will reduce General Fund revenues by $0.4 million in fiscal years 2009-2010 and 2010-2011. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective for taxable years beginning on or after January 1, 2009.

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

- Biomass equipment that uses renewable biomass resources[105] for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; or commercial thermal or electrical generation from renewable energy crops or wood waste materials.
- Hydroelectric generators.
- Solar energy equipment.
- Wind equipment.

The act adds geothermal heat pumps and equipment to the definition of renewable energy property. Geothermal heat pumps use the ground or groundwater as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure. Geothermal equipment uses the internal heat of the earth as a substitute for traditional energy for heating water or active space heating or cooling. The credit is capped at $8,400 per installation of a geothermal heat pump or geothermal equipment for residential property.

Under the current law, the amount of the credit for investing in renewable energy property is 35% of the cost of the property placed in service subject to a cap as set out in the table below. In the case of renewable energy property that services a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service.

The credit may not exceed the following amounts:

TYPE OF PROPERTY	MAXIMUM CREDIT
Non-residential property.	The act increases the credit from $250,000 per installation to $2,500,000 per installation.
Residential property – Solar energy equipment for domestic water heating. The act clarifies that the credit also applies to solar energy equipment for pool heating.	$1,400 per dwelling unit.
Residential property – Solar energy equipment for active space heating, combined active space and domestic hot water systems, and passive space heating.	$3,500 per dwelling unit.
Residential property – Geothermal heat pumps and equipment.	$8,400 per installation.
Residential property – All other renewable energy property for residential purposes.	$10,500 per installation.

[105] Renewable biomass resources are organic matters produced by terrestrial and aquatic plants and animals, such as standing vegetation, forestry and agricultural residues, landfill wastes, animal wastes, and spent pulping liquor.

Under current law, the credit may be taken against the franchise tax or the income taxe. The taxpayer must elect the tax against which the credit will be claimed when the credit is taken. The election is binding, and any carryforwards of the credit must be taken against the same tax. This act allows a taxpayer to elect to take the credit against the gross premiums tax as well.

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

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

The act also extends the sunset on the renewable energy tax credit from January 1, 2011 to January 1, 2016, and maintains the existing sunsets on the other credits in Article 3B (Business and Energy Tax Credits) of Chapter 105 of the General Statutes.

Affiliate Liability for OTP Excise Tax.

Session Law	*Bill #*	*Sponsor*
S.L. 2009-559	**SB 777**	**Senator Garrou**

AN ACT TO ALLOW AFFILIATES OF A TOBACCO PRODUCTS MANUFACTURER TO BE TREATED THE SAME AS THE MANUFACTURER FOR PURPOSES OF PAYMENT OF THE EXCISE TAX ON OTHER TOBACCO PRODUCTS, TO PROHIBIT INTEGRATED WHOLESALE DEALERS FROM SELLING, BORROWING, LOANING, OR EXCHANGING NON-TAX-PAID TOBACCO PRODUCTS OTHER THAN CIGARETTES TO, FROM, OR WITH OTHER INTEGRATED WHOLESALE DEALERS, AND TO REQUIRE PERSONS TRANSPORTING OTHER TOBACCO PRODUCTS TO FILE A SHIPPING REPORT WITH THE SECRETARY OF REVENUE.

OVERVIEW: This act amends the definition of an 'integrated wholesale dealer' for purposes of the excise tax on other tobacco products (OTP) so that an affiliate of a manufacturer of OTP may be treated the same as the manufacturer for purposes of allowing relief from paying the excise tax. The tax will be payable by the wholesale or retail dealer to whom the integrated wholesale dealer sold the product. The act also makes changes to better enable the Department of Revenue to track OTP sales, as requested by the Department.

FISCAL IMPACT: No impact. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2009 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective September 1, 2009.

Analysis: The excise tax rate on OTP is 10% of the cost price of the product. The tax is payable by the wholesale dealer or retail dealer who first acquires or otherwise handles OTP. By definition, all manufacturers are wholesale dealers. A manufacturer who is not a retail dealer and who ships OTP to either a wholesale dealer or a retail dealer may apply to the Secretary of Revenue to be relieved of paying the tax.[106] Once granted permission, a manufacturer may choose not to pay the tax, which would result in the tax being paid by the wholesale or retail dealer to whom the manufacturer sells the product.

In 2007, the General Assembly provided that an integrated wholesale dealer may be treated like a manufacturer for purposes of allowing relief from paying the excise tax on OTP. The statute defines the term 'integrated wholesale dealer' as a wholesale dealer who is an affiliate of a manufacturer of other tobacco products and is the only person to whom the manufacturer sells its products.[107] This act eliminates the requirement in the definition of 'integrated wholesale dealer' that the manufacturer sells its entire product to its affiliate. This change allows an affiliate of a manufacturer of OTP to be treated the same as the manufacturer with respect to payment of the OTP excise tax, even if the manufacturer sells its products to someone other than the affiliate.[108]

The act also modifies the definition of manufacturer to include a contract manufacturer. Currently, contract manufacturers are not explicitly included in the OTP definition of 'manufacturer', but they are specifically included in the definition of a cigarette distributor.[109]

The act makes several changes at the request of the Department of Revenue to better enable the Department to track OTP purchases:

- It specifies that a contract manufacturer must be the exclusive purchaser of the products under the contract.
- It prohibits integrated wholesale dealers from selling, borrowing, loaning, or exchanging non-tax-paid OTP to, from, or with other integrated wholesale dealers.

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106 G.S. 105-113.35(d) establishes the procedure by which a manufacturer can be relieved of payment of the OTP excise tax.

107 The change in 2007, for example, enabled Conwood Sales, an affiliate of Conwood Company, to be relieved of paying the tax on the OTP it received from Conwood Company since Conwood Company could be relieved of paying the tax.

108 This change would allow Reynolds Tobacco, an affiliate of Conwood Company, to be relieved of paying the tax on the OTP it received from Conwood Company, even though Conwood sells part of its products to someone other than Reynolds Tobacco.

109 G.S. 105-113.4(3).

- It requires a person who transports OTP upon the public highways, roads, or streets of this State to file a report, upon notice of the Secretary, in a form prescribed by and containing the information required by the Secretary. This requirement is similar to the one imposed under G.S. 105-113.18(3) for the transportation of cigarettes.

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