2010

FINANCE LAW CHANGES

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Modify Renewable Energy Property Credit.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-4	**SB 388**	**Senator Clodfelter**

AN ACT TO REMOVE CERTAIN GRANTS MADE UNDER THE AMERICAN RECOVERY AND REINVESTMENT TAX ACT FROM THE DEFINITION OF PUBLIC FUNDS FOR WHICH A CREDIT FOR INVESTING IN RENEWABLE ENERGY PROPERTY IS NOT AVAILABLE.

OVERVIEW: This act amends the credit for investing in renewable energy property to allow the credit when the cost of the property was provided by grants made under the American Recovery and Reinvestment Tax Act of 2009.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: The act is effective January 1, 2009, and applies to renewable energy property placed into service on or after that date.

ANALYSIS: North Carolina allows a tax credit for investing in renewable energy property. The credit is equal to 35% of the cost of the property and may be taken against the franchise tax, income tax, or gross premiums tax. The credit applies to the following machinery and equipment or real property:

- Biomass equipment that uses renewable biomass resources[1] for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane using 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.
- Geothermal heat pumps and geothermal equipment.

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 maximum amount of the credit is based upon the type of property serviced.

The renewable energy tax credit is not allowed to the extent the cost of the renewable energy property was provided by public funds. This act removes certain federal grants from the

[1] 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.

definition of "public funds" in the statute. This change allows property funded with these grants to qualify for the credit, placing renewable energy projects on the same footing that they would have been had the recession not greatly reduced potential investors' participation in the projects.

Section 1603 of the American Recovery and Reinvestment Tax Act of 2009 provides eligible taxpayers that develop renewable energy projects a grant equal to up to 30% of the basis of property used to produce electricity from wind energy, closed-loop biomass, open-loop biomass, geothermal, landfill gas, trash combustion, incremental hydropower, marine and hydrokinetic energy, fuel cell property, solar property, and small wind property. Grants of 10% are available for geothermal property that is not eligible for the 30% rate, qualified microturbines, combined heat and power property, and geothermal heat pumps. The property must be placed in service during 2009 or 2010, or after 2010 but before the credit termination date for such property if construction for the property began during 2009 or 2010.

The grant program was enacted, in part, to help the investment market for renewable energy projects. Developers of renewable energy projects often seek investors that are allocated a portion of the income, gains, losses, deductions and tax credits of the project. In the current economic environment, potential tax investors may not be paying federal income taxes and therefore may be reluctant to make these investments. The creation of a grant program removes this obstacle by permitting developers to obtain a federal subsidy by means of a government grant instead of a tax credit.[2]

Appropriations Act of 2010.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-31	**SB 897**	**Senator Dannelly**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 2009 AND FOR OTHER PURPOSES.

OVERVIEW: Part 31 of S.L. 2010-31 provides tax and administrative relief to small businesses, extends various economic development incentives, incorporates four tax proposals recommended by the Revenue Laws Study Committee, and clarifies the application of tax penalties in cases of forced consolidation.

The act provides the following tax relief to small businesses:

- It extends the five-year carryback for net operating losses sustained in 2009. (Section 31.1)

[2]AMERICAN RECOVERY and REINVESTMENT ACT of 2009: *Law, Explanation and Analysis,* 200 (CCH 2009).

- It provides a refundable income tax credit to small business taxpayers whose gross receipts for the taxable year are less than $1 million. The credit amount is equal to 25% of the amount of the unemployment insurance contributions the taxpayer paid during the calendar year on wages paid to an individual. (Section 31.1A)
- It decreases the number of retailers required to submit a pre-payment of 65% of the amount of sales tax revenue to be remitted for the following month by changing the threshold for this payment schedule from $10,000 to $15,000, effective October 1, 2010, and from $15,000 to $20,000, effective October 1, 2011. (Section 31.3)

The act provides administrative relief to small businesses by stipulating that the first annual report of a limited liability company (LLC) is due April 15 following its year of organization. (Section 31.4)

It contains the following provisions to encourage economic development:

- It reserves $9.8 million for commerce business recruitment initiatives.[3]
- It extends the sunset on the following expiring tax credits and refunds: (Section 31.5)
    - The tax credit for mill rehabilitation.
    - The tax credit for qualified business investments.
    - The sales tax refund for air passenger carriers.
    - The sales tax refund for motorsports aviation fuel.

It contains the following tax proposals recommended by the Revenue Laws Study Committee:

- It updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2009, to May 1, 2010. By doing so, North Carolina conforms to the changes made by five federal acts. The bill does not conform to the 5-year carryback for net operating losses (NOL) available to large businesses. (Section 31.1)
- It establishes new sales and use tax and local occupancy tax reporting and remittance obligations on a person who enters into a contract with a provider of transient accommodations to facilitate the rental of an accommodation and who collects payment for the rental. (Section 31.6)
- It extends the admissions tax to the Internet resale of tickets by a person engaged in the business of reselling and restores the Department of Revenue's pre-2009 interpretation of the admissions tax statute to exclude from tax charges for amenities that are bundled with a ticket purchase. (Section 31.7)

[3] See S.L. 2010-89, 2010-91, 2010-147, and 2010-167.

- It directs the Department of Revenue to give taxpayers ample notice when it issues an interpretation that revises a prior interpretation by expanding the scope of a tax or otherwise increasing the amount of tax due. (Section 31.7A)
- It improves the tax and debt collection process of the Department of Revenue by expanding the use of the Setoff Debt Collection Act, authorizing the use of electronic process for sending notice of garnishment, providing for a data match between the Department and financial institutions holding accounts of delinquent taxpayers, and expanding the Statewide Accounts Receivable Program. (Section 31.8)

It applies retroactively a tax law change enacted last session. S.L. 2009-422 excluded from a corporation's franchise tax base all billings in excess of costs, effective for taxable years beginning on or after January 1, 2010. This provision would apply the change retroactively to 2007. (Section 31.9)

Lastly, it provides that a taxpayer may not be assessed a penalty if the taxpayer pays the tax due within the stated period of time. (Section 31.10)

FISCAL IMPACT: See ANALYSIS. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

EFFECTIVE DATE: Except as otherwise noted, the act became effective when the Governor signed it into law on June 30, 2010.

ANALYSIS: Part XXXI of The Current Operations and Capital Improvements Appropriations Act of 2010 made the following tax law and related changes.

IRC Update. – Section 31.1 updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2009, to May 1, 2010.[4] *However, the act does not conform to the five-year carryback of net operating losses incurred by large businesses. This section of the act became effective when the Governor signed it into law on June 30, 2010. The estimated loss to the General Fund for fiscal year 2010-11 is $7.7 million.*

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[5] The General Assembly determines each year whether to update its reference to the Internal Revenue Code.[6] 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

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[4] Recommended by the Revenue Laws Study Committee, SB 1183; HB 1829. House Finance removed the IRC Update provisions from HB 1829 and replaced them with various renewable energy incentives (See S.L. 2010-167).

[5] 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.

[6] 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."

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.

This section conforms North Carolina income tax law to the Internal Revenue Code as of May 1, 2010.[7] This change allows North Carolina taxpayers to take advantage of two business tax benefits that are also available at the federal level and simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset. The two benefits are:

- ***Increased expensing limits*** – It extends for one year the increased expensing limit under Section 179 of the Internal Revenue Code.[8] Section 179 allows the expensing of the purchase price of some business assets[9] in the year of purchase rather than taking depreciation[10] throughout the life of the asset. In other words, expensing trades a smaller yearly deduction over time for a larger deduction in year one. The cost of conforming to this change is approximately $1.2 million in fiscal year 2010-2011.
- ***Five-year carryback period for NOLs*** – It extends the five-year carryback period for NOLs established under the *American Recovery and Reinvestment Act of 2009* (ARRA), but it does not expand the scope of the relief beyond small businesses, which Congress provided for in the *Worker, Homeownership, and Business Assistance Act of 2009* (WHBA).

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. Under the ARRA, eligible small businesses were allowed to carry back 2008 NOLs for three, four, or five years, instead of the normal two years. An eligible small business is a corporation or partnership with less than $15 million in gross receipts for the tax year in which the loss arose. As part of the WHBA, Congress not only extended this benefit for an additional year, but also expanded the scope of the benefit by removing the small business limitation. The current federal relief is applicable to any taxpayer with business losses, except those that received payments under the Troubled Asset Relief Program. The relief also applies to a loss from operations of a life insurance company.

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[7] The act incorporates tax changes made by five federal acts: the Worker, Homeownership, and Business Assistance Act (WHBA), P.L. 111-92; Acceleration of Income Tax Benefits for Haiti Relief, P.L. 111-126; the Patient Protection and Affordable Care Act, P.L. 111-148; the Health Care and Education Reconciliation Act, P.L. 111-152; and the Hiring Incentives to Restore Employment Act (HIRE), P.L. 111-147.

[8] The federal HIRE Act of 2010 extended the 2008 and 2009 expense limit of $250,000 with a phase-out at $800,000 for the 2010 tax year. Prior to the Emergency Economic Stabilization Act of 2008 (EESA), the deduction was limited to $128,000 of the cost of the property with a phase-out at $510,000. EESA temporarily increased the deduction limit and the phaseout through 2008. The American Recovery and Reinvestment Act of 2009 (ARRA) extended the temporary increase through 2009.

[9] The business asset must be newly purchased tangible personal property that is used more than 50% for business purposes and is eligible to be depreciated under the Code.

[10] Generally, taxpayers take the Section 179 expensing deduction first and claim Section 168(k) depreciation on any remaining basis.

This section conforms to the one-year extension for small businesses only. Since North Carolina does not allow NOL for corporate taxpayers, conformity to this provision applies only to individual filers. The cost of conforming to this change is approximately $6.5 million in fiscal year 2010-2011.

This section does not conform to the five-year carryback of NOL for other businesses. It requires these larger businesses to add back for purposes of determining their State taxable income any NOL deductions claimed on their federal returns for 2008 or 2009 losses. Then, for taxable years 2011 through 2013, the taxpayer may deduct from federal taxable income one-third of the NOL absorbed on the taxpayer's 2003, 2004, 2005, and 2006 federal returns.[11]

Conformity to the Internal Revenue Code also allows North Carolina taxpayers the following tax benefits:

- ***DOD Homeowner's Program.*** – Provides that payments made under the Department of Defense Homeowners Assistance Program to certain military and civilian employees in connection with base closures are excluded from taxable income.[12]
- ***Donation for Haiti Relief.*** –Provides a monetary donation to a qualified charitable organization for Haiti relief after January 11, 2010, and before March 1, 2010, may be claimed as a charitable deduction on the person's tax return for either 2009 or 2010.[13]

The *Patient Protection and Affordable Care Act*, as amended by the *Health Care and Education Reconciliation Act*, made the following changes to the tax law. This section conforms to these changes:

- ***Medical expense deduction.*** – Effective January 1, 2013, the threshold for unreimbursed medical expenses will increase from 7.5% to 10% of adjusted gross income. Individuals age 65 and older are temporarily exempt from the increase; it will apply to seniors effective January 1, 2017. Approximately 6% to 8% of North Carolina taxpayers claim the medical expense deduction on their income tax return.
- ***Flexible spending account limits.*** – Effective January 1, 2011, the definition of "qualified medical expenses" for purposes of Flexible Spending Accounts, Health Spending Accounts, and Health Reimbursement Accounts will be modified to conform to the definition of that term for purposes of the medical expense itemized deduction. This modification means that over-the-counter medicines will not be covered unless they are prescribed by a health care professional. Effective January 1, 2013, the amount a person may contribute to a Flexible Spending Account plan will be limited to $2,500, indexed annually after that year. There is no limit under current law, although some employers may limit the amount that may be set aside.

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[11] This provision, G.S. 105-134.6(d)(7) and (8), is similar to what the State did in the past when it decoupled from the federal accelerated depreciation provisions.

[12] Part of the WHBA.

[13] P.L. 111-126.

- ***Executive compensation***. – The *Patient Protection and Affordable Care Act* restricts high-level executive pay for insurance providers if the providers do not meet minimum acceptable coverage requirements. Effective January 1, 2011, if at least 25% of premium income does not meet these requirements, the insurer may not claim a deduction for the executive pay to the extent the remuneration exceeds $500,000.

Small Business Tax Relief.[14] – *Section 31.1A provides a refundable income tax credit to a small business equal to 25% of the amount it paid in unemployment insurance tax on wages paid to employees. This section of the act applies only to the 2010 and 2011 taxable years. The estimated loss to the General Fund for fiscal year 2010-11 is $34.1 million.*

Unemployment insurance (UI) tax is a tax on employer payrolls paid by employers and used to provide funds from which unemployment benefits are paid to qualified unemployed workers. The UI tax is not deducted from employee wages. The State UI tax rate[15] is determined annually based on the employer's experience rating.[16] The State UI tax revenues are credited to the State Unemployment Insurance Fund. The average State UI tax rate for all employers through the first half of 2010 was 1.7%.

This section allows a small business a refundable income tax credit equal to 25% of the UI tax paid during the taxable year with respect to wages paid for employment in this State. A small business is a business whose cumulative gross receipts from business activity for the taxable year do not exceed $1 million. Based upon statistics compiled by the Employment Security Commission, there are approximately 125,000 businesses in North Carolina[17] whose gross receipts are less than $1 million. These businesses employ more than 500,000 people. Most of these businesses have 10 or fewer employees. The average annual State UI tax per employee in North Carolina is $265.

The credit provided by this section lowers the cost of maintaining and adding jobs in North Carolina for the next two years. The credit amount is directly related to the amount the taxpayer spends on employment in this State. It does not distinguish between part-time and full-time jobs. Because the credit is based upon the amount of UI tax paid by the business, there is no need for reporting or clawback provisions.

Lower Sales Tax Compliance Burden on Small Retailers. – *Section 31.3 decreases the number of retailers required to submit a pre-payment of 65% of the amount of sales tax revenue to be remitted for the following month by changing the threshold for this payment schedule from $10,000 to $15,000, effective October 1, 2010, and from $15,000 to $20,000, effective October 1, 2011.*[18] *This change in the law does not change the amount of sales tax revenue remitted to the General Fund, but it does change by one month the timing of the payment for the year of the transition to the higher threshold. It reduces the amount of revenue received in fiscal year 2010-11 by $7 million and the amount received in fiscal year 2011-12 by $12 million.*

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[14] This provision replaces the other provisions proposed by the Senate and House for small business tax relief. The Senate proposed a top rate of 6.9% on small business income (Section 31.2 of SB 897, 3rd Edition) and the House proposed a small business job credit and an extension of the small business health insurance tax credit. (Sections 31.13 and 31.14 of SB 897, 6th Edition).

[15] Based on economic conditions, the rate may be as low as 0.0% or as high as 6.84%.

[16] The experience rating is affected by payroll, tax paid, timeliness of payments, and UI benefits charged against the employer's account.

[17] There are approximately 176,000 firms in North Carolina based on U.S. Census County Business Patterns.

[18] The provision first appeared in the Senate Budget, SB 897, 2nd Edition; it was also in HB 1829, 2nd Edition.

Retailers must remit sales tax payments to the State on one of three filing schedules:

- A retailer who is consistently liable for less than $100 a month in sales and use taxes must file a return and pay the taxes due on a quarterly basis.
- A retailer who is consistently liable for at least $100 but less than $10,000 a month must file a return and pay the taxes due on a monthly basis.
- A retailer who is consistently liable for at least $10,000 a month must make a monthly prepayment of the next month's tax liability. Prior to 2006, retailers in this category had to pay tax twice a month. At the request of several large retailers in the Streamlined Sales Tax Project, North Carolina adopted the once a month payment schedule.[19]

The threshold limit of $10,000 was enacted in 2001 as a means to accelerate the payment of sales and use tax dollars into the General Fund for fiscal year 2001-02.[20] Prior to this change, the threshold amount for making bimonthly payments was $20,000. Since 2001, the State and local tax rate has increased from 6.5% to 7.75%.[21] The lowering of the threshold amount as well as the increase in the tax rate has subjected more retailers to the most extensive sales tax remittance requirements. Some of the small retailers in this category, especially those whose sales are not consistent from month to month, have expressed a cash flow hardship with the pre-payment requirement.

This section restores the sales tax filing thresholds to their pre-2001 level of $20,000 over a two-year period. By increasing the threshold from $10,000 to $15,000, the act relieves 2,133 retailers from the pre-payment requirement. These retailers will continue to file a monthly return and pay the sales tax due on a monthly basis. The increase of the threshold from $15,000 to $20,000 will relieve an additional 1,000 plus retailers from the pre-payment requirement.

Relieve Annual Report Compliance Burden on Small Business. – Section 31.4 stipulates that the first annual report of a LLC is due April 15 following its year of organization. The section became effective when the Governor signed it into law on June 30, 2010. The estimated loss to the General Fund for fiscal year 2010-11 is $400,000.

In March 2009, the Secretary of State's Office mailed 270,000 notices to businesses stating they were late in filing their annual reports. Failure to file an annual report is grounds for administrative dissolution for both business corporations and LLCs. The Secretary of State found that many businesses thought their first annual reports were due the year after their formation.[22] The Secretary of State informed the businesses that the first annual report is due on April 15th, regardless of when the business is formed. Under this interpretation, a LLC that filed its articles of organization on April 10th and paid the $125 filing fee would also have to file an annual report five days later along with a $200 annual report filing fee. The Revenue Laws Study Committee considered the issue at the request of many CPAs.

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[19] Section 9 of S.L. 2006-33.

[20] The acceleration of sales tax payments in 2001 created a nonrecurring revenue gain of more than $40 million in FY01-02.

[21] In some counties, the combined State and local sales tax rate is 8%.

[22] Prior to the enactment of S.L. 2007-475, annual reports were filed on the anniversary of the business' incorporation. In an attempt to make the filing of the report easier, S.L. 2007-475 provided that a business would file its report with its income tax return to the Department of Revenue.

This section does three things to address the areas of concern:[23]

- It conforms the due date for filing annual reports to the due date for filing corporate income tax returns. In 1997, at the recommendation of the General Statutes Commission, the General Assembly set the due date for corporate annual reports at the due date for filing tax returns.[24] The change was designed to make the filing of annual reports easier by establishing a more familiar deadline and allowing the corporation to file the report with its tax return to the Department of Revenue. In 2007, the General Assembly changed the date a corporate tax return is due to be filed from the 15th day of the third month following the close of the corporation's fiscal year to the 15th day of the fourth month.[25] However, a conforming change was not made to the annual report filing statute. The lack of uniformity has caused confusion. Subsection (a) makes the necessary conforming change.

- It provides that the first annual report required to be filed by a LLC is due by April 15th of the year *following* the calendar year in which the company files its articles of organization. The section makes this change retroactively by stipulating in the effective date subsection that a LLC whose articles of organization were filed on or after January 1, 2010, but before April 15, 2010, is not required to file an annual report until April 15, 2011. Likewise, it provides that a LLC that was formed before January 1, 2001, and has filed an annual report for each year after the calendar year in which its articles of organization were filed, is considered to have met its annual report filing requirements.

- It provides that the annual report must specify the year to which the report applies. The practice of the Secretary of State's Office is to credit an annual report that it receives to the oldest year in which an annual report is due and owing.

Extend Sunset on Expiring Tax Incentive Income Tax Credits and Sales Tax Refunds. – *Section 31.5 extends the sunset on four incentive provisions.*

This section extends the sunset on the following four incentive provisions:

- ***Tax Credit for Mill Rehabilitation.*** – Extends the sunset of the credit for rehabilitating vacant historic manufacturing sites from January 1, 2011, to January 1, 2014.[26] The credit was established in 2006 and was last extended in 2008.[27] To be eligible for the credit, a taxpayer must spend at least $3 million to rehabilitate a historic, vacant, former manufacturing facility. The amount of the credit depends upon the development tier in which the site is located and the eligibility of the site for a federal credit.

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[23] The Revenue Laws Study Committee recommended this provision as part of SB 1177 and HB 1810. The Senate included it in its version of the budget, SB 897, 3rd Edition, and the House included it in HB 1829, 2nd Edition.

[24] Section 6.1 of S.L. 1997-475.

[25] Section 14 of S.L. 2007-491.

[26] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. HB 1829, 2nd Edition, would have extended the sunset to 2014.

[27] Section 28.4 of S.L. 2008-107 clarified the applicability of the credit by specifying that the credit would be allowed so long as an application for an eligibility certification is submitted before the sunset date.

- ***Tax Credit for Qualified Business Ventures.*** – Extends the sunset of the credit for investments in qualified business ventures from January 1, 2011, to January 1, 2013.[28] The credit was last extended in 2007. The purpose of the credit is to stimulate early stage investments that help move new technologies from universities and other research laboratories to commercialization. The qualified business investment tax credit is allowed for an individual taxpayer who invests in a qualifying small business. Qualifying small businesses include a business that engages primarily in manufacturing, processing, warehousing, wholesaling, research and development, or a service-related industry, a business that has received within the preceding three years funding from a federal agency under the Small Business Innovation Research Programs, or a business that has been certified by a research university as currently performing under a licensing agreement with the institution for commercializing technology developed at the institution. The credit is equal to 25% of the amount invested and may not exceed $50,000 per individual in a single taxable year. The total amount of tax credits allowed to taxpayers for investments made in a calendar year may not exceed $7.5 million. If the total amount of tax credits claimed exceeds this maximum amount, the credit is allocated proportionately among the taxpayers.

- ***Sales Tax Refund for Passenger Air Carriers.*** – Extends the sunset of the sales tax refund allowed to an interstate passenger air carrier from January 1, 2011, to January 1, 2013.[29] The sunset was last extended in 2008. In 2005, the General Assembly allowed an annual tax refund to an interstate passenger air carrier for the net amount of sales and use tax paid by it on fuel during a calendar year in excess of $2,500,000. The "net amount of sales and use taxes paid" is the amount of sales tax paid by the interstate passenger air carrier less the refund of that tax allowed to all interstate carriers under subsection (a) of G.S. 105-164.14. The refund for which the sunset provision is being extended is in addition to the refund allowed under G.S. 105-164.14(a).

- ***Sales Tax Refund for Motorsports Aviation Fuel.*** – Extends the sunset of the sales tax refund allowed to a professional motorsports racing team or a motorsports sanctioning body from January 1, 2011, to January 1, 2013.[30] The sunset was last extended in 2008. The General Assembly enacted the annual refund provision in 2005. The amount of the refund is equal to the amount of sales and use tax paid on aviation fuel used to travel to or from a motorsports event in this State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State. For the purposes of the refund, a 'motorsports event' includes a motorsports race, a motorsports sponsor event, and motorsports testing.

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[28] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. The House budget, S897, 6th Edition, would have extended the sunset to 2013 and expanded the annual cap from $7.5 million to $8 million. The Governor's budget also recommended expanding the cap to $8 million. The act does not expand the cap.

[29] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. HB 1973, 2nd Edition, would have extended the sunset to 2014.

[30] The Senate budget, SB 897, 3rd Edition, would have extended the sunset to 2012. HB 1973, 2nd Edition, would have extended the sunset to 2014.

<u>Modernize Sales Tax on Accommodations.</u>[31] – Section 31.6 establishes new sales and use tax and local occupancy tax reporting and remittance obligations on a "facilitator," which is a person who enters into a contract with a provider of transient accommodations to market and collect payment for the rental of accommodations. A facilitator would include an online travel company but not a rental agent. This section becomes effective January 1, 2011, and applies to gross receipts derived from the rental of an accommodation that a consumer occupies or has the right to occupy on or after that date.[32] The estimated fiscal impact of this section is a General Fund gain of $1.7 million in fiscal year 2010-11 and $4.9 million in fiscal year 2011-12.

Gross receipts derived from the rental of transient accommodations are subject to State and local sales tax at the general rate, which is currently 7.75% in most counties. Over 70 counties and over 85 cities also levy an occupancy tax on accommodations, with rates ranging from 1% to 6%. Neither the sales tax nor the occupancy tax applies to a private residence or cottage rented for less than 15 days in a calendar year or to any lodging supplied to the same person for 90 or more continuous days.

Deemed "retailers" under the Sales Tax Article, operators of hotels, motels, tourist homes, tourist camps, and similar type businesses and persons who rent private residences and cottages to transients are required to collect and remit the tax due. This includes rental agents or real estate brokers who rent private residences or cottages to transients on behalf of the owners. However, under the plain language of the statute, online travel companies (OTCs) that list available rooms and collect payment for the rental of those rooms are not retailers required to collect State and local sales and use tax or local occupancy tax on accommodations because they are not "operators" of those accommodations. This interpretation was the holding in the Fourth Circuit case of *<u>Pitt County v. Hotels.com</u>*.[33]

Generally speaking, a person who wishes to make a reservation for an accommodation may contact the accommodation directly, use the services of a commissioned travel agent, or make reservations through an OTC, such as Expedia or Travelocity. OTCs contract with accommodation providers for the right to facilitate or market the reservation of the provider's rooms through the OTC's website. By virtue of their contract with the hotels, the OTCs have no ownership interest or legal right to the rooms, nor do they bear any risk of loss if rooms are not booked through their site. Under the contract, the OTC agrees to pay the provider a discounted room rate and then adds a "facilitation fee" or other similarly-named charge to the discounted room rate and also collects an amount that reflects anticipated taxes plus a nominal service or processing fee. Typically, the facilitation fee is not disclosed to the customer or to the provider, and the amount collected for taxes and fees is not itemized.

With regard to payment, a consumer who books with the provider directly or uses a travel agent typically provides the hotel or agent with a credit card number to guarantee the reservation and then pays the hotel directly at the time of check-out. A consumer who books through an OTC pays up front and prior to occupancy. This business model is known as the

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[31] This provision was a recommendation of the Revenue Laws Study Committee and was included in the Senate budget, SB 897, 3rd Edition.

[32] Based on this language, tax would be owed on the total amount charged by an OTC for a person who made a reservation prior to January 1, 2011, but did not occupy the accommodation until after January 1, 2011.

[33] The *<u>Pitt County</u>* case dealt only with the collection and remittance of local occupancy tax, but since the collection of local occupancy tax is tied to the collection of sales tax, the fact that OTCs are not required to collect State and local sales and use tax is consistent with, though not at issue, in that case.

"merchant model" or the "prepaid model." Under this model, once the customer occupies the room, the provider bills the OTC for the discounted room rate plus State and local sales tax and occupancy tax, if applicable, based on that rate. Since the provider does not know the final room rate paid by the consumer, it cannot collect sales and occupancy tax based on that amount.

There is little debate that OTCs are required to remit sales and occupancy taxes to a provider of accommodations based on the discounted room rate that they have negotiated. The central issue that has garnered national attention in this industry over the last several years is to what extent OTCs may be required to collect sales tax and occupancy tax based on the marked-up rate that they ultimately charge consumers, which includes their service fees. The Revenue Laws Study Committee studied this issue during the interim prior to the 2010 Regular Session and recommended legislation requiring OTCs to collect and remit sales and occupancy tax on the sales price charged to the consumer. Section 31.6 of this act is a modified version of that initial recommendation.

Section 31.6 does the following:

- ***Definitions.*** – It creates definitions for the terms "accommodation" and "facilitator." An accommodation is defined as a hotel room, a motel room, a residence, a cottage, or a similar lodging facility for occupancy by an individual. A facilitator is defined as a person who is not a rental agent and who contracts with a provider of an accommodation to market the accommodation and to accept payment from the consumer for the accommodation.

- ***Gross Receipts Include "Sales Price."*** – It provides that the gross receipts derived from the rental of accommodations include the *sales price* of the rental. "Sales price" is currently defined as the total amount or consideration for which tangible personal property, digital property, or services are sold, leased, or rented, and it includes the retailer's costs as well as charges for any services necessary to complete the sale. This section provides that the sales price of the rental of an accommodation is determined as if the rental were the rental of tangible personal property. In addition, since the definition of sales price includes charges for any services necessary to complete the sale, the sales price of an accommodation rented through an OTC would include the OTC's facilitation fees and any other fee it collects. The rationale for incorporating the term "sales price" is to capture the total cost paid by the consumer for an accommodation regardless of whether it is paid to a hotel directly or to a third party that charges facilitation or other service fees in addition to the room rate.

- ***Notice by Retailer.*** – It requires a retailer, who, in this case, is the provider of an accommodation, to notify a facilitator with whom it has a contract when an accommodation marketed by the facilitator is completed.

- ***OTC to Report and Remit Within Three Days.*** – Within three business days of being notified of a completed rental, a facilitator is required to report to the retailer the sales price charged to the consumer and to send the portion of the sales price owed to the retailer and the sales and local occupancy tax due. The retailer is required to remit the sales tax payments received from a facilitator to the Department of Revenue and to remit local occupancy tax payments to the

appropriate local tax collecting body, just as the retailer is required to do under current law with respect to the tax owed on the discounted room rate.

- ***Liability.*** – A facilitator that does not send the tax due on the sales price is liable for the amount of tax the facilitator fails to send, but is not liable for tax sent but not remitted by the retailer. A retailer is not liable for tax due but not received from a facilitator.
- ***Terms of Contract.*** – The requirements of this section are considered to be terms of the contract between a retailer and a facilitator.
- ***Sourcing.*** – It codifies the current practice with regard to sourcing transactions for the rental of transient accommodations by stating that they are sourced to the location of the accommodation.
- ***Local Occupancy Tax.*** – It makes conforming changes to the statute that sets out the uniform provisions for occupancy taxes. In doing so, it imposes the same responsibility and liability on a facilitator with regard to occupancy tax as the facilitator would have for State sales tax on accommodations. It also makes clear that the room occupancy tax applies to the same gross receipts and is calculated in the same manner as the State sales tax on accommodations.

Modernize Admissions Tax and Restore Amenities Exclusion.[34] *– Section 31.7 extends the admissions tax to the Internet resale of tickets by a person engaged in the business of reselling. This provision is effective January 1, 2011, and applies to admission tickets sold on or after that date. This section also restores the Department of Revenue's pre-2009 interpretation of the admissions tax statute to exclude from tax charges for amenities that are bundled with a ticket purchase. This provision is effective for charges for admission received on or after August 1, 2010. The estimated fiscal impact of this section is a recurring annual loss of $700,000.*

Modernize Admissions Tax. – North Carolina imposes a 3% privilege tax on the gross receipts of a person who offers or manages any of the following taxable amusements:

- A dance or athletic contest for which admission fee in excess of 50¢ is charged.
- Amusement or entertainment for which an admission is charged.
- A performance, show, or exhibition, such as a circus or dog show.

G.S. 14-344 limits the total amount a seller or reseller of an admission ticket may charge to "…the combined face value of the ticket, tax and the authorized service fee." The service fee may not exceed $3.00 unless the promoter of the event and the ticket sales agency agree in writing to a different amount and that amount is made known to the public in writing. A violation of this section is punishable as a Class 2 misdemeanor.

In 2008, as part of S.L. 2008-158 (Senate Bill 1407), the General Assembly enacted G.S. 14-344.1. This statute authorizes a person to resell an admission ticket on the Internet with no cap on price unless the resale is prohibited by the venue. A person who resells an admission ticket under this statute is required to provide a ticket guarantee that must be conspicuously displayed on the person's Website and to direct a prospective purchaser to the

[34] This provision was a recommendation of the Revenue Laws Study Committee and was included in the Senate budget, SB 897, 3rd Edition.

ticket guarantee before completion of the resale transaction. The guarantee must provide that a purchaser will be given a full refund if any of the following occurs:

- The event is cancelled.
- The purchaser is denied admission other than due to an act or omission by the purchaser.
- The ticket is not delivered as promised resulting in purchaser's inability to attend event.

Under current law, ticket resales are not subject to the admissions tax because the secondary seller is not "giving, offering, managing, or exhibiting" the amusement. The reseller does not fall within the scope of the statute. As a compromise agreement in 2008, the General Assembly required Internet ticket resellers to report their gross receipts for North Carolina events to the Department of Revenue on a monthly basis. Since August 2008, there have been 65 reports, reflecting 17 reporting entities.

Section 31.7 modernizes the tax on admissions as follows:

- It extends the 3% admissions tax to the gross receipts of a person who is engaged in the business of reselling tickets under G.S. 14-344.1. The gross receipts exclude the price printed on the face of the ticket. Thus, the tax is imposed on the difference between the price sold and the face value of the ticket. If the price is not printed on the ticket, the tax applies to the difference between the amount the reseller paid for the ticket and the amount the reseller charges for the ticket.[35] This provision modernizes the admissions tax by recognizing the current business model for the sale and resale of tickets, which did not exist at the time the admissions tax was originally enacted in the 1930s. It also equalizes the admissions tax by treating the markup in a resale transaction the same as the face value price in the first sale.
- It makes the collection and remittance of the admissions tax on ticket resales a condition of reselling tickets on the Internet. Under current law, there are only two conditions. First, a person may resell tickets on the Internet if the venue has not prohibited the resale by filing a notice with the Secretary of State. Second, the ticket reseller must also provide the purchaser with a guarantee assuring the legitimacy of the ticket and offering a refund in the event the purchaser is denied access to the event through no fault of the purchaser.
- It repeals the reporting requirement. The reporting requirement was added to S.L. 2008-158 when the tax provision was removed. That act originally included a sunset, which required the General Assembly to revisit the legislation. At the time, the rationale for the reporting requirement was to provide the General Assembly with data for when it reconsidered the legislation. Now, by taxing these transactions, there is no need for a reporting requirement.
- It provides for the repeal of G.S. 14-344.1 if a court finds that the privilege tax violates the Internet Tax Freedom Act (ITFA) or is otherwise found to be

[35] This same tax provision passed the Senate when S.L. 2008-158 was being considered during the 2008 Regular Session, but it was removed when the bill was considered in the House Finance Committee.

invalid. ITFA temporarily prohibits states from imposing multiple or discriminatory taxes on electronic commerce. A discriminatory tax is one that is not generally imposed and legally collectible on transactions involving similar property, goods, services or information accomplished through other means. Arguments have been raised as to whether this legislation might violate ITFA because it taxes only those ticket resales that occur on the Internet. However, face-to-face ticket resales for greater than face value are generally illegal in North Carolina. As such, a counter argument may be made that Internet ticket resales are, in fact, given preferential treatment to the extent they are authorized, with no cap, whereas face-to-face ticket resales are essentially prohibited. A similar transaction cannot be conducted by a means other than the Internet. However, since the issue has been raised, the section provides that if a court finds that the privilege tax violates ITFA, then the authority to resell tickets on the Internet is repealed.

- It prohibits cities or counties from imposing a privilege license tax on Internet ticket resellers.

This part of the section becomes effective January 1, 2011, and applies to admission tickets sold on or after that date.

Restore Amenities Exclusion. – Entertainment venues frequently offer their patrons certain amenities in conjunction with the sale of admission tickets to performances of live entertainment. Those amenities may include parking privileges, preferential or more luxurious seating, access to special concession stands, access to luxury viewing suites, and access to concierge staff. In some cases, the venue will separately state the "seat price" on the face of a ticket with charges over and above that price reflecting the cost of the amenities. In other cases, a purchaser may buy a package or contract for the lease of a suite where the price includes a seat for an event as well as amenities, but the charges are not separately stated.

The current admissions tax statute does not specifically address how these amenities are to be taxed. In 1994, a taxpayer requested a written opinion from the Department of Revenue as to whether the admissions tax applied to amenities, and the Department responded that amenities were excludable from the tax. This interpretation was in place for over 15 years, and during that time, the statute did not change in any substantive way. However, on January 30, 2009, the Department issued a directive, effective the following day, stating that amenities are subject to the admissions tax. Specifically, the directive reads:

> "Gross receipts are taxes computed on the admission price of the amusement. An admission price is the price paid to enter an event. Effective for tickets for admission sold on or after February 1, 2009, the gross receipts tax is due on the price paid by the customer for admission into an event regardless of whether that price just covers the seat price or also includes amenities."

The Revenue Laws Study Committee considered this issue during the 2009-2010 interim given that it is a matter of tax policy on which the statute is silent and because the Department reversed its longstanding interpretation of the statute despite the fact that the statute has remained the same. The Committee concluded that the decision of whether amenities should be subject to the admissions tax is one for the Legislature and should not be determined by an interpretive ruling.

Subsection (a) of this section restores the Department's pre-2009 interpretation of the admissions tax statute by excluding amenities from the tax. If the charges for the amenities are not separately stated on the face of the ticket, then the charge for admission would be equal to the charge for a ticket to the same event that does not include amenities and that is for a seat located directly in front of or closest to a seat that includes amenities. This provision became effective for charges for admission received on or after August 1, 2010.

<u>Give Taxpayers Notice of Revised Tax Interpretations.</u>[36] *– Section 31.7A requires the Department of Revenue to provide ample notice to taxpayers when it issues an interpretation that revises a prior interpretation by expanding the scope of a tax or otherwise increasing the amount of tax due. This provision became effective when the Governor signed the act into law on June 30, 2010.*

G.S. 105-264 provides that it is the duty of the Secretary of Revenue to interpret all laws administered by the Department. When the Secretary interprets a law by adopting a rule or publishing a bulletin or directive, the interpretation is a protection to the officers and taxpayers affected by the interpretation, and taxpayers are entitled to rely upon the interpretation. The Secretary is permitted to change an interpretation, and that change may apply on and after the effective date of the change, but there is no statutory requirement that the Department provide a certain amount of notice to taxpayers prior to applying a revised interpretation.

In the course of considering whether amenities associated with ticket sales should be subject to tax, the Revenue Laws Study Committee learned that the Department reversed its position on the taxability of amenities with one-day's notice to taxpayers. The Committee was persuaded that G.S. 105-264 should be amended to require some level of notice prior to the Department changing the interpretation of a tax law that expands the scope of a tax. Therefore, this provision requires the Department to provide notice to taxpayers if it revises a prior interpretation by expanding the scope of a tax or otherwise increasing the amount of tax due. Under this section, a revised interpretation would not become effective until the sooner of the following:

- For a tax that is payable on a monthly or quarterly basis, the first day of a month that is at least 90 days after the date the revised interpretation is issued.
- For a tax that is payable on an annual basis, the first day of a tax year that begins after the date the revised interpretation is issued.

<u>Improve Tax and Debt Collection Process.</u>[37] *Section 31.8 improves the tax and debt collection process of the Department of Revenue by:*

- *Expanding the use of the Setoff Debt Collection Act to allow the following: debts owed by a business to be set off against a tax refund due the business, a setoff against any type of tax refund, and a community college to submit for setoff debts owed the college.*

[36] This provision was a recommendation of the Revenue Laws Study Committee and was included in the Senate budget, SB 897, 3rd Edition.
[37] The Revenue Laws Study Committee recommended this provision in SB 1188 and HB 1881. The provision also appeared in HB 1829 2nd Edition.

- *Authorizing the use of electronic process for sending notice of garnishment.*
- *Providing for a data match between the Department of Revenue and financial institutions holding accounts of delinquent taxpayers.*
- *Expanding the Statewide Accounts Receivable Program to allow for collection of the following accounts receivable by setoff against payments the State owes to individuals and businesses: accounts receivable that are submitted to the Department of Revenue under the Setoff Debt Collection Act and overdue tax debts.*

These improvements to the tax and debt collection process were initially recommended to the Revenue Laws Study Committee by the Department of Revenue, developed in collaboration with the Office of State Controller and the North Carolina Bankers Association. [38] *Unless otherwise stated, section 31.8 became effective when the Governor signed the act into law on June 30, 2010.*

The improvements are expected to increase revenue by $3 million for each fiscal year beginning in fiscal year 2010-2011.

Expansion of Setoff Debt Collection Act. – The Setoff Debt Collection Act, enacted in 1997, authorizes the Department of Revenue to set off an individual's income tax refund against a debt the individual owes a State agency or local agency.[39] Under the Act, a claimant agency sends the Department notice of the debt and the Department immediately sets off the debt against the tax refund and notifies the taxpayer and the claimant agency.

Subsections (d) through (g) of this section expand the Setoff Debt Collection Act to allow community colleges to collect debts owed to them through setoff of tax refunds and to allow debts that a business owes a claimant agency to be set off against the entity's tax refund. Previously, the Act only allowed debts owed to claimant agencies by individuals to be set off against the individual's income tax refund. The act also expands the Setoff Debt Collection Act to apply to any type of tax refund, not just income tax refunds.

Notice of Garnishment by Electronic Process. – The Department of Revenue is authorized by statute to attach and garnish intangible property in payment of taxes owed to the Department. The kinds of property that are subject to attachment and garnishment are wages and salaries, rents, bank deposits, the proceeds of property subject to levy, and property in the Escheat Fund. When the property sought to be attached is the taxpayer's checking account, the garnishee is the bank. When the property is wages, the taxpayer's employer is the garnishee. No more than 10% of a taxpayer's wages or salary per month is subject to attachment and garnishment. Current law requires that the notice of garnishment must be delivered in person or by mail.

Subsection (i) of this section authorizes electronic notice, if the garnishee agrees to this method and the Department and garnishee have an agreement that establishes the protocol for electronic notice. The act also streamlines the process if the garnishee is a financial institution by reducing the time period for filing a response to the notice of garnishment from 30 days to 20 days and by releasing the notice of garnishment when the institution

[38] See a synopsis of this legislation at the following School of Government website: http://sogweb.sog.unc.edu/blogs/localgovt/?m=201007

[39] State agency includes a unit of the executive, legislative, or judicial branch of State government and a local agency to the extent it administers a program supervised by the Department of Health and Human Services. A local agency includes a county, municipality, water and sewer authority, regional joint agency created by interlocal agreement, public health authority, metropolitan sewerage district, or sanitary district.

complies with the notice. All other garnishees will continue to receive a notice of release. Streamlining is consistent with the current garnishment practice with banks wherein the Department faxes notice of garnishment to a bank and the bank then sends money in the account to the Department within 10 to 15 days.

A "financial institution" is defined as a banking corporation, trust company, savings and loan association, credit union, or other entity principally engaged in the business of lending money or receiving or soliciting money on deposit.[40]

Data Match between Financial Institutions and the Department of Revenue. – Subsection (h) of this section becomes effective January 1, 2011, and will further streamline the attachment and garnishment process by providing for a data match between financial institutions and the Department of Revenue. The Department will be authorized to submit information to a financial institution on a quarterly basis, or with the agreement of the financial institution, more frequently. The information will identify any delinquent taxpayer to a financial institution and require the financial institution to notify the Department of the amount the institution may hold that belongs to the taxpayer. The Department will reimburse the financial institution for the cost of providing the information. The cost may not exceed the amount that the Department of Health and Human Services currently pays to financial institutions for conducting a data match in order to attach and garnish the account of an absent noncustodial parent.[41]

The federal government has issued a proposed rule to implement statutory restrictions on the garnishment of federal benefit payments.[42] These payments are protected under federal law from garnishment and include Social Security benefits, Supplemental Security Income benefits, and VA benefits. The rule sets forth uniform procedures for financial institutions to follow in order to minimize the hardships encountered by federal benefit payment recipients whose accounts are frozen pursuant to a garnishment order. The rule also assists financial institutions to determine whether exempt funds were directly deposited to the account.

Expansion of Statewide Accounts Receivable. – The Statewide Accounts Receivable Program, enacted in 1993, requires the State Controller to monitor accounts receivable owed to State agencies, to adopt procedures for the management and collection of accounts receivable, and to establish procedures for writing off accounts receivable.[43] The Program also provides for written-off accounts receivable to be set off against payments the State owes to debtors. A written-off accounts receivable is one that has been removed from a State agency's accounts receivable records.

Subsections (a) through (c) of this section expand the Statewide Accounts Receivable Program as follows:

- Expand the definition of "accounts receivable" to include taxes.

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[40] G.S. 53B-2.

[41] The DHHS and financial institutions have developed a data match system that requires a financial institution to provide DHHS the following information on a quarterly basis in order to secure child support: name, SSN, address, telephone number, account numbers, and other identifying data for any person who maintains an account at the financial institution.

[42] Garnishment of Accounts Containing Federal Benefit Payments 75 Fed. Reg. 20299 (April 19. 2010).

[43] An account receivable is an asset of the State reflecting a debt owed to the State. The term includes claims, damages, fees, fines, forfeitures, loans, overpayments, and tuition as well as penalties, interest and other costs authorized by law. The term does not include court costs or fees.

- Allow debts that have been submitted to the Department of Revenue under the Setoff Debt Collection Act to be set off against payments the State owes to these debtors. The following is an example of how this improvement will work. The Department of Revenue will give the State Controller a list of debtors under the Setoff Debt Collection Act. The State Controller will then check to see if any of these debtors are vendors that are owed money by the State for services or goods received by the State. The State Controller will then deduct the amount of the debt from the amount owed by the State. The State Controller will send this amount to the claimant agency owed the debt.

Reduce Franchise Tax Burden on Construction Companies.[44] *– Section 31.9 applies the provision enacted last session excluding from a corporation's franchise tax base all billings in excess of costs retroactively to taxable years beginning on or after January 1, 2007.*

The State imposes a franchise tax on C-corporations and S-corporations. The tax rate is \$1.50 per \$1,000[45] and is applied to a company's capital stock, surplus, and undivided profits.[46] 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 include 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, 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. S.L. 2009-422 adopted the industry's position by providing billings in excess of costs that are determinable using the percentage of completion principles are exempted from surplus and

[44] This provision was included in the Senate budget, SB 897, 3rd Edition.
[45] The minimum tax is \$35.
[46] A corporation's capital base may not be less than 55% of the appraised value of tangible property in NC, or less than its actual investment in tangible property in the State.

divided profits, and therefore, excluded from the franchise tax base. The act became effective for taxable years beginning on or after January 1, 2010.

The Department of Revenue audited some companies and assessed additional tax on them for taxable years prior to 2010 for excluding billings in excess of costs from their capital base. This section applies the 2009 law change retroactively to 2007. It also allows a taxpayer that paid franchise tax in taxable years 2007, 2008, or 2009 and that included billings in excess of costs in its capital base to apply to the Department for a refund of any excess tax paid to the extent the refund is the result of the retroactive application of the billings in excess law change. A request for a refund must be made on or before January 1, 2011. A request for a refund received after that date is barred.

Fair Tax Penalties. – Section 31.10 provides that a penalty for understatement of tax due does not apply to a taxpayer who complies with the Secretary of Revenue's request and files a consolidated or combined return and that a failure to pay penalty does not apply to a taxpayer who has requested a hearing on the tax liability used as the basis for the penalty. It requires a corporation to file a consolidated or combined return when the corporation's facts and circumstances meet those described in a permanent rule adopted by the Department of Revenue or when they meet those described in a letter of written advice provided by the Secretary to the corporation at the request of the corporation.[47] This section became effective when the Governor signed it into law on June 30, 2010. This section does not impact the General Fund.

North Carolina is a single entity filing state, meaning that a multistate corporation must determine its State net income as if it filed a separate return for federal income tax purposes. G.S. 105-130.14 prohibits a corporation from filing a consolidated or combined return in North Carolina unless specifically directed to do so by the Secretary of Revenue. Under G.S. 105-130.6, the Secretary can require a corporation to file a combined return with other parent, subsidiary, or affiliated corporations when the Department believes the corporation's net income attributable to this State is not accurately reflected on its separate entity filing return.[48] G.S. 105-130.6 states that a corporation has 60 days to file a combined return after being directed to do so by the Secretary before the corporation is subject to penalties under G.S. 105-236. The penalties under G.S. 105-236 include a failure to file penalty of 5% to 25%, a failure to pay penalty of 10%, a negligence penalty of 10%, and a large understatement penalty of 25%. It appears the Department's penalty practice when it requires combined returns is as follows:

Action	**Failure to File Penalty** 105-236(a)(3)	**Failure to Pay Penalty** 105-236(a)(4)	**Large Deficiency/ Negligence Penalty** 105-236(a)(5)
Return filed within time requested and payment made	No	No	Yes
Return filed within time	No	Yes	Yes

[47] This provision was included in the Senate budget, SB 897, 3rd Edition, and in SB 1172.
[48] The Department of Revenue has collected millions of dollars in taxes from forced combinations. The Department generated $424 million through Resolution Initiative in 2009. The Current Operations and Capital Improvements Appropriations Act of 2010 includes $110 million in its adjustments to availability attributable to 'Department of Revenue Settlement Initiative'.

requested but no payment with return because hearing requested			
Return not filed within time requested but hearing requested	Yes	Yes	Yes

This section clarifies the circumstances under which a corporation may be required to file a consolidated or combined return and the applicability of the penalties to those returns. It also provides that a failure to pay penalty does not apply to a taxpayer who has requested a hearing on the tax liability used as the basis for the penalty.

Subsection (d) of this section allows the Secretary to adopt rules that describe facts and circumstances under which the Secretary would require a corporation to file a consolidated or combined return. This provision does not limit the Secretary's authority under G.S. 105-130.6 to require a corporation to file a consolidated or combined return when the Secretary finds as a fact that a single entity report does not disclose the true earnings of a corporation on its business carried on in this State. Subsection (f) of this section provides expedited notice and hearing procedures for the Department to follow when adopting these rules.[49] The expedited notice and hearing procedures mirror those required of the State Ethics Commission.

Subsection (e) of this section creates two new exceptions to the general rule requiring a corporation to file a single entity return. Under prior law, a corporation could not file a consolidated or combined return unless the Secretary required the corporation to do so in writing. This subsection requires a corporation to file a consolidated or combined return in the following circumstances:

- The corporation's facts and circumstances meet the facts and circumstances described in a permanent rule adopted by the Department.
- Pursuant to a written request from the corporation, the Secretary has provided written advice to the corporation stating that the Secretary will require a consolidated or combined return under the facts and circumstances set out in the request.

Subsection (b) of this section affects taxpayers that file a combined return at the written direction of the Secretary, under a permanent rule adopted by the Department, or pursuant to written advice the taxpayer receives from the Secretary at the request of the taxpayer. It provides that the difference between the taxes due on a combined return filed under one of these circumstances, as compared to the taxes due on a single entity return, is not considered a deficiency and is not subject to the negligence or understatement penalties under G.S. 105-236(a)(5). Previously, these penalties were being assessed even though the taxpayer could not lawfully file the combined return without receiving the request from the Secretary.

[49] As a general rule, the Department of Revenue is exempt from notice and hearing requirements under Chapter 150B of the North Carolina General Statutes.

Subsection (a) of this section makes it clear that a taxpayer who disputes the amount of tax owed and requests a hearing on the issue is not subject to a penalty for failure to pay the disputed tax before the hearing is held. As set out in this subsection, a taxpayer who requests a hearing has 45 days after the conclusion of the administrative process to pay any amount that is determined to be due without incurring a failure to pay penalty. If the amount is not paid within the 45-day period, the penalty applies. This change is consistent with the tax appeal provisions contained in G.S. 105-241.9 through G.S. 105-241.16, which provide that a taxpayer does not need to pay the tax due when an assessment is made against the taxpayer in order to have a hearing on the merits of the taxpayer's defense to the assessment before an independent hearing officer.

Subsections (a) and (b) of this section apply to penalties that are assessed and unpaid as of the effective date, except penalties and taxes that are the subject of pending litigation in a General Court of Justice as of the effective date, and to penalties and taxes assessed on or after that date.

Subsection (c) of this section is a technical change that makes it clear that the filing of a combined return at the request of the Secretary does not trigger the automatic collection of the tax. G.S. 105-241.22(1) is intended to apply when a taxpayer files an original or amended individual income tax return that shows an amount due but does not include payment.

Subsection (g) specifically states that the changes made by this section should not be construed to affect the interpretation of any statute that is the subject of litigation pending as of the effective date of this act in the General Court of Justice or to affect any other aspect of such pending litigation.

No Add-Back for Film Credit/Apportionment.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-89	**HB 713**	**Rep. Allen, Gibson**

AN ACT TO PROVIDE THAT THE ADDITION TO FEDERAL TAXABLE INCOME OF AMOUNTS ALLOWED AS A CREDIT AGAINST NORTH CAROLINA INCOME DOES NOT APPLY TO THE FILM CREDIT AND TO INCREASE THE PERIOD OF TIME FOR WHICH THE SECRETARY OF REVENUE MAY ALLOW A CORPORATION TO USE AN ALTERNATIVE APPORTIONMENT FORMULA.

OVERVIEW: This act does two things:

- It reduces the corporate tax liability of a taxpayer who claims the film credit by providing that the taxpayer does not have to make an addition to federal taxable income when computing North Carolina taxable income for the amount of the credit taken against the tax.

- It increases the period of time for which the Secretary may allow a corporation to use an alternative apportionment formula from three taxable years to fifteen taxable years.

FISCAL IMPACT: The film credit change will result in an annual loss to the General Fund of approximately $800,000, beginning in fiscal year 2011-12. The fiscal impact of increasing the period of time for which a taxpayer may use an alternative apportionment formula is unknown. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

EFFECTIVE DATE: The change in the corporate income tax law applicable to taxpayers claiming the film credit becomes effective for taxable years beginning on or after January 1, 2011. The remainder of the act became effective when the Governor signed it into law on July 11, 2010.

ANALYSIS: This act includes two changes to the corporate income tax laws to make them more favorable to film production companies and to certain companies seeking to use an alternative apportionment formula.

Film Production Credit. – In 2009, the General Assembly increased the income tax credit for a production company from 15% to 25% of the company's qualifying expenditures,[50] and this session the General Assembly increased the cap of the film credit from $7.5 million to $20 million.[51] Section 1 of this act provides another enhancement to the corporate income tax film credit by not requiring a taxpayer to add back to its federal taxable income for State income tax purposes the amount of any film credit the taxpayer received during the taxable year.[52] The General Assembly made this change at the request of the film industry, who argued the taxation of the credit amount reduced the value of the credit taken. This exception to the general law will reduce the corporate income tax liability of a taxpayer claiming a film credit in the subsequent taxable year and will result in annual loss to the General Fund of approximately $800,000. The change becomes effective for taxable years beginning on or after January 1, 2011.

Alternative Apportionment Formula. – Section 2 of the act allows the Secretary of Revenue to apply a written decision granting a corporation's request for an alternative apportionment formula method for fifteen years instead of three years, effective for requests filed on or after July 11, 2010. Subsections (a) and (b) apply to the corporate income tax; subsection (c) makes a similar change to the corporate franchise tax.

A corporation must use the statutory double-weighted sales factor apportionment formula unless the corporation requests an alternative apportionment formula and the Secretary of Revenue grants the request. A return filed that uses an alternative apportionment formula that is not permitted by the Secretary is not a lawful return. A corporation that believes the double-weighted sales factor apportionment formula subjects a greater portion of its income to tax than is attributable to its business in this State may make a written request to the Secretary of Revenue for permission to use an alternative method. The request must set out the reasons for the corporation's belief and propose an alternative method. A corporation

[50] S.L. 2009-529.
[51] S.L. 2010-147.
[52] The film credit may also be taken against the personal income tax when the taxpayer is a pass-through entity. However, the personal income tax does not require a similar add-back to federal taxable income; therefore, a corresponding change in the personal income tax statute was not needed.

has the burden of establishing by clear, cogent, and convincing proof that the proposed alternative method is a better method of determining the amount of the corporation's income attributable to the corporation's business in North Carolina.

The Secretary must issue a written decision on a corporation's request. If the decision grants the request, it must describe the alternative method the corporation is authorized to use and state the tax years to which the alternative method applies. The Secretary's decision is final and is not subject to administrative or judicial review. A decision may apply to no more than three tax years. A corporation may renew its request to use an alternative apportionment method.

This section allows a corporation that signs a letter of commitment by September 15, 2010, certifying it plans to invest at least $500 million in private funds to construct a facility in a development tier one area within five years after the time construction begins[53] to request the Secretary of Revenue to grant the corporation permission to use an alternative apportionment method. The Secretary of Commerce would have to certify that the corporation meets the investment criteria. The corporation would follow the same procedures as prescribed by current law to make the request and would have to meet the same burden of proof as required by current law. The only difference would be that if the Secretary of Revenue grants the request, the decision may apply for as many as fifteen tax years, instead of only three tax years.

The apportionment formula is the conventional method used by states to source income of a corporation that does business in more than one state.[54] 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). 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 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. 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.

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[53] Microsoft requested this change because it was considering investing at least $500 million in a datacenter in Cleveland County. However, on August 27, 2010, it was announced that Microsoft decided to locate the datacenter in Virginia.

[54] 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.

Last session[55] the General Assembly changed the corporate income tax apportionment formula used by a capital intensive multistate corporation[56] meeting specific investment criterion from a three-factor formula based upon property, payroll, and double weighted sales to a single sales factor formula. 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. Unlike the provision in this act, a corporation meeting the statutory conditions to be considered capital intensive[57] may use the single sales factor apportionment method; it does not have to make a written request of the Secretary, and the Secretary has no decision-making responsibility in the matter.

Keeping NC Competitive Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-91	**SB 1171**	**Senator Clodfelter**

AN ACT TO MODIFY ELIGIBILITY FOR ECONOMIC INCENTIVE SALES AND USE TAX EXEMPTIONS AND REFUNDS; TO MODIFY ELIGIBILITY FOR THE ONE PERCENT PRIVILEGE TAX ON DATACENTER MACHINERY AND EQUIPMENT; AND TO MODIFY THE CIRCUMSTANCES UNDER WHICH THE DEPARTMENT OF COMMERCE MAY EXTEND THE BASE PERIOD FOR A JDIG GRANT.

OVERVIEW: This act provides the following tax incentives requested by the Department of Commerce to aid in its recruitment initiatives:

- An expansion of the sales tax exemption available to an Internet datacenter for the electricity and business property used at its facility to include a datacenter engaged in software publishing.
- An annual refund of the sales and use tax paid on building materials, supplies, fixtures, and equipment to construct a paper-from-pulp manufacturing facility and a turbine manufacturing facility.
- A modification of the requirements for a datacenter to qualify for the 1% excise tax on the machinery and equipment it purchases. The modification allows a datacenter to meet its investment threshold through the construction of two facilities, rather

[55] S.L. 2009-54. The act provided that if no corporation met the capital intensive requirements by January 1, 2019, the single sales factor provision would be repealed.

[56] The General Assembly made the change at the request of Apple, who built a major datacenter in Maiden, N.C.

[57] The corporation must meet certain investment, employment, wage, employee benefit, and location conditions. G.S. 105-130.4(s1).

than one facility. The act also extends the sunset on this provision from July 1, 2013, to July 1, 2015.

- The creation of an option for contractors and subcontractors that allows them to elect to pay the lower 1% excise tax rather than the sales and use tax on its purchases of machinery and equipment in connection with a datacenter.
- A modification of the circumstances under which the Department of Commerce may extend a business' base period and the length of that extension under the Job Development Investment Grant Program.

FISCAL IMPACT: Fiscal Research estimates a fiscal impact of $8.9 million in fiscal year 2010-11 and $13.7 million in fiscal year 2011-12. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

EFFECTIVE DATE: See ANALYSIS.

ANALYSIS:

Sales Tax Exemptions. – In 2006, the General Assembly granted a sales tax exemption to an Internet datacenter for the electricity and business property used at its facility.[58] For purposes of the exemption, an "eligible Internet datacenter" is defined as a facility that meets the following requirements:

- Its primary business is as a Web search portal included in Industry 51811 of NAICS.[59]
- It is comprised of a structure or series of structures located on contiguous parcels of land owned by the same operator.
- It is located in a development tier one or two county.
- The owner commits at least $250 million of private funds in the facility over a five-year period.

Under this definition, the exemption applied to a facility engaged in Web search portals.[60] Section 1 of this act broadens the definition of an eligible Internet datacenter to include not only a facility that operates Web search portals but also facilities engaged in software publishing.[61] The remaining components of the definition did not change. This change became effective July 1, 2010, and applies to sales made on or after that date.

[58] G.S. 105-164.13(55); S.L. 2006-66. At the time the legislation was being considered, Google was considering Lenoir as a possible site for one of its server farms, and this tax incentive was part of the recruitment package being offered.

[59] The North American Industry Classification System, or "NAICS," is the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. It was developed under the auspices of the Office of Management and Budget (OMB) and adopted in 1997 to replace the Standard Industrial Classification (SIC) system.

[60] Google and Facebook are examples of an Internet datacenter that operate Web search portals.

[61] Microsoft is an example of an Internet datacenter engaged in software publishing. North Carolina was one of three sites Microsoft considered for the location of its datacenter to serve as the East Coast hub for its online services. Microsoft selected a site near Boydton, Virginia in August 2010.

The General Assembly began offering sales tax exemptions to encourage companies to locate and expand in North Carolina[62] in 1998 when it granted a sales tax exemption to a major recycling facility[63] for the lubricants and other additives used at its facility for its machinery and equipment, for the electricity used at its facility, and for the materials and supplies consumed in the manufacturing processes at its facility.[64]

To be exempt, the business property must be located at the facility, it must be capitalized for tax purposes under the Code, and it must be used for one of the following purposes:

- For the provision of a service provided as part of its primary business.
- For the generation, transformation, transmission, distribution, or management of electricity.
- For the provision of related computer engineering or computer science research.

The owner of an Internet datacenter must forfeit the sales tax exemptions it has been allowed if it fails to meet the investment threshold, fails to locate and use the property at the datacenter, or fails to use the electricity at the datacenter. A taxpayer that forfeits an exemption is liable for all past taxes avoided as a result of the exemption, computed from the date the taxes would have been due if the exemption had not been allowed, plus interest. The past taxes and interest are due 30 days after the date the exemption is forfeited.

Section 2 of the act updates the NAICS reference used in the sales and use tax statutes to the most recent edition of NAICS.[65] The Office of Management and Budget[66] updates NAICS every five years. As part of this update, the 2002 NAICS classification for "Internet Service Providers and Web Search Portals," Industry 51811, was changed in the 2007 edition of NAICS to "Internet Publishing and Broadcasting and Web Search Portals," Industry 519130. Section 1 made this conforming change. Section 3 also makes a conforming change in language that was based upon the wording used in the 2002 edition of NAICS.

Sales Tax Refunds. – Section 4 expands the list of industries allowed an annual sales and use tax refund to include paper-from-pulp manufacturing[67] and turbine manufacturing.[68] This change became effective July 1, 2010, and applies to sales made on or after that date.

The General Assembly has allowed various industrial facilities to apply for an annual refund of the sales and use tax paid by them on building materials, supplies, fixtures, and equipment installed during the construction of a facility. Purchases for subsequent repair, renovation or equipment replacement do not qualify for the refund. The list of industrial facilities entitled to this refund has increased over the years:

- Air courier services. (1998)

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[62] There are at least seven sales tax exemptions targeted to specific industries: G.S. 105-164.13(10a), (45), (45a), (45b), (45c), (55), and (56).
[63] Nucor.
[64] G.S. 105-164.13(10a); S.L. 1998-55.
[65] G.S. 105-164.3 and G.S. 105-187.51B use NAICS references. In those instances, the industry codes did not change with the most recent update. Therefore, no conforming changes were necessary.
[66] OMB is the White House office responsible for devising and submitting the president's annual budget proposal to Congress.
[67] Governor Perdue announced on June 10, 2010, that Clearwater Paper Corporation would build a new tissue paper plant in Shelby, North Carolina.
[68] Siemens Energy announced plans to expand its Charlotte manufacturing plant for turbines and generators in March 2010.

- Aircraft manufacturing. (2004 and 2007)
- Bioprocessing. (2003)
- Computer manufacturing. (2004)
- Financial services. (2006)
- Motor vehicle manufacturing. (2004)
- Pharmaceutical and medicine manufacturing and distribution of pharmaceuticals and medicines. (2003)
- Semiconductor manufacturing. (2004)
- Solar electricity generating materials manufacturing. (2008)

To be allowed the refund, all of the listed industries must meet an investment threshold.[69] If the facility is located in a development tier one area, the required investment level is $50 million. For all other facilities, the investment level is $100 million. If the required investment level is not made within five years after the first refund is allowed, the facility loses its eligibility for the refund and must forfeit all refunds already received.[70] Only one of the listed industries must also meet a wage standard;[71] no industry listed must meet a specified employment level. A request for a refund must be made within six months after the end of the State's fiscal year. A refund applied for after the due date is barred. Under existing law, this refund provision will expire for all industries, including the newly added industries, for sales made on or after January 1, 2013.

1% Excise Tax, Subject to $80 Cap, on Certain Machinery & Equipment. – In 2007, the General Assembly substituted the 1%, $80 cap excise tax for the sales and use tax on certain purchases of machinery and equipment located and used at a datacenter.[72] This provision expires for sales occurring on or after July 1, 2013. To be taxed at the lower rate, the machinery and equipment must be used to provide datacenter services or for the generation, transformation, transmission, distribution or management of electricity. To qualify for the reduced tax rate, a datacenter must meet the following requirements:

- Provide infrastructure for hosting or data processing services.[73]
- Satisfy the wage standard and health insurance requirements of Article 3J.[74]
- Meet a minimum investment threshold.[75] The minimum investment threshold is $150 million within five years for development tier one areas.[76] The investment threshold is $300 million for facilities not located in a development tier one area. A business that fails to meet the minimum investment threshold forfeits the lower tax

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[69] The costs of construction may include the cost of acquiring and improving the land for the facility and the costs of the equipment for the facility.
[70] The owner of the facility is liable for past taxes due plus interest.
[71] Solar electricity generating materials manufacturing.
[72] S.L. 2007-323, Section 31.22. The 1% excise tax available to a datacenter does not apply to an "eligible Internet datacenter" to the extent the equipment and machinery of an Internet datacenter is exempt from sales tax.
[73] G.S. 105-164.3(5c).
[74] G.S. 105-164.50(2)c.
[75] G.S. 105-164.50(2)b.
[76] The 3rd Edition of SB 1171 had removed the lower threshold because no company was currently taking advantage of the incentive, and it became known that the company for which the lower threshold was targeted was planning to locate in a development tier two or three county.

rate provided by this Article and must pay all sales and use taxes, with interest, that would have been due on ineligible purchases.[77]

This act allows a datacenter to meet its $300 million investment threshold through the construction of two facilities. The act requires one facility to meet a large investment threshold of $225 million. Once a taxpayer qualifies for the lower 1% privilege tax by constructing a facility satisfying this large investment threshold, the taxpayer may also qualify for the lower tax rate on a second datacenter if all of the following requirements listed below are met. It also extends the sunset of this section from July 1, 2013, to July 1, 2015. The requirements are:

- The owner invests at least $75 million in the second datacenter.
- The two datacenters are linked through a fiber optic connection or a similar connection.
- The two datacenters are placed into service within five years of each other.

This act also adds a "contractor option" for the tax imposed on the machinery and equipment of a datacenter. Under this option, a contractor or subcontractor may elect to pay the lower 1% privilege tax rather than the sales and use tax on its purchases of machinery and equipment in connection with the datacenter. To make this election, the contractor or subcontractor must register with the Secretary of Revenue. An eligible contractor must purchase the machinery and equipment for use in performance of a contract with the owner of a datacenter. A subcontractor must purchase the machinery and equipment for use in performance of a contract with a general contractor that has a contract with the owner of a datacenter.

Sections 5 through 7 of the act make the following stylistic and clarifying changes to Article 5F:

- Incorporate the investment threshold, as well as the wage and health insurance requirements, in the statute providing the lower tax rate for a datacenter so that all of the provisions governing the applicable tax may be found in one statute. Section 5 removes the investment, wage, and health insurance requirements from the definitional statute for Article 5F.
- Clarify that the excise tax does not apply to equipment and machinery of an eligible Internet datacenter or software used in an eligible Internet datacenter that is exempt from sales tax. This provision is effective January 1, 2010.[78]

The 2001 General Assembly enacted Article 5F in response to the requirement of the Streamlined Agreement that states must simplify their sales tax rates.[79] The 2001 legislation repealed the 1% sales tax rate and $80 per article cap imposed on mill machinery and replaced it with a privilege excise tax having the same rate. Since that time, the Article has been expanded to tax other machinery and equipment at the lower rate, so long as the

[77] A credit, in the amount of the privilege tax paid, is allowed against the sales and use taxes due following forfeiture, and interest is not computed against the amount of this offset. The past taxes and interest are due 30 days after the date of forfeiture.
[78] With this change, the clarifying language will have the same effective date as the change made in last year's budget regarding the sales tax exemption for certain "enterprise" software (Section 27A.3(f) of S.L. 2009-451). This effective date was requested by the Department of Revenue.
[79] S.L. 2001-347.

machinery and equipment are capitalized by the following companies for tax purposes under the Code:

- o A major recycling facility. (2005)
- o A research and development company in the physical, engineering, and life sciences. (2006)
- o A software publishing company. (2007)
- An industrial machinery refurbishing company. (2008)

JDIG Changes. – Section 8 of the act authorizes the Economic Investment Committee charged with administering the JDIG Program to extend a business' base period by up to four years if the business has created and maintained at least 1,000 jobs. The current law remains in place if the business creates fewer than 1,000 jobs, which means that the Committee may extend the base period for up to two years. The act makes clear that under no circumstances may the base period be extended by more than four years. This section became effective when the Governor signed the act into law on July 11, 2010, and applies to all agreements in effect on or entered into after that date. This section expires January 1, 2013.

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.[80] JDIG is used to attract businesses to the State by allowing a five-member Economic Investment Committee[81] (Committee) to award grants to businesses. The grants may be awarded over as many as 12 years, and the amounts of the grants are based on income tax withholdings from new jobs created by the businesses. The Committee may enter into no more than 25 agreements per calendar year and may commit no more than $15 million in any fiscal year under all agreements entered into during a single calendar year.

If a business that receives a grant fails to meet any condition or requirement set forth in its agreement, the Committee, in consultation with the Attorney General, must reduce the amount of the grant or the term of the agreement, may terminate the agreement, or both. The reduction of the grant amount or the term must be proportional to the failure to comply.

If a business fails to maintain employment at the levels stipulated in the agreement or otherwise fails to meet a condition of the agreement for two consecutive years, one of two actions must be taken. The action taken will depend on whether the business is still within the "base period" established by the Committee and set forth in their agreement. If the business is no longer within the base period, the agreement must be terminated. If the business is still within the base period, the grant payment must be withheld for any consecutive year after the second consecutive year remaining in the base period in which the business fails to comply with any condition of the agreement. The Committee may extend the base period for up to two years, but under no circumstances may the term of the agreement be extended beyond the date set at the time the Committee awarded the grant.

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[80] Part II of S.L. 2002-172.

[81] 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.

Rev. Laws Technical & Admin. Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-95	**SB 1177**	**Senator Clodfelter**

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 various tax statutes and related laws.

FISCAL IMPACT: No significant impact.

EFFECTIVE DATE: Except as otherwise specified, the act became effective when the Governor signed it into law on July 17, 2010.

ANALYSIS: This act makes the following changes:

Section	Explanation
VARIOUS TAX LAW CHANGES	
1	Corrects a reference.
2	Corrects a statutory cite.
3	Conforms the definition of "political party" in Chapter 105 to the definition in Chapter 163. When the General Assembly enabled taxpayers to designate part of their tax refund to a political party, the definition of "political party" in the tax statute conformed to the definition of "political party" in Chapter 163. The General Assembly changed the definition of "political party" in Chapter 163 in 2006, but failed to make a conforming change in Chapter 105. The two different definitions have led to confusion because the definition under Chapter 163 recognizes three political parties while the definition in the tax statutes recognizes only two political parties.
4	Allows a sales and use tax refund to a public library created by an act of the General Assembly. Unlike other public libraries that are part of a city or county government, the Public Library of Charlotte and Mecklenburg County is a creature of law. The General Assembly chartered the library in 1903 as a body corporate. Other public libraries are allowed an annual sales and use tax refund as part of a unit of local government. This section adds public libraries created pursuant to an act of the General Assembly to the list of governmental entities allowed an annual refund. Prior to 2008, the Public Library applied for semi-annual sales and use tax refunds as a charitable entity under G.S. 105-164.14(b). The General Assembly clarified the charitable refund provision in 2008 as applying to 501(c)(3) organizations to limit the expansion of the provision by a Court of Appeals decision in *The Lynnwood Foundation v. N.C. Department*

	of Revenue.[82] The Public Library of Charlotte and Mecklenburg County is not organized as a 501(c)(3) entity. The section 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.
5	Consolidates two subsections into one because both subsections define the retail value of a motor vehicle for purposes of the highway use tax.
6	Provides that a certificate of title issued as the result of a transfer to a revocable trust from an owner who is the sole beneficiary of the trust is exempt from the highway use tax. This transfer is essentially a transfer to the same owner. The current law currently exempts transfers to the same owner to reflect a name change.
7	*Reserved.*[83]
8	Consolidates two separate notices concerning taxes owed into one notice. The two notices are a notice of a proposed assessment of tax and a notice of a failure to pay penalty if the proposed assessment of tax is not paid within 45 days. Subsection (a) requires a notice of a proposed assessment of tax to inform the taxpayer that a failure to pay penalty will apply to the assessed tax if the assessment is not paid or protested within 45 days. This change streamlines the assessment process and eliminates the mailing costs for the current, separate notice of the failure to pay penalty. Subsection (b) clarifies that the protest of a proposed assessment applies to any failure to pay penalty imposed on the underlying assessment.
9	Clarifies a disputed tax amount must be paid before seeking judicial review.
10	Clarifies that the federal mailbox rule governs when a document that is mailed to the Department of Revenue is timely filed. Under the federal mailbox rule, documents submitted by mail to the IRS are considered to be filed on the date shown on the postmark stamped by the USPS. Under current NC law, a notice of appeal submitted to the Property Tax Commission by mail is considered to be filed on the date shown on the postmark stamped by the USPS. However, in regards to other documents submitted to the Department, the issue is unclear. The statutes typically provide that a return or payment must be filed by a certain date or is due by a certain date. The Department has traditionally abided by the mailbox rule. As part of the Tax Appeals changes in 2007, G.S. 105-241.11 provides that requests for review of a denial of a refund or a proposed assessment are considered timely filed on the date the Department receives it. The Department believes the law is now unclear

[82] S.L. 2008-107.

[83] A section in a bill may be reserved to preserve the sequential numbering in a bill. It denotes that the section as currently written does not make any changes to the law. Sections may be reserved to accommodate changes that may be added to the bill at a later time or to reflect provisions that have been removed from the bill.

	with regards to other filings. This section clarifies the law with respect to documents submitted by mail to the Department and it makes a conforming change to the Tax Appeals statute to remove any ambiguity.
11	Enables nonparticipating manufacturers to have access to the information that is used to determine their escrow payments, which are based upon the volume of tobacco product sales in this State.
12	Provides that a local sales tax rate may be changed on the first day of any calendar quarter so long as the county gives the Department of Revenue at least 90 days notice. Under prior law, a local tax rate change could only be made on the first day of either January or July. The General Assembly enacted that provision in July 2000 as part of the Streamlined Sales Tax Agreement changes. The Agreement, subsequently enacted in January 2001, provided for the quarterly dates and 60 days notice. Upon the request of the counties, this section conforms to the quarterly date allowed under the Agreement. Upon the request of the Department of Revenue, the act retains the 90-day notice requirement; the extra 30 days gives the Department the time it needs to notify retailers of the local sales tax change. (See temporary modification in Section 44.)
13	Repeals a redundant statute. G.S. 105-254 gives the Secretary of Revenue the authority to prepare the necessary forms, and to provide those forms upon request.
14	Corrects the reference to the Department of Human Resources to the Department of Health and Human Services; and directs DHHS to give the Secretary of Revenue the data the Department of Revenue needs to calculate the county hold-harmless payments required by G.S. 105-523 by February 24th and July 24th of each year. The State is required to make hold harmless payments to counties to ensure that each county benefits by at least $500,000 as a result of the provisions of the Medicaid swap, enacted in S.L. 2007-323. In calculating this hold-harmless amount, the Secretary must estimate Medicaid expenditures, based upon data provided to it by DHHS.
PROPERTY TAX CHANGES	
15	Clarifies that liens are extinguished when an historic structure is located on the site within the allowed statutory time period.
16	Amends the definition of "disabled veteran" to include a veteran whose death was the result of a service-connected condition and adds a definition for the term "service-connected."
17	Clarifies that no deferred taxes are due and all liens are extinguished on historic properties when the historical significance of the property is lost or impaired due to fire or other natural causes.
18	Clarifies that liens are extinguished when property is used for low or moderate income housing within the allowed statutory time period.

19	Removes the obsolete term "radio common carrier" from the definition of "public service company" in G.S. 105-333.
20	Adds a definition of "terminal" to the property tax statutes that govern the assessment and taxation of public service companies.
21	Clarifies the repeal of the builder's inventory property tax deferral does not affect the eligibility of certain property receiving the benefit.
22	Corrects an incorrect effective date for the combined motor vehicle system.
23-24	*Reserved.*[84]
MOTOR FUEL TAX CHANGES	
25	Expands the electronic funds transfer[85] (EFT) requirement to motor carriers and kerosene suppliers under Article 3 of Chapter 119. Since 1999, the State has required EFT of the following tax payments: taxes due by corporations that pay federal estimated tax by EFT, as well as sales tax prepayments, utilities franchise tax payments, and taxpayers of motor fuel taxes and alternative fuel taxes that must file the return electronically[86]
26	Changes the word "report" to "return" to more accurately reflect the type of document described.
27	Updates the reference to the International Fuel Tax Agreement (IFTA) from June 1, 2008, to June 1, 2010.
28	Provides that a motor carrier who wants to register in North Carolina as its base state under IFTA must be incorporated in this State or authorized to transact business in this State. This change imposes the same licensing restrictions on motor carriers that the State imposes on refiners, suppliers, terminal operators, and others.
29	Repeals some of the purposes for which a distributor may obtain a monthly refund for the motor fuel tax the distributor paid on kerosene used for a non-highway purpose. In most instances, kerosene used for a non-highway purpose will be dyed fuel, upon which the motor fuel tax has not been imposed. To the extent the motor fuel tax has been paid on the kerosene, an end-user of the fuel that uses the fuel for a non-highway purpose may continue to receive the benefit of the tax refund by applying annually for a refund of the motor fuel tax paid on the kerosene under G.S. 105-449.197. In 1994, the federal government began requiring motor fuel to be dyed if it was non-tax-paid fuel. The dyed fuel indicates that the fuel is used for a nontaxable purpose under federal law and for a non-highway use in North Carolina. Dyed fuel is not subject to either the federal or State

[84] See the footnote for Section 7 of the act for an explanation regarding the term "Reserved."
[85] G.S. 105-163.40.
[86] G.S. 105-241(b).

	excise tax on motor fuel. Effective July 1, 1998, the federal government began requiring diesel fuel to be dyed. Kerosene is defined as diesel fuel. By requiring kerosene to be dyed, the federal government provided a way to purchase kerosene for non-highway uses, such as heating, without having to pay the motor fuel excise tax on the fuel. At the time, the public feared that dyed kerosene could not safely be used in kerosene heaters and because of that fear many people would only use undyed kerosene. When North Carolina conformed to the federal law in 1998, it enacted this refund provision so as not to impose the motor fuel tax on kerosene, which was often used for heating purposes.[87] The fear that dyed kerosene would be unsafe for heaters has not materialized and the refund provision at the distributor level is no longer necessary since retailers who wish to sell kerosene for non-highway uses may purchase and sell dyed kerosene. Specifically, this section repeals the refund provided to a distributor who sells kerosene to a retailer and dispenses the kerosene into a dispensing device that is kept locked by the retailer and must be unlocked by the retailer for each sale of kerosene. The distributor is liable for any overpayment of the refund, even if the overpayment is attributable to an act of the retailer. It also repeals the refund provided to a distributor who sells kerosene to an airport to be used only for fueling airplanes because no tax has been refunded for this purpose for at least the past four years. This section becomes effective January 1, 2011, and applies to sales of kerosene made by a distributor on or after that date.
30	Removes a miscellaneous word created by a redlining error.
31	Subsection (a) provides a definition of taxicab that is substantially the same as the one that existed in G.S. 20-87(1), prior to repeal. Subsection (b) clarifies that the quarterly refund of motor fuel tax paid on fuel used to operate special mobile equipment (SME) is for the *non-highway* operation of the equipment and for equipment that is registered as SME under Chapter 20. This subsection becomes effective October 1, 2010, and applies to motor fuel purchased on or after that date.
32	Provides that applications for refunds must be filed in the form required by the Secretary. This change will allow for the electronic filing of refund applications.
33-34	*Reserved.*[88]
OTHER RELATED LAW CHANGES	
35	Corrects a statutory reference.
36	Removed from the bill. The General Assembly enacted the substance of

[87] S.L. 1994-726 and S.L. 1998-146.

[88] See the footnote for Section 7 of the act for an explanation regarding the term "Reserved."

	this provision in S.L. 2010-31, section 31.4.
37	Corrects a drafting error in S.L. 2009-520. This section became effective July 1, 2010; the same date S.L. 2009-520 became effective.
38	Removes a reference to the privilege tax imposed on manufacturing fuel because the tax no longer exists. This section became effective July 1, 2010, the date the privilege tax imposed on manufacturing fuel was repealed.[89]
39	Removes a duplicate subsection header.
40	Corrects an incorrect statutory reference.
41	Repeals a redundant provision. S.L. 2009-527 adjusted the local vehicle registration fee that may be imposed by a transit authority from $5 to $8 as part of an overarching plan designed to provide funding options to improve public transportation and to relieve transportation-related congestion, as recommended by the 21st Century Transportation Committee. The subsection being repealed states that a regional public transportation authority may not impose a vehicle registration fee that exceeds $5. The subsection not only conflicted with the 2009 law change but also became unnecessary in light of the 2009 law change.
42	Corrects an effective date error. Section 27A.3(b) of S.L. 2009-451 eliminated the delayed repeal of G.S. 105-269.14. G.S. 105-269.14 requires taxpayers to report and pay use tax annually on the individual income tax return. The elimination of the repeal means that taxpayers will continue to report and pay use tax annually on the individual income tax return. Section 27A.3.(c) amended the effective date of the original legislation enacted in 2000. By amending the effective date, the change inadvertently triggered a retroactive application of the way individuals would be required to pay the use tax between July 14, 2000, and August 7, 2009. To correct this interpretation, this section repeals Section 27A.3.(c) of S.L. 2009-451, as suggested by the codifier of the General Statutes.
43	Extends the moratorium on the collection of the 911 fee from prepaid wireless providers from the 2010 calendar year to the first nine months of the 2011 calendar year. The moratorium has been extended twice.
44	Provides that during the 2010 calendar year, a local sales and use tax levied under Article 46 of Chapter 105 of the General Statutes may become effective on the first day of any calendar quarter so long as the county gives the Secretary at least 75 days advance notice of the new tax levy, rather than 90 days advance notice. Under the Streamlined Sales Tax Agreement, the notice requirement is 60 days. In earlier versions of this legislation, the 90-day notice provision

[89] See G.S. 105-187.51A.

	was shortened to 60 days. (See summary for Section 12) A couple of counties[90] had a successful sales tax referendum this spring and hoped to implement the new rate October 1, based upon the 60-day notice period in the earlier versions of the legislation. This date could not be achieved with the 90-day notice provision. This provision gives the counties the ability to begin collecting sales tax at the higher rate with 75 days notice for the 2010 calendar year only.
EFFECTIVE DATE	
45	Except as otherwise noted, this act is effective when it becomes law. The Governor signed the legislation into law on July 17, 2010.

Remove Sunset/ Priv. Sale Local Gov't Bonds.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-125	**HB 1936**	**Representative Owens**

AN ACT TO REMOVE THE SUNSET ON THE AUTHORIZATION TO SELL, THROUGH A PRIVATE SALE, LOCAL GOVERNMENT BONDS THAT ARE EITHER NOT RATED OR RATED BELOW "AA," SO AS TO CONTINUE TO TAKE ADVANTAGE OF THE FEDERAL "BUILD AMERICA BONDS" PROGRAM.

OVERVIEW: This act removes the sunset on the authorization to sell through a private sale local bonds that are either not rated or rated below "AA."

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 21, 2010.

ANALYSIS: This act removes the December 31, 2010 sunset on the private sale of obligation bonds issued under the Local Government Bond Act that have been rated by a nationally recognized credit rating agency at a credit rating below "AA" or are unrated.

Bonds issued by units of local government must be sold by the Local Government Commission after advertisement and upon sealed bids, unless they meet one of nine statutory exceptions.[91] One of the exceptions is for general obligation bonds issued under

[90] New Hanover and Wilkes Counties.

[91] Eight of the exceptions are as follows: (1) bonds that a State or federal agency has previously agreed to purchase; (2) bonds for which no legal bid is received within the time allowed for submission of bids; (3) revenue bonds and special obligations bonds issued under G.S. 159-84; (4) refunding bonds issued under G.S. 159-78; (5) refunding bonds issued under G.S. 159-72 if the Local Government Commission determines that a private sale is in the best interest of the issuing unit; (6) bonds that result in a tax credit to the owners under federal income tax laws if the Local Government Commission determines that a private sale is in the best interest of the issuing unit; (7) project development financing debt instruments; (8) bonds that are part of an issue in which the interest payment on some or all of the bonds is intended to be subsidized by payments from

the Local Government Bond Act that have been rated by a nationally recognized credit rating agency at a credit rating below "AA" or are unrated if they are sold before December 31, 2010. This exception was added to the statute in 2009[92] because of a provision in the *American Recovery and Reinvestment Tax Act of 2009* (ARRTA). ARRTA expanded the ability of banks to buy bonds issued by small local governmental units and certain nonprofit entities because those entities were facing considerable challenges in borrowing during the economic downturn. The federal provisions are scheduled to expire December 31, 2010. According to the State and Local Government Finance Division of the Office of the State Treasurer, allowing the private sale of general obligation bonds with no rating or rated below AA would enable local governments to take advantage of the debt issuance relief afforded under ARRTA. Presently, there is movement at the federal level to extend the relief given the continued uncertainty in the bond market. Lifting the current sunset date, in anticipation of the extension of the federal provisions, allows local governments to continue taking advantage of these instruments.

Construction of Wills and Trusts.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-126	**SB 1176**	**Senator Clodfelter**

AN ACT TO CONSTRUE CERTAIN FORMULA CLAUSES THAT REFER TO FEDERAL ESTATE AND GENERATION-SKIPPING TRANSFER TAX LAWS.

OVERVIEW: This act construes certain formula clauses that reference federal estate and generation-skipping transfer tax laws that take effect in 2010, during which time there is no applicable federal estate or generation-skipping transfer tax, to refer to the applicable laws as they applied with respect to estates and trusts of decedents dying on December 31, 2009. The Revenue Laws Study Committee recommended this legislation.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 21, 2010.

ANALYSIS: Effective January 1, 2010, the federal estate tax and generation-skipping transfer tax law is repealed for one year. North Carolina imposes an estate tax on the estate of a decedent when a federal estate tax is imposed on the estate. Consequently, North Carolina's estate tax is also repealed for one year. The Fiscal Research Division estimates an $85 million loss of revenue associated with this repeal to the General Fund for fiscal year 2010-2011.

Many wills and trust agreements include formula provisions to determine what amounts of the estate will pass to different beneficiaries or to trusts for the benefit of different beneficiaries. These formula provisions are usually based upon the estate and

the federal government if the Local Government Commission determines that a private sale is in the best interest of the issuing unit.

[92] S.L. 2009-140; SB 754.

generation-skipping transfer tax laws applicable at the time of the decedent's death. With the repeal of the federal estate law for the year 2010, these provisions could result in a devise contrary to the decedent's intent. For example, a will or trust agreement could include a formula provision allocating the largest amount or percentage of the testator's estate that can pass free of estate tax to a "Family Trust" for the benefit of the testator's children and the remainder of the estate to a "Marital Trust" for the benefit of the testator's surviving spouse. In the absence of an estate tax, it is possible that this kind of provision could result in the entire estate passing to the Family Trust and nothing passing to the Marital Trust.

This act addresses the confusion and ambiguity in formula clauses caused by the repeal of the estate tax law for 2010 by generally putting people who die in 2010 in the position they would have been in if they had died on December 31, 2009. It also addresses instruments executed by a person who dies before 2010, but who left a document with formula language that takes effect in 2010. The act provides that a will or codicil, or trust instrument or amendment to a trust instrument, that refers to federal estate and generation-skipping transfer tax laws and becomes applicable during the time in which no such laws exist, will be construed to refer to the federal estate and generation-skipping transfer tax laws as they existed on December 31, 2009, unless the document clearly manifests an intent that a contrary rule applies. At least nine other states have adopted similar construction provisions.[93]

Homebuilder Property Tax Deferral Change

Session Law	*Bill #*	*Sponsor*
S.L. 2010-140	**HB 1249**	**Rep. Harrell, England**

AN ACT TO MODIFY THE INVENTORY PROPERTY TAX DEFERRAL.

OVERVIEW: This act modifies the homebuilders' inventory property tax deferral program by allowing residences constructed by a builder and owned by either the builder or a business entity of which the builder is a member to qualify for the deferral.

FISCAL IMPACT: This act has no fiscal impact.

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

ANALYSIS: In 2009, the General Assembly added for taxable years beginning on or after July 1, 2010, a property tax deferral program for occupant-ready residences constructed and owned by a general contractor for resale on a parcel of real property.[94] 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. This act modifies the ownership requirements for qualifying for the inventory tax deferral program. Under previous law, the property had to be owned by a builder. Interpretive conflicts arose in situations where a builder constructed a residence on property, the title to which was held

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[93] Idaho, Indiana, Maryland, Nebraska, New York, South Dakota, Tennessee, Virginia, and Washington.
[94] S.L. 2009-308.

by a business entity of which the builder was a member.[95] This act addresses that conflict and allows property so held to qualify for the deferral program.

Administrative provisions for the inventory tax deferral program are consistent with the other tax deferral programs and include (i) taxes that are deferred become a lien on the property, which is extinguished when the taxes are paid; (ii) the deferred taxes are due and payable on the day the property loses its eligibility for deferral as a result of a disqualifying event; (iii) interest accrues during the deferral period as of the date the taxes would have originally become due without the deferral program; and (iv) upon disqualification, the tax for a year in which a disqualifying event occurs is computed without the benefit of the deferral program. Applications for the deferral program 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.

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 four disqualifying events:

- The builder transfers the residence.
- The residence is occupied by the builder or another with the builder's consent.
- Five years have passed from the time the improved property was first subject to listing for taxation by the builder.
- Three years have passed from the date the improved property first received the property tax benefit provided by this deferral program.

Various Economic Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-147	**HB 1973**	**Rep. Owens, Gibson, Wainwright, Brubaker**

AN ACT TO MODIFY EXISTING ECONOMIC DEVELOPMENT INCENTIVES AND TO INCENT NEW ECONOMIC DEVELOPMENT OPPORTUNITIES; TO PROVIDE FUNDING FOR THE DNA DATABASE AND DATABANK; AND TO ENCOURAGE THE USE OF MULTIPLE AWARD SCHEDULE CONTRACTS WHEN ISSUING REQUESTS FOR PROPOSALS FOR STATE CONTRACTS.

OVERVIEW: This act does the following:

- Extends the sunset for the following tax credits:
  - Article 3J of Chapter 105 of the General Statutes.
  - Oyster shell recycling.

[95] "Member" is defined in G.S. 105-277.2 as a shareholder of a corporation, a partner of a general or limited partnership, or a member of a limited liability company.

- Enhances the film production tax credits.
- Creates a new tax credit for interactive digital media.
- Creates economic development incentives and favorable tax treatment for Eco-Industrial Parks.
- Exempts certain wood chippers from sales tax.
- Provides funding for the DNA Database and Databank.
- Encourages the Department of Administration to consider the use of multiple award schedule contracts when issuing requests for proposals for State term contracts.

FISCAL IMPACT: Fiscal Research estimates a fiscal impact of $830,000 for fiscal year 2010-2011. Of the various incentives in this act, the expansion of the film production tax credit is estimated to have the most significant impact over the next five years reaching a General Fund loss of $56 million in fiscal year 2012-2013. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

EFFECTIVE DATE: Except as otherwise stated, this act became effective when the Governor signed it into law on July 22, 2010.

ANALYSIS: This act enhances several of North Carolina's existing economic development tools and creates some new incentives. It is one of five acts the General Assembly passed this year to encourage economic development.[96]

Part I: Extend and Revise Tax Credits for Growing Businesses

Established to replace the Bill Lee tax credits, Article 3J provides credits for job creation and investment in real and business property. The credits became effective for tax years beginning on and after January 1, 2007.

Under prior law, Article 3J for growing businesses was scheduled to sunset for business activities that occur on or after January 1, 2011. In order to qualify for a number of economic incentives[97] offered by the State, including Article 3J, a taxpayer must meet an environmental impact test. In addition, under Article 3J, a taxpayer may receive a credit for investing in business property if the investment meets a specified threshold. The amount of the credit varies, depending upon the tier designation. Activities that occur in an agrarian growth zone may receive enhanced economic incentives.

This act makes three changes to Article 3J. First, it extends the sunset by two years from January 1, 2011, to January 1, 2013.

Second, it makes a technical change to the definition of an "agrarian growth zone." An agrarian growth zone is a zone that meets each of the following conditions: (i) it is comprised of one or more contiguous census tracts, census block groups, or both, in the most recent federal decennial census, (ii) all of the area is located in whole within a county that has no municipality with a population in excess of 10,000, and (iii) each census tract and each census block group that comprise the area has more than 20% of its population below the poverty level according to the most recent federal census. The act modifies the third requirement by allowing each census tract either to have more than 20% of its population

[96] S.L. 2010-31; S.L. 2010-89; S.L. 2010-91; S.L. 2010-167.

[97] These incentives include site infrastructure development, JMAC (Job Maintenance and Capital Development Fund), and any tax incentive that incorporates, by reference, the environmental test set forth in Article 3J.

below the poverty level or to be adjacent to another census tract or census block group in the zone that has more than 20% of its population below the poverty level according to the most recent federal census. The act further requires that the zone, as a whole, have more than 20% of its population below the poverty level according to the most recent federal census. This change is effective for taxable years beginning on or after January 1, 2011.

Third, the act clarifies what constitutes an environmental disqualifying event for purposes of qualifying for certain economic incentives. A taxpayer qualifies for certain economic incentives only if the taxpayer certifies that it has no pending administrative, civil, or criminal enforcement actions based on alleged significant violations of any DENR-implemented programs and has had no final determination of responsibility for any significant administrative, civil, or criminal violation of any DENR-implemented program within the last five years. These are civil and criminal violations with associated penalties. While Article 3J has a definition for what constitutes a "significant" violation, some confusion has arisen as to whether certain violations meet this definition. The Department of Revenue has interpreted the current language to make no distinction between civil and criminal violations or on the basis of whether the violation was knowing or knowing and willful. This act clarifies that for certain economic incentives[98] an environmental disqualifying event occurs when (i) a civil penalty is assessed by DENR for failure to comply with an order to abate or remediate a violation of any DENR program, (ii) a criminal penalty is imposed in connection with any DENR-implemented program, or (iii) DENR finds a taxpayer knowingly and willfully committed a violation of a DENR-implemented program, an assessment for damages to fish or wildlife is made, or a judicial order for injunctive relief was issued in connection with a violation of any DENR-implemented program.[99] This clarification is designed to ensure that minor violations do not inadvertently disqualify a taxpayer that would otherwise be eligible for a tax incentive and was vetted with the Departments of Commerce and Revenue. The clarification of a disqualifying environmental event for existing agreements is effective for credits claimed for taxable years beginning on or after January 1, 2007. The clarification of a disqualifying environmental event for new applicants became effective when the Governor signed the act into law on July 22, 2010, and applies to all agreements in effect on or entered into on or after that date.

Part II: Expand Tax Credits for Production Companies[100]

In 2005, the General Assembly replaced the film industry development grant program with a refundable income tax credit calculated based on the qualifying expenses spent by a production company in connection with a production.[101] The credit included a $1 million cap on employee compensation. In 2006, the General Assembly clarified that amounts paid to a highly compensated individual are not eligible for the credit regardless of whether paid directly by the production company or indirectly through another entity.[102] In 2009, the credit was modified to provide a production company with the choice of two different credit

[98] Article 3J, the Site Infrastructure Fund, and the Jobs Maintenance and Capital Development Fund (JMAC).

[99] The first two apply only for the tax year in which the activity occurred; the last includes the current tax year as well as the prior two tax years.

[100] The 2010 General Assembly further expanded the film credit in S.L. 2010-89. Section 1 of that act provides that a taxpayer is not required to add back to federal taxable income amounts allowed for the film credit.

[101] Section 39.1 of S.L. 2005-276.

[102] Section 4 of S.L. 2006-162. In the film industry, it is a customary practice to pay actors indirectly through a contract with a personal services company.

amounts: either a credit equal to 15% of qualifying expenses[103] or an alternative credit 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, which has historically been applied to cameras, film, props, building materials used in construction of sets, and chemicals/equipment used to develop and edit film, 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.[104]

The refundable film credit is capped at $7.5 million. In order to obtain the credit, the taxpayer's qualifying expenses must exceed $250,000, which cannot include any amount in excess of $1 million in compensation paid to an individual. The credit is 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.

Part II of this act does the following, effective for taxable years beginning on or after January 1, 2011:

- Increases the applicable percentage used to calculate the credit from 15% of the amount of qualifying expenses to 25% of the amount of qualifying expenses and eliminates the alternative credit.
- Allows a taxpayer to include as qualifying expenses both employee fringe contributions (including health, pension, and welfare contributions) and per diems, stipends, and living allowances paid for work being performed in the State.
- Increases the cap of the film credit from $7.5 million to $20 million.
- Clarifies that the scope of mill machinery for privilege tax purposes does not include purchases of cameras, film, props, building materials used in construction of sets, and chemicals/equipment used to develop and edit film. With this change, these purchases will be subject to the general rate of sales tax beginning January 1, 2011.

Part III: Tax Credit for Developing Interactive Digital Media

North Carolina does not provide any statutory incentive programs for companies that produce virtual world, flight, or training simulations or engines, platforms, or other programmed components of simulations. Effective for taxable years beginning on or after January 1, 2011, Part III of this act creates a new economic incentive to help recruit producers of interactive digital media (IDM) to North Carolina. The term 'interactive digital media' is defined as a product that meets all of the following requirements:

[103]Qualifying expenses are the total amount spent in North Carolina on (i) goods and services leased or purchased by a production company in connection with a production, (ii) compensation and wages paid by a production company on which it remitted withholding payments to the Department of Revenue, other than an amount paid in excess of $1 million to an individual, and (iii) the 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.
[104] S.L. 2009-529.

- Produced for distribution on electronic media, including distribution by file download over the Internet.
- Contains a computer-controlled virtual universe with which an individual who uses the program may interact in order to achieve a goal.
- Contains a significant amount of at least three of the following: text, sound, fixed images, animated images, and 3D geometry.

The credit is equal to a percentage of the taxpayer's expenses paid during the taxable year in developing the media, platform, or engine that exceed $50,000. The percentage amount varies as follows:

- 20% for expenses paid to a "participating community college," defined as a community college that offers an associate in applied science degree in simulation and game development, or to a research university.
- 15% for all other allowable expenses.

The credit is available only if the taxpayer meets the wage standard, health insurance, environmental impact, safety and health programs, and no-tax-delinquency requirements of Article 3J. IDM credits may be taken against either franchise or income tax liability. The taxpayer must elect which tax the credit will be claimed against when filing the return and that election is binding, including with respect to carryfowards. IDM credits may not exceed 50% of the amount of tax against which the credit is claimed, and unused portions of a credit may be carried forward for eight years. If a producer claims or has claimed an IDM credit with respect to a facility, that taxpayer is ineligible for One NC Fund and JDIG grants. This credit expires January 1, 2014.

Part IV: Extend Sunset for Recycling Oyster Shells Credit

This act extends the sunset on the tax credit for recycling oyster shells from January 1, 2011, to January 1, 2013. The General Assembly first enacted this credit in 2006[105] to offer an additional incentive to recycle oyster shells. Beginning October 1, 2009, oyster shells may not be disposed in landfills.

The credit is a nonrefundable income tax credit of one dollar for each bushel of oyster shells that a taxpayer donates to the Division of Marine Fisheries of the Department of Environment and Natural Resources. To be eligible for the credit, the taxpayer must provide the Department of Revenue with documentation, supplied by the Division of Marine Fisheries, verifying the donation and the number of bushels donated. The credit may be carried forward for five years. The taxpayer may not claim a deduction for any oyster shells for which a credit is claimed.

The Division of Marine Fisheries operates a voluntary oyster shell donation program. The Division of Marine Fisheries purchases oyster shells in very large quantities from shucking houses at a negotiated price per bushel.[106] Recycled oyster shells offer the following value: (1) aid in the restoration of oyster populations by their placement in sanctuaries and/or estuaries; (2) landscaping purposes; and (3) nutritional supplements.

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[105] S.L. 2006-66, Section 24.18.
[106] In 2006, the negotiated price was 50¢ per bushel.

Part V: Create Economic Development Incentives for Eco-Parks

Part V of this act provides new economic development incentives for Eco-Industrial Parks. To qualify as an Eco-Industrial Park, it must meet the following requirements: (i) it has at least 100 developable acres; (ii) it is located in a county that is not subject to motor vehicles emissions inspections; (iii) each building in the park meets the energy-efficiency and water usage standards established in G.S. 143-135.37; and (iv) each business in the park is in a clean industry. If these requirements are met, an Eco-Industrial Park will enjoy certain favorable treatment with regard to existing economic incentives. First, an Eco-Industrial Park has a development tier one designation for purposes of economic development programs. Second, for purposes of selecting applicants for the Job Development Investment Grant Program and selecting projects in a priority area for the NC Green Business Fund (Fund), an applicant or a project in an Eco-Industrial Park has priority over comparable projects that are not in an Eco-Industrial Park. Third, with respect to the Fund and unlike with other projects, the Department of Commerce may neither set a cap on a grant nor require matching funds for a grant from the Fund for projects in an Eco-Industrial Park. Fourth, the limitation on the tax credit for the installation of renewable energy property in nonresidential property is increased to $5 million per installation if the property is located in an Eco-Industrial Park. Under current law, the tax credit available against income, franchise, or gross premiums tax liability for taxpayers investing in renewable energy property for nonresidential property has a ceiling of $2.5 million per installation. Lastly, under current law, a taxpayer that has qualified research expenses is allowed a credit equal to the percentage of the expenses ranging from 1.25% to 3.25%.[107] This Part provides that the applicable percentage for expenses with respect to research performed in an Eco-Industrial Park is 35% of the expenses.

The priority treatment afforded projects in an Eco-Industrial Park with respect to grants under JDIG or the NC Green Business Fund applies to grant applications submitted on or after July 1, 2010. The remaining provisions such as the tier one designation and the tax credit changes are effective for taxable years beginning on or after January 1, 2011.

Part VI: Sales Tax Exemption for Wood Chippers

Under prior law, companies that produce wood chippers that are for use by out-of-state customers and that are immediately removed from North Carolina and are delivered to the customer's out-of-state location are required to collect sales tax for certain sales. This practice has, in practical effect, put these companies at a competitive disadvantage with similarly situated companies located in other States. These taxable sales included (i) where a customer's employee picks up the chipper at the company location using the customer's vehicle, (ii) where the customer pays a drive-away service driver to pick up the chipper at the company, and (iii) where the customer pays a drive-away service driver to pick up the chipper at the company using the customer's vehicle. These chippers are commercial units that are towed behind another vehicle and are assigned a vehicle identification number.

This act exempts from sales tax a wood chipper that meets all of the following requirements:

- Is designed to be towed by a motor vehicle.

[107] North Carolina university research expenses get a credit equal to 20% of the expenses.

- Is assigned a 17-digit vehicle identification number by the National Highway Transportation Safety Association.
- Is sold to a person who purchases a motor vehicle in this State that is to be registered in another state and who uses the purchased motor vehicle to tow the wood chipper to the state in which the purchased motor vehicle is to be registered.

This Part became effective July 1, 2009, and applies to sales made on or after that date.

Part VII: Funding for the DNA Database and Databank

During the 2010 Session, the General Assembly enacted S.L. 2010-94, Collect DNA Sample on Arrest. Under this act, DNA samples will be taken from persons upon arrest for specified offenses, and the general method of sampling is changed from blood sample to cheek swab for all DNA sampling. Part VII of this act provides a funding mechanism for this new program. A two-dollar ($2.00) criminal court cost will be assessed in every criminal case in Superior or District Court where the defendant is convicted, enters a guilty or nolo contendere plea, or when costs are assessed against the prosecuting witness. The cost does not apply to infractions. The funds are appropriated directly to the Department of Justice for the support and services of the SBI's DNA Database and DNA Databank.

The additional court cost becomes effective October 1, 2010, and applies to court costs imposed or collected on or after that date. However, in misdemeanor cases where the citation was issued before October 1, 2010, and the case is disposed of on or after that date by written appearance, by waiver of trial or hearing, or by plea of guilty or admission of responsibility, then the cost shall be the lesser of the cost specified in G.S. 7A-304(a), as amended by this act, or the cost specified in the notice portion of the defendant's copy of the citation. This Part also provides that if the $2.00 court cost is insufficient to fund the program, the Department of Justice must cover the additional costs through other funds appropriated to it and by applying for grants or seeking funds from the federal government or other sources.

Part VIII: Use of Multiple Award Schedule Contracts

This act encourages the North Carolina Department of Administration to consider the use of multiple award schedule contracts when issuing requests for proposals for State term contracts. This Part became effective when the act was signed into law by the Governor on July 22, 2010.

The use of multiple award schedules allows the government to leverage its purchasing power to garner volume discounts for commercial supplies and services, and it allows multiple vendors to compete and be awarded a contract based upon the value of their products or services. Under this process, vendors provide their total catalogue for lines of equipment and attachments to eligible purchasers, including State agencies, departments, institutions, public school districts, political subdivisions, and higher education facilities. The State then evaluates vendors based on a variety of factors, including discounts, total life cycle costs, service, warranty, distribution channel, and past vendor performance. Multiple award schedule contracts can result in competitive pricing, transparency, administrative savings, expedited procurement, and flexibility for State purchasers.

Sales Tax Changes/Study Competing Systems.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-153	**HB 455**	**Rep. Insko, Bryant, Current, Neumann**

AN ACT TO ALLOW A SALES TAX REFUND TO A JOINT GOVERNMENTAL AGENCY CREATED TO OPERATE A CABLE TELEVISION SYSTEM.

OVERVIEW: This act allows cities that jointly operate a cable television system to obtain a refund of State and local sales and use tax paid by the entity on purchases made between July 1, 2007, and June 30, 2010. The request must be made in writing before January 1, 2011.

FISCAL IMPACT: The estimated fiscal impact of this provision for the State's General Fund is a revenue loss of less than $25,000; it also reduces local sales tax revenues by approximately $5,000. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 22, 2010.

ANALYSIS: Cities and counties may apply for an annual refund of the State and local sales tax paid by the governmental entity on direct and indirect purchases of tangible personal property, other than electricity and telecommunications service. Other governmental entities allowed this refund include various regional authorities and joint agencies created by interlocal agreements to operate a public broadcasting television station.

MI Connection is a locally owned and operated cable and Internet system serving the towns of Mooresville, Davidson and Cornelius in the counties of Mecklenburg and Iredell. The municipalities have created a joint agency through an interlocal agreement pursuant to G.S. 160A-462 to operate a cable television system. A cable television system is one of the listed systems that a municipality has the authority to operate as a public enterprise under Article 16 of Chapter 160A of the General Statutes.

Under current law, a city that operates a cable television system may obtain a sales tax refund of the purchases it makes. However, because the cities that operate MI Connection do so as a joint agency, they are not entitled to the sales tax refund. The only joint agency allowed a sales tax refund is one that operates a public broadcasting television station.

This act enables cities that have created a joint agency to operate a cable system that provides video programming to obtain a refund of State and local sales and use tax paid by the entity on purchases made between July 1, 2007, and June 30, 2010. Ordinarily, a request for a refund is due within six months of an entity's fiscal year, and it is barred if it is received more than three years after the due date. However, for purposes of the refund allowed by this act, the request must be made before January 1, 2011.

The act limits the refund provision to a specified time period in deference to the General Assembly's continued study of local government owned and operated communication systems. Senate Bill 1209 would have restricted the issuance by a local government of

non-voted debt in the form of certificates of participation for the purpose of financing a communication system, such as a cable system or a system that provides internet access service. The General Assembly did not enact the restriction, but it did authorize the Revenue Laws Study Committee to continue to study local government owned and operated communication services.[108] The time period in the act corresponds to the time when MI Connection undertook large capital expenditures to begin the operations of the cable system.

Use of 911 Funds.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-158	**HB 1691**	**Rep. Bryant, Faison, Sager, West**

AN ACT TO AMEND THE STATUTES GOVERNING EMERGENCY TELEPHONE SERVICE, AS RECOMMENDED BY THE HOUSE SELECT COMMITTEE ON THE USE OF 911 FUNDS, AND TO INCREASE FUNDS FOR SUPPLEMENTAL PEG CHANNEL SUPPORT.

OVERVIEW: This act makes various changes to the statutes governing Emergency Telephone Service, and increases the funding available for supplemental PEG channel support.

FISCAL IMPACT: This act has no impact on General Fund revenues.

EFFECTIVE DATE: Except as otherwise provided, this act became effective July 1, 2010.

ANALYSIS:

911 Emergency Telephone Service

Prior to 2007, local government entities collected a 911 service charge from subscribers of local telephone providers, and the Wireless 911 Board collected a monthly service charge on each subscriber of wireless providers. The entire fee collected by local governments, and a portion of the fees collected by the Wireless 911 Board was distributed to "public safety answering points" (PSAP). Each PSAP is the public safety agency that receives incoming 911 calls and dispatches public safety agencies in response. Funds from the Wireless 911 Board not distributed to PSAPs were used to reimburse wireless providers for the costs of updating equipment necessary for PSAPs to geographically locate individuals who call 911 from wireless phones. In 2007, the local 911 service charge was eliminated and a new statewide administrative system was adopted for collecting the 911 service charge and distributing the funds. The 911 Board oversees the distribution of funds to PSAPs and wireless providers. The amount of the distributions to each eligible PSAP is based on the prior distribution to the PSAP from both the local service charge and the Wireless 911 service charge. Due to the differences in the fee that was previously collected on the local level, the distribution to some PSAPs was insufficient to cover actual costs while other PSAPs received distributions that far exceeded the actual cost of providing 911 service.

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[108] S.L. 2010-152, Section 7.5.

This act makes the following changes to the statutes governing Emergency Telephone Service:

The 911 Board. – The membership of the 911 Board is changed to increase the total number of local government representatives. One position representing a Commercial Mobile Radio Service (CMRS) provider, and one position representing the National Emergency Number Association (NENA) are removed. Two positions are added to the Board: a fire chief with experience operating or supervising a PSAP upon the recommendation of the NC Firemen's Association, and a Rescue or Emergency Medical Services Chief with experience operating or supervising a PSAP upon the recommendation of the NC Association of Rescue and Emergency Medical Services. The Act also prohibits Board members from serving more than two terms.

The Act amends the authority of the 911 Board to allow the Board to establish operating standards for PSAPs that receive distributions from the Fund, to create, design, or acquire public education materials regarding the proper use of 911, and to pay a private vendor for the provisioning of a network for the purpose of providing 911 service. The Board is authorized to increase from 1% to 2% the percentage of funds it retains for administrative expenses.

PSAP Distributions. – The 911 Board is authorized to determine the monthly distributions to eligible PSAPs. The distribution of funds to eligible PSAPS will be based on the cost of providing 911service, rather than on prior distribution levels. The new distribution amount is based on a formula adopted by the Board and is effective for distributions beginning in fiscal year 2011. The Board must notify each PSAP of the estimated distributions of the next fiscal year by December 31st of the prior year, and notify each PSAP of the actual amount of distributions by June 1.

- Base amount formula: The Board must establish a formula to determine each PSAP's base amount. The formula must consider information including population, area served, and cost history.
- Additional distributions: The Board may increase the distribution to a PSAP above its base amount if the PSAP receives less than its eligible costs in any fiscal year. The Board may not distribute less than the base amount unless the PSAP carries forward excess amounts.
- Reconsideration: The Board must provide a procedure for a PSAP to request a reconsideration of its distribution or eligible expenses.
- Carry forward: A PSAP may carry forward to the next fiscal year up to 20% of the total funds disbursed by the Board during a fiscal year for eligible expenditures for capital outlay, capital improvements, or equipment replacement. If more than 20% is carried forward, the Board may use the amount carried forward to lower the PSAPs annual distributions.

Fund Use and Fund Balance. **–** The use of the 911 Fund is expanded to include dispatch equipment within the building where the PSAP is located excluding the costs of base station transmitters, towers, microwave links and antennae used to dispatch emergency call information from the PSAP. The use is also expanded to include training specific for supervising and training a primary PSAP.

Due to the restriction on use of funds and the inequality in PSAP distributions under the prior law, some PSAPS have accumulated a large fund balance of distributed funds that are not required for eligible expenses. A PSAP may use 50% of its fund balance on July 1, 2010 for public safety needs, including costs that are not eligible expenses under G.S. 62A-46.

Statewide Projects. – The 911 Board is authorized to implement statewide projects for the benefit of 911 service. Under current law, surplus funds designated to be used for reimbursement for CMRS providers may be reallocated to the PSAP Grant Account. The Grant Account is redesignated the PSAP Grant and Statewide Projects Account. In order for the Board to use funds for a statewide project, the Board must determine the project is consistent with the 911 Plan, is cost effective and efficient when compared to the aggregated costs of similar projects if implemented by primary PSAPs, the expenses are eligible under the Fund, and the project has a statewide benefit.

Supplemental PEG Channel Support

S.L. 2007-151, the Video Service Competition Act, equalized the taxation of video programming services and replaced locally negotiated franchises of cable service with a State-issued franchise. The 2007 legislation distributed a portion of the sales tax revenue derived from video programming to cities and counties. The distributions are made quarterly. City and county revenue from the video programming tax has exceeded the projections of anticipated revenue.

G.S. 105-164.44I(b) designates $2 million of the video programming sales tax revenue distributed to cities and counties for Supplemental PEG channel support.[109] Up to $6,250 per quarter ($25,000 per year) may be distributed for each certified channel. The amount distributed per PEG channel depends on the total number of PEG channels certified. For the first quarter of 2010, there were 107 certified PEG channels. Each certified channel eligible to receive funding received $4,672.90 for that quarter.

Although the amount of sales tax revenue has exceed expectations, the amount distributed per PEG channels has been less than anticipated due to a greater number of certified PEG channels than expected. The 2007 legislation anticipated there would be excess revenue dedicated to PEG channel support. Excess revenues not expended for Supplemental PEG support would be transferred to the PEG Grant Fund, administered by e-NC Authority.[110] With the higher number of PEG channels, there are not excess Supplemental PEG support revenues to transfer to the PEG Grant Fund.

This act repeals the PEG Grant Fund and increases the revenues from the video programming sales tax designated for Supplemental PEG channel support to $4 million per year. Cities and counties must continue to certify PEG channels and may certify up to three PEG channels. The yearly cap on funding per PEG channel is removed. Each PEG channel will receive a proportional share of the total revenues available. Based on the number of certified PEG Channels in the first quarter of 2010, each PEG channel would receive

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[109] A PEG channel is a channel set aside by a cable operator for public, educational, or governmental use. To receive a distribution of the Supplemental PEG channel support funds, a city or county must certify the PEG channels provided to the city or county for its use.

[110] A grant may only be used for capital expenditures necessary to provide PEG channels. The size of a grant may not exceed $25,000, and an applicant may receive no more than one grant per fiscal year. The applicant must match the grant on a dollar-for-dollar basis. The Authority must publish an annual report on the grants awarded from the Fund.

approximately $9,300 per quarter. The repeal of the PEG Grant Fund was effective July 1, 2010. The increase in Supplemental PEG Channel support is effective July 1, 2011.

Economic Incentives Alignment & Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-166	**SB 1215**	**Senator Jenkins**

AN ACT TO INCREASE UNIFORMITY IN SUNSET AND REPORTING REQUIREMENTS OF ECONOMIC INCENTIVES TOOLS AND TO ELIMINATE NONUTILIZED ECONOMIC INCENTIVES.

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, does the following:

- Harmonizes sunset and reporting features and requirements across the State's various economic incentives.
- Creates a single, unified economic incentives report that contains the information currently reported separately for each economic incentive.
- Deletes obsolete credits under Articles 3C and 3G of Chapter 105 of the General Statutes.

FISCAL IMPACT: Fiscal Research estimates no fiscal impact for fiscal year 2010-2011. For subsequent fiscal years, Fiscal Research estimates a fiscal impact of roughly $2.14 million. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

EFFECTIVE DATE: This act became effective July 1, 2010, and included effective date language that ensures that sales and use tax refund eligibility are not affected.

ANALYSIS: Under prior law, many of the economic incentives enacted as the Article 3 credits, the income tax credits in Article 4, and the sales and use tax benefits in Article 5 had some combination of reporting requirements[111] and sunset provisions; however, those requirements were not uniformly set out in each incentive. Where reporting requirements were set out, there were inconsistencies with respect to itemization by taxpayer,[112] itemization by credit,[113] the reporting entity,[114] and other miscellaneous differences.

[111] Currently, there is no reporting requirement for Article 3H or for sales and use tax refunds for analytical services, for railroad intermodal facilities, or for vehicle parts for motorsports racing teams.

[112] While itemization by taxpayer for economic incentives credits is generally required, it is not currently required by the reporting requirements of Articles 3B, 3D, or 3E.

[113] Both Articles 3B and 3J contain multiple credits. While Article 3J's reporting provisions require itemization by credit, Article 3C's reporting provisions do not.

[114] Generally speaking, the reporting entity is the Department of Revenue for each economic incentives report required; however, the reporting entity differs for Article 3C (in which Revenue and Commerce jointly report) and for the credit for utilizing State ports to export cigarettes while increasing employment (in which the corporation claiming the credit reports).

In addition, there were two economic incentives that were either never utilized or were no longer being utilized. The first was the credit in Article 3C for large recycling facilities, which was intended for Wisconsin Tissue; however, that company never located in North Carolina. The second credit was for major computer manufacturing facilities in Article 3G. Other than the Dell facility for which the credit was enacted, no other taxpayer utilized that credit.

Part I of the act requires data on each of the State's economic incentives to be reported in a single economic incentives report and establishes sunsets for various economic incentives, as provided in the chart below. Part II of the act eliminates obsolete economic incentives. Part III of the act makes conforming changes to various statutory provisions. The following table describes the changes in more detail by section number of the act:

Section Number(s)	Effect
1.2	Adds requirement of itemization by taxpayer and by credit to the Art. 3B (Business and Energy Tax Credits) report.
1.4, 1.6	Adds requirement of itemization by taxpayer to Arts. 3D (Historic Rehabilitation Tax Credits) and 3E (Low-Income Housing Tax Credits) report, respectively.
1.8	Creates reporting requirement for Art. 3H (Mill Rehabilitation Tax Credits).
1.13	Transfers reporting requirement for G.S. 105-130.46 (credit for exporting cigarettes and increasing employment) from the corporation claiming the credit to DOR and harmonizes reporting requirements.
1.17, 1.18, 1.19, 1.20	Separates and categorizes the current sales and use tax refunds, all of which are currently found in G.S. 105-164.14, into three types of refunds: (1) refunds that were enacted for non-industrial facilities for economic incentives purposes (found in the newly created G.S. 105-164.14A), (2) refunds that were enacted for industrial facilities for economic incentives purposes (found in the newly created G.S. 105-164.14B), and (3) refunds that were not enacted for economic incentives purposes (remaining in G.S. 105-164.14)[115].
1.21	Creates the economic incentives report.
1.1, 1.2, 1.3, 1.4, 1.6, 1.7, 1.9, 1.10, 1.11, 1.12, 1.13, 1.14, 1.15, 1.16	Makes conforming and technical changes to the reporting requirement necessary to transfer the current, separate reports into a new, unified annual report.
1.5, 1.18	Proposes sunsets for Art. 3D historic rehabilitation credit (2014), and for the sales and use tax refund for low-tier machinery (aligns sunset to Art. 3J), motorsports racing vehicle

[115] Session Laws 2010-31 and 2010-91 extended the repeal dates from 2011 to 2013 for interstate passenger air carriers and aviation fuel for motorsports events and added pulp-to-paper manufacturing and turbine manufacturing to the industries eligible for sales tax refunds, respectively. However, these changes were not incorporated into Session Law 2010-166. A technical correction will be included in the 2011 Revenue Laws Technical Changes bill to adjust the repeal dates.

	parts (2014), analytical services supplies (2013), and railroad intermodal facilities (2038).
2.1	Eliminates credit for large recycling facilities.
2.2	Repeals Art. 3G (Tax Incentives for Major Computer Manufacturing Facilities).
Part III	Makes conforming changes.

Renewable Energy Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-167	**HB 1829**	**Representative Luebke**

AN ACT TO PROMOTE THE USE OF RENEWABLE ENERGY BY EXTENDING THE CREDIT FOR CONSTRUCTING RENEWABLE FUEL FACILITIES AND THE CREDIT FOR BIODIESEL PRODUCERS, REVISING THE TAX CREDIT FOR INVESTING IN RENEWABLE ENERGY PROPERTY, REINSTATING AND EXPANDING THE TAX CREDIT FOR A RENEWABLE ENERGY PROPERTY FACILITY, CLARIFYING THE AUTHORITY OF LOCAL GOVERNMENTS TO FINANCE ENERGY PROGRAMS, CLARIFYING THAT REAL PROPERTY DONATED FOR A CONSERVATION PURPOSE CAN BE USED ONLY FOR THAT PURPOSE, AND TO DESIGNATE THE APPROPRIATE PERSON TO PROVIDE A WRITTEN ALLOCATION OF THE FEDERAL §179D TAX DEDUCTION FOR ENERGY EFFICIENT COMMERCIAL BUILDINGS OWNED BY A GOVERNMENTAL ENTITY.

OVERVIEW: This act, which embodies the energy incentive legislation enacted this session, does the following:

- Extends credits for constructing renewable fuel facilities and biodiesel producers.
- Modifies the credit for investing in renewable energy property by amending the definitions and adding combined heat and power property to the credit.
- Reinstates and expands the credit for a renewable energy property facility.
- Clarifies the local government authority to finance energy programs.
- Clarifies that real property donated for conservation purposes may only be used for those purposes.

- Clarifies who is responsible for making the allocation of the federal §179D tax deduction.

<u>FISCAL IMPACT:</u> The act will reduce General Fund revenues by $0.7 million in fiscal year 2010-2011 and $1.3 million in fiscal year 2011-2012. *(For a more complete fiscal analysis, see NC 2010 Legislative Session Budget and Fiscal Policy Highlights. Available online:* http://www.ncleg.net/fiscalresearch/highlights/highlights_pdfs/2010_Session_Highlights.pdf*)*

<u>EFFECTIVE DATE:</u> Except as otherwise noted, this act became effective when the Governor signed it into law on August 2, 2010.

<u>ANALYSIS:</u>

<u>Extension of Credit for Constructing Renewable Fuel Facilities and Credit for Biodiesel Producers</u>. – The General Assembly enacted a credit for constructing renewable fuel facilities in 2004.[116] The credit includes a 15% credit for the costs of constructing a facility for dispensing renewable fuel and a 25% credit for the costs of constructing a facility for producing renewable fuel. In 2006, the sunset was extended until January 1, 2011, and an enhanced credit was created for taxpayers that invest at least $400 million in three separate facilities over a five-year period.[117]

The General Assembly enacted a tax credit for certain biodiesel providers in 2006.[118] In order to qualify for the credit, the provider must be a producer of biodiesel (as opposed to an importer) that produces at least 100,000 gallons of biodiesel during the taxable year. The amount of the credit is equal to the per gallon excise tax paid by the producer on the biodiesel. The credit is repealed for taxable years beginning on or after January 1, 2010.

Section 1 of the act extends the sunset for both credits. Each credit is repealed for taxable years beginning on or after January 1, 2013.

<u>Changes to Credit for Investing in Renewable Energy Property.</u> – Under current law, the credit for investing in renewable energy property applies to biomass equipment, hydroelectric generators, solar energy equipment, wind equipment, and geothermal heat pumps and equipment. The amount of the credit for investing in renewable energy property is 35% of the cost of the property placed in service. In the case of renewable energy property that services a single-family dwelling, the credit must be taken for the taxable year in which the property is placed in service. For all other renewable energy property, the credit must be taken in five equal installments, beginning with the taxable year in which the property is placed in service. The amount of the credit is subject to certain limits depending on the type of property and whether the property is placed in service in a residential or nonresidential setting. The credit will sunset on January 1, 2016.

Section 2 of the act makes the following changes to the credit for investing in renewable energy property:

- Amends the definition of "cost" to follow the federal definition under the Internal Revenue Code. Prior to the act, the cost of leased property was determined by multiplying the annual rent by eight.[119] This definition is the same one that is used under the Bill Lee Act and Article 3J. In some instances, a developer will structure a

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116 S.L. 2004-153.

117 S.L. 2006-66, Section 24.7.

118 S.L. 2006-66, Section 24.8.

119 G.S. 105-130.4(j)(2).

project in such a way as to elect for federal purposes to pass through the federal tax credit to an affiliated entity that is leasing the equipment. In these instances, the actual cost of the renewable energy property and installation can be greater than the amount derived by multiplying the annual rent by eight. This change to the definition will allow a person who elects to pass through the federal credit to use the actual cost of the property when calculating the tax credit.

- Creates a definition for the term "installation" that is consistent with the interpretation of the term by the Department of Revenue in private letter rulings. The tax credit is limited to $2.5 million per nonresidential installation. Because the term "installation" was not defined, investors routinely sought rulings from the Department of Revenue for clarification of this term and its application to particular projects. The Department had defined installation as "renewable energy property that standing alone or in combination with other machinery, equipment, or real property is able to produce usable renewable energy on its own."
- Adds combined heat and power equipment to the types of property that is eligible for the credit. Combined heat and power equipment produces heat and electricity simultaneously. The paper and pulp industry is the primary State industry that uses combined heat and power equipment.
- Amends the definition of wind turbine to include equipment used in relaying the electricity produced by a wind turbine by cable to the power grid.
- Makes other technical and conforming changes to the statute.

This section of the act is effective for taxable years beginning on or after January 1, 2010.

Reinstate and Expand Credit for Renewable Energy Property Facility. – Prior to 2006, a corporation that constructed a facility in North Carolina for the manufacture of renewable energy equipment such as solar energy and wind equipment could receive a corporate income tax credit for the costs of constructing the facility.[120] The credit was equal to 25% of the installation and equipment costs of construction paid during the taxable year. This credit, which was never used, was repealed for costs incurred during taxable years beginning on or after January 1, 2006. Renewable energy equipment was defined as biomass equipment, hydroelectric generators, solar energy equipment, and wind equipment.

Section 3 of the act reinstates and expands the credit for a renewable energy property facility. The credit is also expanded to include a facility for the manufacture of major component subassembly for a solar array or a wind turbine facility. The credit is equal to 25% of the cost to the taxpayer of converting a facility, or 25% of the costs to the taxpayer of constructing and equipping the facility. Renewable energy property includes biomass equipment, combined heat and power equipment[121] hydroelectric generators, geothermal equipment, solar energy equipment, and wind equipment. The credit may be taken against the franchise tax or the income tax. The entire credit must be taken in five equal installments, beginning with the taxable year the facility is placed in service. If the facility is disposed of, or taken out

[120] This credit is distinguished from the credit in Section 2 of this act in that this credit is for constructing a facility that manufactures renewable energy equipment or property as opposed to a credit for the placement into service of such equipment or property once manufactured.
[121] Combined heat and power equipment is added under the changes in Section 2 of this act.

of service, the taxpayer may not take any remaining installments. The credit is subject to the following limitations:

- The 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 with respect to the construction of a facility to manufacture renewable energy property may not take this credit with respect to the same facility.

This section is effective for taxable years beginning on or after January 1, 2010, and sunsets for facilities placed in service on or after January 1, 2014.

Clarify Local Government Authority to Finance Energy Programs. – In 2009, the General Assembly authorized 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.[122] North Carolina cities and counties were eligible to obtain federal grant funds under the *American Recovery and Reinvestment Act of 2009* (ARRA), during the 2009-2011 biennium to finance certain energy-related programs. The Energy Efficiency Conservation Block Grants Program (EECBG) sought to assist eligible entities to reduce fossil fuel emissions, to reduce total energy use, and to improve energy efficiency in transportation and buildings. Cities and counties may use EECBG funds and any other unrestricted funds for the program. The loans may be used for energy efficiency improvements and the installation of distributed renewable energy sources that are permanently affixed to commercial and residential real property. The term of the loans may not be greater than 15 years, and the annual interest rate charged on the loans may not exceed 8%. The term "renewable energy source" has the same meaning as "renewable energy resource" in G.S. 62-133.8.[123]

Section 4 of the act clarifies that cities and counties may establish loan loss reserve funds to finance energy improvements, and may establish other energy programs funded through federal grants. This section also clarifies that cities and counties may use State and federal grants and loans, and property taxes for the financing program.

Clarify Use of Real Property Donated for a Conservation Purpose. – The General Assembly first enacted the conservation income tax credit in 1983. The credit is allowed to a taxpayer that donates real property for public beach access or use, public access to public waters or trails, fish and wildlife conservation, or other similar land conservation purposes. To qualify for the credit, the land must be donated in perpetuity to and accepted by the State, a local government, or a body organized to receive and administer lands for conservation purposes and qualified to receive charitable contributions. The amount of the credit is 25% of the fair market value of the donated property interest, capped at $250,000 for individuals and $500,000 for corporations. This credit was taken by an individual after donating ocean front property in Currituck County to the Audubon Society, an organization whose mission is to conserve and restore natural ecosystems. The Audubon Society is currently seeking to sell

[122] S.L. 2009-522.

[123] That definition does not include peat, fossil fuel, or nuclear energy resources, but does include solar electric, solar thermal, wind, hydropower, geothermal, ocean current or wave energy resource, biomass resource, waste heat, and hydrogen derived from a renewable energy resource.

the donated property to a group that plans to turn the property into a development that will include a hotel, shops, and condominiums.

Section 5 of the act clarifies that donations of real property must be for a qualifying use listed in the statute, and the donation must be subject to a perpetual restriction on the use of property.

Allocation of Federal §179D Tax Deduction for Energy Efficient Commercial Buildings Owned by a Governmental Entity. – To encourage businesses to incorporate energy efficiency into their operational plans, Congress enacted the section 179D energy tax deduction as part of the Energy Policy Act of 2005. This deduction relates to the design and construction of energy-efficient commercial buildings. The deduction allows a taxpayer to take an immediate expense, subject to a cap, for the cost of energy-efficient improvements that would normally take years to recover through depreciation. To qualify, energy-efficient improvements must reduce total annual energy and power costs with respect to interior lighting systems and heating, cooling, ventilation, and hot water systems by 50%. The deduction is allowed for the taxable year the property is placed in service, and it expires for property placed in service after December 31, 2013.[124] North Carolina also allows this deduction.[125]

For energy-efficient commercial building property expenditures made by a public entity, the IRS issued guidance on March 12, 2008, that allows the deduction to be allocated to the person primarily responsible for designing the property in lieu of the public entity. Some believe the deduction is underutilized in North Carolina for energy efficient property placed in governmental buildings owned by the State because designers do not know how to obtain the governmental allocation. Section 6 of the act clarifies the Secretary of Administration is the person responsible for providing the written allocation to the designer for property owned by the State.

[124] The deduction was originally set to expire for property placed in service after December 31, 2007. Congress extended the sunset until December 31, 2013.

[125] North Carolina, as part of the IRC Update legislation of 2006, conformed to this federal tax law deduction. The State also conformed to the extension of the sunset when it enacted the IRC Update legislation in 2009.

Low-Profit Limited Liability Company.

Session Law	*Bill #*	*Sponsor*
S.L. 2010-187	**SB 308**	**Senator Jacumin**

AN ACT TO PROVIDE FOR THE FORMATION OF A LIMITED LIABILITY COMPANY AS A LOW-PROFIT LIMITED LIABILITY COMPANY.

OVERVIEW: This act recognizes a new type of corporate designation known as a low-profit limited liability company (L3C).

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on August 3, 2010.

ANALYSIS: Chapter 57C of the North Carolina General Statutes provides for the formation of a limited liability company (LLC). A low-profit limited liability company is a LLC that is formed for both a business purpose and a charitable purpose that requires operation of the company in accordance with these three requirements:

- To accomplish one or more charitable or educational purposes within the meaning of section 170(c)(2)(B) of the Code.
- To operate so that no significant purpose of the company is the production of income or the appreciation of property.
- To operate so that no purpose of the company is to accomplish one or more political or legislative purposes within the meaning of section 170(c)(2)(D) of the Code.

A LLC may choose to put these conditions on its operations by including them in its articles of organization and by operating in accordance with them. This act allows a company that meets these requirements to call itself a "low-profit limited liability company" and to use the designation "L3C."[126] Like a LLC, a L3C is subject to federal and State tax and investments in a L3C are not tax deductible.

The formation of a L3C is designed to facilitate program-related investments (PRI) by private foundations. Private foundations must distribute at least 5% of their capital for charitable purposes to maintain their nonprofit status. Although foundations often expend these funds through grants, they may also meet the expenditure requirement with IRS-sanctioned PRIs. A PRI is an investment that supports charitable activities but may involve the potential return of capital. An example of a PRI is a loan, a loan guarantee, and an equity investment in a charitable organization.

[126] Vermont became the first state to recognize the L3C as an official legal structure in April 2008, and Michigan become the second state in January 2009.

Foundations do not usually make PRIs without an IRS private letter ruling that the investment meets the IRS requirements as an acceptable PRI. The expense of obtaining a private letter ruling deters foundations from this form of investment. The founders of the L3C designation hope that the IRS or Congress will choose to treat an investment in a L3C as a PRI without the need for a private letter ruling because the three requirements to form as a L3C mirror the IRS requirements for a PRI. Neither the IRS nor Congress has evidenced any movement on this issue.

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