2011

FINANCE LAW CHANGES

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TC: Eligibility: Indus Facil/Fix Uwharrie Com.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-3	**SB 76**	**Sen. Hartsell, Rucho, Clary**

AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE INDUSTRIAL FACILITIES SALES TAX REFUND, A TECHNICAL CORRECTION TO THE MEMBERSHIP COUNT OF THE UWHARRIE COMMISSION, TO PROVIDE INTEREST ON OVERPAYMENT OF PROPERTY TAX, AND TO PROVIDE DELAY OF THE COLLECTION OF PROPERTY TAX PENDING APPEAL.

OVERVIEW: This act reenacts and amends the sales tax refunds for industrial facilities, provides for interest on overpayments of property tax, and delays the collection of property tax pending appeal. The remainder of this act does not affect North Carolina tax laws and is not discussed below.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The section related to the sales tax refunds for industrial facilities is effective July 1, 2010, and applies to sales on or after that date. The section relating to interest on overpayments of property tax is effective for taxable years beginning on or after January 1, 2011.

ANALYSIS: This act makes changes in two unrelated areas. Section 1 of the act deals with the sales tax refund for industrial facilities. Section 3 of the act deals with property tax overpayments and appeals.

Sales Tax Refund for Industrial Facilities. – In 2010, the General Assembly expanded the list of industries allowed an annual sales and use tax refund to include paper-from-pulp manufacturing[1] and turbine manufacturing[2] as part of the Keeping NC Competitive Act.[3] The change was intended to become effective July 1, 2010, and apply to sales made on or after that date. During the same session, another act made technical changes to the sales and use tax refunds generally, but inadvertently failed to include

[1] This incentive coincided with the announcement by Clearwater Paper Corporation that it would build a new tissue paper plant in Shelby, NC. The plant opened in June of 2011. According to a press release, the company has hired 100 local employees and plans to hire 150 more before the project is complete. When completed, the facility is expected to produce 10 million cases of bathroom tissue and paper towels annually.

[2] In March 2010, Siemens Energy announced plans to expand its Charlotte manufacturing plant for turbines and generators, investing over $100 million and creating over 800 jobs.

[3] Section 4 of S.L. 2010-91.

the newly enacted refunds.[4] Statutory construction provides that when the General Assembly enacts two bills that amend the same existing general statute, the bill enacted last controls. Therefore, the refunds enacted in the Keeping NC Competitive Act (S.L. 2010-91) were, in effect, removed by S.L. 2010-166.

This act reenacts the sales tax refunds for paper-from-pulp manufacturing and turbine manufacturing enacted in S.L. 2010-91. It also makes the following changes to the refunds for industrial facilities:

- Amends the definition of "owner" to include lessees under a capital lease.
- Deletes the defined term "strategic partner." This term was used only in the refund for computer manufacturing facility, which has been repealed.
- Removes additional reference to computer manufacturing facilities.
- Clarifies the minimum investment requirement for the refunds can be met by funds invested directly or indirectly through a related entity.

Property Tax Overpayments and Appeals. – Section 3 of this act provides interest on overpayments and suspension of the enforcement proceedings for property valuations that have been appealed to the county boards of equalization and review.

Individuals may appeal property tax valuations to the county board of equalization and review. The State Property Tax Commission hears appeals from the local boards of equalization and review. If the Property Tax Commission reduces the value of the property, or removes the property from taxation, the taxpayer receives interest on any overpayment of taxes. The tax collector may not enforce collection of the tax while the appeal to the Property Tax Commission is pending, but interest will accrue if the taxes are not timely paid. Under prior law, there were not corresponding provisions for appeals pending at county boards of equalization and review. Section 3 establishes similar provisions at the county level. If the county board of equalization and review reduces the value of the property, or removes the property from taxation, the taxpayer receives interest on any overpayment of taxes. The interest for overpayments is the same as the interest charged for delinquent taxes. The tax collector may not enforce collection of the taxes while the appeal to the board is pending, but interest will accrue if the tax is not timely paid.

[4] S.L. 2010-166.

Clarify Refunds of Tax Overpayments.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-4	**SB 97**	**Sen. Rucho, Hartsell, Daniel**

AN ACT TO CLARIFY WHEN THE DEPARTMENT OF REVENUE IS REQUIRED TO INITIATE A REFUND OF AN OVERPAYMENT OF TAX AND TO AUTHORIZE THE ISSUANCE OF REFUNDS OF OVERPAYMENTS THAT HAVE BEEN IDENTIFIED BY THE DEPARTMENT CONSISTENT WITH THIS CLARIFICATION.

OVERVIEW: This act clarifies when the Department of Revenue is required to initiate a refund of an overpayment of tax and directs the Department to issue refunds for overpayments that have been discovered within the statute of limitations consistent with this clarification.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 9, 2011.

ANALYSIS: Prior to the effective date of this act, the law provided two methods for obtaining a refund of tax from the Department of Revenue. If a taxpayer was aware that he or she had made an overpayment, then the taxpayer could request a refund by filing an amended return or by filing a claim for refund. If a taxpayer was not aware of an overpayment, the Department was required to initiate the refund process if, within the statute of limitations period, it became aware of or "found" the overpayment. Specifically, the Department was required to initiate a refund of an overpayment of tax when the Department processed a return and found all of the following:

1. The statute of limitations[5] for obtaining a refund has not expired.
2. The amount shown due on the return is not correct.
3. The correction of the amount due shows that the taxpayer has overpaid the tax.

Prior law did not specify what constitutes "finding" or discovering an overpayment for purposes of satisfying the statute of limitations. In other words, it did not identify what action must take place by the Department before the statute of limitations expires.

[5] The general statute of limitations for obtaining a refund is the later of three years after the due date of the return or two years after the payment of tax.

During 2009 and 2010, the Department was engaged in working through a backlog of returns that were flagged for review by the Department's computer system, some dating as far back as 1996. By December of 2010, the vast majority of returns had been reviewed and many refunds were issued. However, at the beginning of 2011, approximately 7,000 returns remained in which an overpayment was made but a refund was not issued because the Department believed it needed clarification from the General Assembly about the application of the then existing law. Those overpayments totaled a little over $2 million plus interest.

The Revenue Laws Study Committee examined the issue during the interim following the conclusion of the 2010 Regular Session. The Committee heard differing opinions about the interpretation of the law and its application to overpayments. The Secretary of Revenue testified that the Department had been advised by the Attorney General's office that the existing law required the Department to issue a refund of an overpayment only if the overpayment was verified by a Departmental employee within the statute of limitations period. Under this interpretation, a taxpayer's receipt of a refund is dependent on the Department's ability to timely review the return, which can vary depending on its workload and resources.

An alternative interpretation of the then existing law was that the Department is required to issue a refund of an overpayment if the return is flagged by the Department's computer system within the statute of limitations. The Department may need to verify the existence of an overpayment by manual review of a flagged return, but the manual review need not occur within the statute of limitations. Because returns are processed by the computer system almost immediately after they are filed, this interpretation assures that taxpayers will eventually get a refund if an overpayment was made.

Despite a finding by the Revenue Laws Study Committee that the existing law could reasonably be interpreted to authorize the Department to release the remaining 7,000 refunds because, although they had not been manually reviewed within the statute of limitations, they had been flagged by the Department's computer system within the statute of limitations thereby putting the Department on notice, the Department sought clarifying legislation.

The act clarifies when the discovery of an overpayment occurs, triggering the Department of Revenue's obligation to issue a refund. Under the act, discovery occurs in any of the following circumstances:

1. When the automated processing of a return indicates the return requires further review.
2. When a review of a return by an employee indicates an overpayment.
3. When an audit of a taxpayer by an employee indicates an overpayment.

If the Department's computer system flags a return for further review, the Department must verify that an overpayment exists before issuing a refund because the automated flagging does not always indicate the precise nature of an error on a return. However, this act clarifies that the verification need not occur within the statute of limitations period. The flagging of the return is sufficient to put the Department on notice that a refund may be due for purposes of satisfying the statute of limitations.

The act also directed the Department to issue refunds of overpayments that have been discovered within the statute of limitations in a manner consistent with the clarification set out by the act. After passage of this act, the refunds were issued in April of 2011 with 5% interest.

IRC Update.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-5, as amended by S.L. 2011-330	**HB 124**	**Rep. Howard, Brubaker, Starnes, Setzer**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE

OVERVIEW: This act updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2010, to January 1, 2011. The act incorporates many, but not all, of the tax provisions contained in the federal Small Business Jobs Act of 2010 and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010.

- It conforms to the Code by extending for an additional two years various individual and business tax deductions that expired in 2010, such as the tax deduction for higher education expenses and the $250 tax deduction for teacher's classroom supplies.
- It decouples from the bonus depreciation provision, but maintains the same basis in the property for federal and State tax purposes, by requiring an 85% addback of any accelerated depreciation a taxpayer claimed on the federal return for taxable years 2010[6] through 2012 and a corresponding deduction of 20% of this amount over the next five tax years.
- It conforms to some of the section 179 changes, and decouples from others. It maintains the current section 179 expense deduction limit and cap through 2011 and conforms to the federal section 179 expense deduction limit and cap

[6] The effective date of the federal 100% bonus depreciation provision applied to property placed in service after September 8, 2010, *in taxable years ending after such date.* This effective date means the bonus depreciation provision may be taken in the 2009 taxable year if a taxpayer had a taxable year ending after September 8, 2010, and before December 31, 2010. Therefore, the bill would provide that the adjustments needed to decouple from this provision may be reflected on a taxpayer's 2009 tax year return.

for 2012. It conforms to the expanded definition of qualifying property for taxable years 2010 and 2011. It decouples from the additional section 179 expense deduction by requiring an 85% addback of the additional expensing taken under federal law and providing a corresponding deduction of 20% of this amount over the next five tax years.

FISCAL IMPACT: With the exception of the estate tax, the act's impact on General Fund availability is minimal. Conformity to the higher estate tax exclusion amount of $5 million, and effectively $10 million for married couples, will reduce General Fund revenues by $59 million in Fiscal Year 2011-12 and by $79 million in Fiscal Year 2012-13. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 17, 2011.[7] Several of the tax provisions contained in the federal acts became effective retroactively. Article I, Sec. 16 of the North Carolina Constitution prevents North Carolina from enacting a law that retroactively increases a person's tax liability. Therefore, any amendments to the Internal Revenue Code enacted after May 1, 2010 that increase North Carolina taxable income for the 2010 taxable year or impose an estate tax on the estate of a decedent dying in calendar year 2010 become effective for taxable years beginning on or after January 1, 2011.

ANALYSIS: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[8] The General Assembly determines each year whether to update its reference to the Code.[9] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made. Maintaining conformity with federal tax law simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset.

[7] S.L. 2011-330, Section 11, clarified that the act applies to the estates of decedents dying on or after January 1, 2011. The Department of Revenue requested the clarifying change so there would be no confusion as to the applicable exclusion amount for the estates of decedents dying on or after January 1, 2011, and before March 17, 2011.

[8] 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.

[9] 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."

This act updates the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2010, to January 1, 2011. The act incorporates many, but not all, of the tax provisions contained in the Small Business Jobs Act of 2010, enacted September 27, 2010, as P. L. 111-240 (2010 Jobs Act), and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act, enacted December 17, 2010, as P. L. 111-312 (2010 Tax Relief Act).

The 2010 Jobs Act enhances existing business tax incentives and partially offsets this revenue loss with changes that are expected to increase revenue. The incentives in the 2010 Jobs Act are not limited to small businesses, and the accelerated deduction for depreciation represents a major benefit to large businesses. The 2010 Tax Relief Act boosts some of the business tax incentives in the 2010 Jobs Act and extends for two years the Bush-era individual and business tax incentives, included in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)[10]

Extension and Expansion of Bonus Depreciation for 2010, 2011, and 2012. – Businesses may depreciate the cost of a new asset[11] over a period of time, usually five to 15 years. Bonus depreciation allows a business to claim more of a deduction up front and spread the remaining deduction amount over the normal depreciation schedule. The federal Economic Stimulus Act of 2008[12] provided a 50% first-year bonus depreciation for qualified property acquired and placed in service in 2008. The federal American Recovery and Reinvestment Act of 2009 extended the 50% bonus depreciation provided to qualified property for an additional year through 2009.

The 2010 Jobs Act extended retroactively the bonus depreciation for 2010 to property acquired and placed in service in 2010.[13] The 2010 Tax Relief Act increased the 50% bonus depreciation extended under the 2010 Jobs Act to 100% for property acquired and placed in service after September 8, 2010, and before January 1, 2012. It also provided 50% bonus depreciation for qualified property placed in service after December 31, 2012, and before January 1, 2013. Under the 2010 Jobs Act, the bonus depreciation would have expired for the 2012 taxable year. Under the 2010 Tax Relief Act, the bonus deprecation expires for the 2013 taxable year.

[10] Most of the tax provisions in EGTRRA were scheduled to expire in 2010 or 2011 and revert to the provisions as they existed in 2001.

[11] One important difference between bonus depreciation and section 179 expensing is that bonus depreciation applies only to new equipment, while section 179 expensing may apply to new and used equipment.

[12] Congress has authorized bonus depreciation several times to encourage business investment, specifically after September 11, 2001. The Jobs Creation and Worker Assistance Act of 2002 provided a 30% bonus depreciation allowance. The Jobs and Growth Tax Relief Reconciliation Act of 2003 extended the sunset and increased the amount to 50%.

[13] The property may be placed in service during 2011 for property with a recovery period of 10 years or longer and for transportation property (i.e., tangible personal property used to transport people or property).

This act decouples from the bonus depreciation provisions for 2010, 2011, and 2012[14] in the same manner as it has decoupled from them in 2008 and 2009: a taxpayer may deduct the same amount of an asset's basis under State law as under federal law, it is just that the timing of the deduction differs. Under State tax law, a taxpayer must add back 85% of the accelerated depreciation amount[15] in the year that it is claimed for federal purposes. Then, in subsequent tax years, the taxpayer may deduct from federal taxable income the total amount of the add-back, divided into five equal installments. This adjustment means that for State tax purposes, a taxpayer may deduct a greater depreciation amount in the outlying tax years, which will be the normal depreciation amount plus 20% of the accelerated depreciation amount the taxpayer had to add back.

Under the 2010 Tax Relief Act, the 100% bonus depreciation applied to property placed in service after September 8, 2010, *in taxable years ending after such date.* This effective date means the bonus depreciation provision may be taken in the 2009 taxable year if a taxpayer had a taxable year ending after September 8, 2010, and before December 31, 2010. Therefore, the act provides that the adjustments needed to decouple from this provision may be reflected on a taxpayer's 2009 tax year return.

Enhanced Section 179 Expensing for 2010, 2011, and 2012. – Section 179 of the Code allows the expensing of the purchase price of some business assets[16] in the year of purchase rather than taking depreciation[17] throughout the life of the asset. In other words, expensing trades a smaller yearly deduction over time for a larger deduction in year one. Section 179 is commonly thought to apply to small businesses because of its maximum deduction and investment limits. Prior to the Emergency Economic Stabilization Act of 2008 (EESA), the deduction limit for section 179 expensing was $128,000[18] of the cost of the property with a dollar-for-dollar phaseout of this amount whenever the total cost of qualifying property placed in service that year exceeded $510,000.[19] EESA increased the deduction limit from $128,000 to $250,000 with a phaseout at $800,000 for the 2008 tax year. The American Recovery and Reinvestment Tax Act of 2009 (ARRTA) extended the temporary increase through 2009. The federal Hiring Incentives to Restore Employment Act of 2010 extended the 2008 and 2009

[14] The cost to conform to the bonus depreciation provision would have been approximately $460 million. As of February 16, 2011, it appears 15 of 43 states conformed to this provision in some form while the remaining 28 states did not.

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

[16] 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. The newly purchased property may be new or used equipment.

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

[18] Prior to the EESA, the dollar limits would have been $125,000 with a phase-out beginning at $500,000; both amounts would have been indexed for inflation resulting in the limits of $128,000 and $510,000.

[19] For example, if the taxpayer placed in service during the taxable year one or more items of qualifying property totaling $520,000, the amount that could be expensed under section 179 would be $118,000 -- $128,000 less $10,000, which is the excess of $520,000 over $510,000.

increase through 2010. The limits were scheduled to revert to the prior levels of $25,000 and $200,000 in taxable year 2011.[20]

The 2010 Jobs Act not only delayed the reversion to the prior levels until the 2012 taxable year, it also increased the section 179 expensing deduction for tax years 2010 and 2011 from $250,000 and $500,000 to $800,000 and $2 million. The enhancements made by the 2010 Jobs Act are the most expansive ever enacted. The 'small business' label associated with the section 179 deduction does not reflect the true scope of the deduction as enhanced by the 2010 Jobs Act since it currently impacts businesses of many sizes. In addition to the expansion of the limits, the 2010 Jobs Act broadened the definition of qualified property to include qualified leasehold improvement property, qualified restaurant property, qualified retail improvement property, and computer software.[21] The enhancements made by the 2010 Jobs Act are set to expire for the 2012 taxable year.

The 2010 Tax Relief Act does not continue the expansion of the types of property that may qualify for the deduction beyond the 2011 taxable year, but it does increase the limits for the 2012 taxable year from $25,000 and $200,000 to $125,000 and $500,000. Under the 2010 Tax Relief Act, the deduction limits are set to revert to their prior levels of $25,000 and $200,000 in 2013.

This act conforms to the expanded definition of qualified property; but it maintains the 2010 deduction limits of $250,000 and $800,000 for taxable years 2010 and 2011; and it decouples from the enhanced limits of $500,000 and $2,000,000 for taxable years 2010 and 2011.[22] The act provides that the property's basis remains the same for federal and State purposes by treating the difference in the same manner as State tax law has historically treated the bonus depreciation: A taxpayer must addback 85% of the additional expensing taken under federal law in 2010 and 2011 and deduct 20% of this amount over the succeeding five years. The act conforms to the expensing limits of $125,000 and $500,000 for the taxable year 2012 and, like federal law, reverts to the prior expense limits of $25,000 and $200,000 for the taxable year 2013.

Estate Tax for 2010 - 2012. – EGTRRA gradually reduced the federal estate tax over a period of years and abolished it for decedents dying in 2010. During the year of its repeal, the basis of property passing through an estate was determined by the modified carryover basis rules under EGTRRA. EGTRRA also repealed the state estate tax credit for decedents dying on or after 2004 and replaced the credit with a deduction. The estate tax was scheduled to revert to the 2001 law in 2011: the 2001 maximum estate tax rate of 55% and a $1 million applicable exclusion amount.

The 2010 Tax Relief Act revived the estate tax retroactively for decedents dying on or after January 1, 2010; the revival of the estate tax allowed property passing through the

[20] North Carolina conformed to these changes.

[21] Qualified real property is limited to a maximum deduction of $250,000.

[22] Full conformity to the section 179 expense deduction would have reduced General Fund revenue by approximately $97 million. As of February 16, 2011, it appears 24 of 43 states conformed to this provision in some form while the remaining 19 states did not.

estate to acquire a stepped-up basis. The maximum federal estate tax rate is 35% with an applicable exclusion amount of $5 million. The 2010 Tax Relief Act also provided for portability between spouses of the exclusion amount. This portability means that any unused exclusion amount by one spouse is available to the surviving spouse, effectively allowing a married couple to exclude up to $10 million from estate tax.[23] The new estate tax law is scheduled to sunset on December 31, 2012, to the pre-EGTRRA amounts. The 2010 Tax Relief Act gives the estates of decedents dying in 2010 the option to pay no estate tax and assume the modified carryover basis in the property.

North Carolina imposes an estate tax on the estate of a decedent when a federal estate tax is imposed on the estate.[24] By virtue of this language, the federal and state exclusion amounts are the same. The amount of the State's estate tax is the amount of the credit allowed on the federal estate tax return for state estate tax paid, as the federal law provided in 2001.[25]

Since the federal estate tax did not exist in 2010, North Carolina's estate tax was repealed for 2010. With the revival of the federal estate tax in 2011, North Carolina's estate tax is revived for the estates of decedents dying on or after January 1, 2011.[26] Unlike Congress, North Carolina cannot tax retroactively[27] the estates of decedents dying on or after January 1, 2010, and before January 1, 2011. However, by conforming to the definition of federal taxable income for income tax purposes, the basis of any property passing through an estate has the same basis for both federal and State tax purposes.

Business Tax Extenders for 2010 and 2011. – The 2010 Tax Relief Act extended many of the tax incentives enacted in EGTRRA for two years. The business tax incentives included enhanced deduction and expensing items, charitable deductions, and tax credits. North Carolina conformed to these incentives in 2002[28] this act conforms to these extensions.

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[23] The portability election is set to sunset December 31, 2012. Therefore the utility of the portability election is limited to situations where both spouses die within the two-year term (2011 and 2012).

[24] North Carolina repealed its inheritance tax in 1998 and replaced it with an estate tax that was equivalent to the federal state estate tax credit allowed on a federal estate tax return. This type of state estate tax was known as a "pick up" tax because it picked up for the state the amount of federal estate tax that would otherwise be paid to the federal government.

[25] When Congress phased out the state estate tax credit, beginning in 2002, North Carolina enacted legislation not to conform to the phaseout of the credit. In other words, North Carolina began tying the amount of the State estate tax owed to the federal credit as it existed in 2001 rather than as it currently exists. Georgia, South Carolina, and Tennessee have not had an estate tax since January 1, 2005, because their estate tax equals the amount of the state estate tax credit allowed on the federal estate tax return. Virginia repealed its estate tax, effective July 1, 2007.

[26] North Carolina's estate tax would have been revised in 2011 based upon the Code as written on May 1, 2010.

[27] Article I, Sec. 16 of the North Carolina Constitution.

[28] S.L. 2002-126.

The 2010 Tax Relief Act extended the following business tax incentives that were set to expire for the 2010 taxable year for the 2010 and 2011 taxable years:

- 15-year recovery period for qualified leasehold improvements, restaurant building and improvements, and retail improvements.
- Seven-year recovery period for motor sports entertainment costs recovery.
- Expensing election for certain film and television production costs.
- Brownfields remediation expensing.

The 2010 Tax Relief Act extended the Work Opportunity Tax Credit (WOTC) to include individuals who begin employment after August 31, 2011, and before January 1, 2012. The WOTC is equal to 40% of up to $6,000 of the targeted employee's qualified first-year wages. North Carolina's WOTC is equal to 6% of the federal WOTC for wages paid for positions located in this State. The federal WOTC was scheduled to expire September 1, 2011.

The 2010 Tax Relief Act extended the following charitable incentives for taxable years 2010 and 2011:

- Deduction for contributions of food inventory.
- Deduction for contributions by C corporations of books to public schools.
- Deduction for corporate contributions of computer equipment for educational purposes.
- Basis adjustment to stock of S corporations making charitable contributions of property.

Individual Income Tax Extenders for 2010, 2011, and 2012. – The 2010 Tax Relief Act extended many of the Bush-era individual tax incentives included in the EGTRRA for two years. Some of the tax incentives expired in 2010 and others were scheduled to expire in 2011. North Carolina conformed to these incentives in 2002[29] this act conforms to these extensions.

The following three individual income tax incentives were scheduled to expire in 2010, but the 2010 Tax Relief Act extended them retroactively for the 2010 tax year and the 2011 tax year:

- Tax deduction for higher education tuition expenses
- Up to $250 deduction for teacher's classroom expenses
- Charitable contribution of IRA proceeds

The following individual income tax incentives were scheduled to expire in 2011, but 2010 Tax Relief Act extended the incentives for the 2011 and 2012 taxable years:

[29] S.L. 2002-126.

- *No limitation on itemized deductions.* Section 68 of the Code, first added in 1990, established an overall limitation on itemized deductions. This limitation was gradually repealed starting in 2006, with the phase-out complete in taxable year 2010. The limitation was scheduled to revert in full in 2011. The 2010 Tax Relief Act extended the complete repeal of the limitation for 2011 and 2012.

- *Enhancements to the earned income tax credit (EITC).* The EITC is a refundable tax credit that varies depending on the number of the taxpayer's qualifying children. North Carolina's EITC is equal to 5% of the federal credit amount. EGTRRA increased the credit amount from 40% to 45% of a family's first $12,570 of earned income for families with three or more children and the beginning point of the phase-out range for married coupled filing a joint return by $1,880. The enhancements were set to expire for the 2011 taxable year. The 2010 Tax Relief Act extended the enhancements through the 2011 and 2012 taxable years.

- *Enhancements to the adoption tax credit.* EGTRRA increased the dollar limitation for the credit and the income exclusion for employer-paid expenses to $10,000, indexed for inflation. The Patient Protection and Affordable Care Act increased the credit and exclusion by another $1,000 for 2010 and 2011. The credit cap was scheduled to return to $5,000[30] for taxable years beginning on or after January 1, 2012. North Carolina's adoption tax credit is equal to 50% of the federal credit amount. The 2010 Tax Relief Act extended the enhancements made by EGTRRA for one year. Under the Act, the credit caps will revert to their prior levels in taxable year 2013.

- *Deductibility of mortgage insurance premiums.* Mortgage insurance premiums became deductible in 2007. The insurance must be in connection with home acquisition debt for a first or second home. The deduction is subject to phase-out based on a taxpayer's income. The deductibility of mortgage insurance premiums was set to expire for taxable year 2011. The 2010 Tax Relief Act extended the deduction for one more year, through taxable year 2011.

- *Educational assistance exclusion.* EGTRRA allowed employees to exclude up to $5,250 in employer-provided education assistance from income and employment taxes. The exclusion was set to expire for taxable year 2011. The 2010 Tax Relief Act extended the exclusion for taxable years 2011 and 2012.

- *Student loan interest deduction.* The student loan interest deduction is a deduction from gross income used to determine a taxpayer's adjusted gross income (AGI). The deduction is subject to a phase-out based on the taxpayer's AGI. EGTRRA eliminated the rule that the deduction only applies to payments made during the first 60 months that interest payments were required, and it increased significantly the phaseout amounts. These changes

[30]The limit is $6,000 for a special needs child.

were set to expire in 2011, but the 2010 Tax Relief Act extended the changes for taxable years 2011 and 2012.

- *Coverdale education savings accounts.* Coverdale education savings accounts allow a taxpayer to make nondeductible contributions and to withdraw the proceeds tax-free if they are used towards educational expenses. EGTRRA increased the amount that may be contributed to an account from $500 to $2,000, and it made elementary and secondary school expenses qualified expenses. The enhancements were set to expire for the 2011 taxable year. The 2010 Tax Relief Act extended the enhancements for taxable years 2011 and 2012.

- *Qualified scholarships.* Qualified scholarships may be excluded from taxable income. EGTRRA provided that the national Health Services Corps Scholarship Program and the Armed Forces Scholarship Program are qualified scholarships for exclusion for income purposes. These scholarships were scheduled to be included in a recipient's income in taxable year 2011. The 2010 Tax Relief Act extended the income exclusion for taxable years 2011 and 2012.

Miscellaneous Business Incentives. -- The 2010 Jobs Act provided several tax incentives for businesses. This act conforms to those incentives.

- *Increase in amount allowed as a deduction for start-up expenditures*. The Code allows up to $5,000 of start-up expenses to be deducted. The deduction is reduced by the amount of start-up costs that exceed $50,000. The 2010 Jobs Act increased the deduction to $10,000 for start-up and organization expenses of the taxpayer's trade or business in 2011 and increased the phase-out threshold to $60,000.

- *Modification to exclusion for gain from certain small business stock.* Fifty percent of the gain realized on qualified small business stock may be excluded from income. To qualify, the stock must be purchased at its original issue and the aggregate gross assets of the issuing corporation may not exceed $50 million and at least 80% of the value of its assets must be used in the active conduct of one or more trades or businesses. The exclusion is capped at the greater of 10 times the taxpayer's basis in the stock or $10 million. ARRTA temporarily increased from 50% to 75% the exclusion for qualified small business stock sold by an individual. The increased exclusion percentage is applicable to stock acquired after February 17, 2009, and before January 1, 2011. North Carolina conformed to ARRTA's temporary increase of the exclusion. The 2010 Jobs Act increased the exclusion percentage to 100% for stock acquired after September 27, 2010, and before January 1, 2011.

Provisions in the 2010 Jobs Act Designed to Increase Revenue. – The 2010 Jobs Act contained provisions to increase revenues. The provisions projected to raise the most revenue were related to higher federal tax penalty provisions. These provisions would not apply to North Carolina and would not increase any revenues payable to North

Carolina. The Act also contained some retirement-friendly provisions that, if chosen by the taxpayer, would encourage up-front distributions that would be taxable. This act conforms to these changes.

- *Deduction for health insurance costs in computing self-employment taxes.* The 2010 Jobs Act allows self-employed individuals to deduct the cost of health insurance for the individual and immediate family to determine income subject to federal self-employment taxes. Health insurance costs were already deductible for regular income tax purposes. The reduction in self-employment taxes affects North Carolina taxable income because self-employment taxes were deductible in determining State taxable income. Self-employed taxpayers with health insurance costs will have larger State taxable incomes because less self-employment taxes were imposed and deducted at the federal level.
- *Allow participants in governmental 457 plans to treat elective deferrals as Roth contributions*. The 2010 Jobs Act gives participants the option to move retirement savings from government 457(b) plans to Roth accounts starting in 2011. The conversion will be taxable while the earnings and distributions from Roth accounts are generally tax-free.
- *Allow rollovers from elective deferral plans to Roth designated accounts.* The 2010 Jobs Act allows retirement plans to offer participants the option starting September 27, 2010 to rollover distributions into Roth accounts within the same retirement plan. The rollover will be taxable while the earnings and distributions from the Roth account are generally tax-free.
- *Permit partial annuitization of a nonqualified annuity contract.* The 2010 Jobs Act allows the owner of an annuity contract to begin receiving benefits based on a portion of the value of the annuity and leaving the balance of the annuity to accumulate earnings tax free. This option starts in 2011.
- *Source rules for income on guarantees.* The 2010 Jobs Act clarifies the federal tax treatment of guarantee fees as income sourced to the United States if connected to the United States by a domestic payer or by the conduct of a trade or business in the United States.

Business Entity Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-9	**HB 123**	**Rep. Howard, Brubaker, Luebke, Hill**

AN ACT TO REVISE THE BUSINESS ENTITY OWNERSHIP REQUIREMENTS OF LAND AT PRESENT-USE VALUE.

OVERVIEW: This act makes changes to the business entity ownership requirements for qualification of land at its present-use value for property tax purposes, so that the requirements are met when the current owner of the land shares members in common with the prior owner of the land. This act was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: This act has no General Fund impact.

EFFECTIVE DATE: This act becomes effective for taxable years beginning on or after July 1, 2011. However, applications filed beyond the listing period (January 1-January 31) will be accepted up to and through September 1, 2011, so that an owner may benefit from the property tax relief during the July 1, 2011 tax year.

ANALYSIS: Since 1973, farmland[31] has been appraised and assessed at its present-use value (PUV) as opposed to fair market value for property tax purposes if the farmland meets certain ownership, size, and use requirements. Farmland owned by a business entity meets the ownership requirements if the land was owned by the business entity or one of its members for the four years immediately preceding January 1 of the year for which the benefit is claimed.

This act allows the business entity ownership requirements to be satisfied when the business entity that currently owns the farmland shares one or more members in common with the business entity that previously owned the farmland. For example, if one or more partners of the partnership that currently owns the farmland are the same partners of the partnership that previously owned the farmland, the ownership requirement is met.

This act was a recommendation of the Revenue Laws Study Committee, which examined this issue after several counties denied PUV status to farmland owned as described below based upon the language in G.S. 105-277.3(b1). In this example, the farmland was not owned by its current owner, ABC Partnership, for four years immediately preceding the application, nor was the land owned by a partner of ABC Partnership.

- Farmland owned by ABC Partnership for past four years applies for PUV status.

[31] Agricultural land, horticultural land, and forestland.

- The partners of ABC Partnership are Tom, Dick, and Harry.
- The previous owner of the farmland was XYZ Partnership.
- XYZ Partnership shares one or more partners in common with the current owner ABC Partnership.

Prior to 2008, the members of the business entity had to be individuals. In 2008, the Revenue Laws Study Committee proposed legislation to broaden the ownership requirements so that farmland could be owned by a business entity whose membership includes modern estate planning vehicles such as a family limited partnership, a family limited liability company, or a trust.[32] S.L. 2008-146 alleviated problems tax assessors were having with recognizing these types of ownership. Now, for example, if the farmland is owned by a business entity, the members of the business entity are no longer restricted to individuals but may include trusts and other business entities. The 2008 changes to the PUV statutes focused on problems the tax assessors were having with recognizing types of ownership. Ownership is determined on the basis of the name on the deed but does not always consider real parties in interest.

Reform UI Tax Structure/Expedite Analysis.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-10	**SB 99**	**Sen. Clary, Rucho, Hartsell**

AN ACT TO EXPEDITE THE ANALYSIS OF THE TAX STRUCTURE FOR UNEMPLOYMENT INSURANCE IN NORTH CAROLINA GIVEN THE SUBSTANTIAL NEGATIVE BALANCE IN THE STATE'S UNEMPLOYMENT INSURANCE TRUST FUND AND THE SUBSTANTIAL FEDERAL LOAN BALANCE OWED BY THE STATE FOR PAYMENT OF UNEMPLOYMENT INSURANCE BENEFITS.

OVERVIEW: This act authorizes the Department of Commerce to hire a consultant to analyze the State's unemployment insurance (UI) tax structure without adhering to the State's purchase and contract provisions.

FISCAL IMPACT: The act does not appropriate any funds to the Department of Commerce for the contract. The act states that the Department may seek and accept

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[32] When the membership of a business entity includes a business entity or trust, then the individual members of the business entity and the individual beneficiaries of the trust are deemed to be indirect members of the qualified business entity.

non-State funds, grants, and in-kind contributions to pay for the analysis as well as use funds available within the Employment Security Commission, including State and federal funds that may be used for this purpose. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 25, 2011.

ANALYSIS: The act directs the Department of Commerce to contract with a consultant to conduct a thorough analysis of the State's UI tax structure and it exempts the Department from purchase and contract requirements of Article 3C as they relate to this contract. The Department must provide periodic updates on the progress of the analysis and it must report the findings and recommendations of the analysis to the General Assembly within 45 days after the analysis is complete. The report must include recommendations on any tax structure changes and financial options the General Assembly may need to consider that addresses the servicing of the State's debt incurred to pay unemployment insurance benefits.

Article 3C of Chapter 143 directs the Department of Administration to ensure that consultant contracts be let to other agencies of the State if there is an agency that can reasonably perform the service, and if there is not an agency that can reasonably perform the consulting service, that a sufficient number of sources for the contract be solicited through competitive proposals. This act allows the Department of Commerce to use the contractor of its choice without soliciting competitive bids, and regardless of whether another State agency could reasonable perform the service. Through House and Senate Finance Committee discussions, members learned that South Carolina had undertaken a similar study prepared by *The Lucas Group,* a consultant in Boston, Massachusetts. The Department would not say who it would choose to conduct the study.[33]

The General Assembly made substantial changes in the State's UI tax structure in the 1990s.[34] There have been no legislative changes made to the rate structure since 1999. The current State UI tax rates range from 0% to 6.84%.[35] The standard beginning tax rate is 1.2%. The average UI tax rate for 2011 is 1.688%. The average UI tax rate for 2010 was 1.427%. The revenue generated from the tax is credited to the State's

[33] It would cost between $200,000 and $300,000 to contract with *The Lucas Group.*

[34] The General Assembly reduced the UT tax contribution rate in 1993, 1994, 1995, and 1996. The UI tax rate automatically adjusts downward whenever the UI Trust Fund balance reaches $800 million. The Trust Fund balance has not exceeded $800 million since 2001. The last positive Trust Fund balance was in 2008 at $414 million.

[35] All states' UI rate structures use a system of experience rating by which individual employers' contribution rates are varied on the basis of their experience with the risk of unemployment. An employer may qualify for the 0% tax rate if no unemployment insurance benefits have been paid to employees after five years.

Unemployment Trust Fund[36] to pay benefits to people who lost their job through no fault of their own

If the amount of revenue in the State's Unemployment Insurance Trust Fund is insufficient to make the necessary benefit payments to claimants, the federal government loans money to the State. The State received a loan from the federal government in February 2009. The current loan balance is $2.6 billion. Interest began accruing on the loan in January 2011. The first interest payment is due September 30, 2011.[37] The necessary funds are available in the State's reserve account to make this interest payment.

In addition to the State UI tax, employers pay a federal payroll tax. The federal payroll tax (FUTA) on employers is 6.2% on a taxable wage base of $7,000.[38] Employers in states that are in compliance with federal regulations receive a 5.4% credit on their FUTA. This tax credit percentage is reduced by 0.3% annually on states with a federal loan balance outstanding for two consecutive Januarys. January 2012 will mark the second consecutive January North Carolina has a federal loan balance outstanding. To avoid a 0.3% reduction in the FUTA credit, the entire balance of the loan must be paid by November 10, 2011.[39] The 0.3% increase would effectively increase employers FUTA from 0.08% to 1.1%; this increase equates to $21 per employee.[40]

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[36] Unemployment tax contributions are paid by employers on a quarterly basis and deposited into the State Unemployment Insurance Trust Fund. After deducting any refunds payable from the Fund, the money is deposited with the Secretary of the Treasury of the United States to the credit of this State's account in the Unemployment Trust Fund. Funds in the State's account earn interest that is also credited to the account. As money in the State's account is needed to pay benefits, it is transferred to the State and credited to the benefits account of the State's Unemployment Insurance Fund.

[37] President Obama's budget proposal includes waiving the interest payment due September 30, 2011. Congress has not acted on this provision as of August 1, 2011.

[38] The federal taxable wage base has not been increased since 1983. The taxable wage base in NC is $19,700. This amount is indexed annually. The taxable wage base in other states ranges from $7,000 to $37,300.

[39] President Obama's budget proposal includes suspending the FUTA tax increase. Congress has not acted on this issue as of August 1, 2011.

[40] The revenue collected from the FUTA rate increase would be applied to the State's principal balance or it would lessen the amount of funds the State needs to borrow if the State is still a borrowing State at that time.

Repeal Land Tansfer Tax.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-18	**HB 92**	**Rep. Howard, Starnes, Brawley, Jordan**

AN ACT TO REPEAL THE LAND TRANSFER TAX.

OVERVIEW: This act repeals the authority granted to counties in 2007 to levy, upon approval of voters in the county, a tax on the sale of real property at the rate of up to 0.4% of the value of the property.

FISCAL IMPACT: This act has no fiscal impact because none of the counties implemented the levy.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on March 31, 2011.

ANALYSIS: This act repeals the County Land Transfer Tax Act, which authorized counties to levy, with voter approval, a tax on the transfer of real property at the rate of up to 0.4% of the consideration or the value of the property interest, whichever is greater.

In 2007, legislation was enacted authorizing a board of county commissioners, by resolution and after 10 days public notice, to levy a local land transfer tax on instruments conveying interests in real property located in the county, up to a rate of 0.4%, in increments of 0.1%.[41] The imposition of the tax is subject to voter approval in a public referendum. The tax is payable by the transferor of the property. The tax is in addition to the excise stamp tax on conveyances of land, and land exempt from the stamp tax is also exempt from the land transfer tax.[42] This tax was one of two local financing options enacted during the 2007 session. As an alternative to the land transfer tax, counties also received the option of levying a one-quarter cent sales and use tax.[43] However, a county could not levy the land transfer tax at the same time as the local option one-quarter cent sales and use tax.

To date, no county has achieved voter approval to levy this local land transfer tax, although 21 counties have conducted public referendums. The 21 counties are Ashe,

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[41] Section 31.17 of S.L. 2007-323.

[42]The State excise tax on conveyances is imposed at the rate of $1 for each $500 of sales price. The proceeds from this tax are distributed as follows: ½ to the county for any public purpose, and the remaining ½ to the Department of Revenue (75% goes to Parks and Recreation Trust Fund and 25% goes to Natural Heritage Trust Fund). The following transfers are exempt from the State excise tax on conveyances: (1) by operation of law; (2) by lease for a term of years; (3) by will; (4) by intestacy; (5) by gift; (6) no consideration paid; (7) by merger, conversion, or consolidation; and (8) by instrument securing indebtedness. This act does not affect the imposition of the State excise tax.

[43] To date, 18 counties have successfully enacted the local option one-quarter cent sales and use tax authorized by the 2007 legislation.

Avery, Brunswick, Chatham, Clay, Davie, Gates[44] Graham, Harnett, Henderson, Hoke, Johnston, Macon, Moore, Orange, Pender, Polk, Rutherford, Swain, Tyrrell[45] and Union.

However, the General Assembly has given four counties the authority to levy a land transfer tax on instruments conveying an interest in real property without a referendum: Dare,[46] Currituck,[47] Chowan,[48] and Camden.[49] The General Assembly has authorized the following three counties to levy, upon approval of the voters, a land transfer tax: Pasquotank,[50] Perquimans,[51] and Washington.[52] This act does not affect these local authorizations.

Tax of Improved Prop. in Roadway Corridors.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-30	**SB 107**	**Sen. Brunstetter, Garrou**

AN ACT TO REDUCE THE PROPERTY TAX OWED FOR IMPROVED PROPERTY INSIDE CERTAIN ROADWAY CORRIDORS.

OVERVIEW: This act classifies improved property inside a roadway corridor as a special class of property and provides that it will be taxable at 50% of its appraised value.

FISCAL IMPACT: The act does not affect State General Fund revenues. It will reduce local property tax revenues in counties where such property exists. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act becomes effective for taxes imposed for taxable years beginning on or after July 1, 2011, and sunsets for taxes imposed for taxable years beginning on or after July 1, 2021.

ANALYSIS: Article V, Sec. 2(2) of the North Carolina Constitution grants the General Assembly the power to classify property for taxation. That power must be

[44] Gates County conducted two public referendums, one on November 6, 2007 and one on May 4, 2008.
[45] Tyrrell County conducted two public referendums, one on May 4, 2008 and one on November 4, 2008.
[46] S.L. 1985-525.
[47] S.L. 1985-670.
[48] S.L. 1985-881.
[49] S.L. 1985-954.
[50] S.L. 1989-393.
[51] S.L. 1989-393.
[52] S.L. 1989-393. The issue has been on ballot three times, but has never passed.

exercised on a State-wide basis, by uniform rule, in a general law uniformly applicable in every unit of local government. In 1987, the General Assembly classified *unimproved* property in a transportation corridor marked on an official map as a special class of property and provided that it would be taxable at 20% of its appraised value. This act classifies *improved* property within a transportation corridor marked on an official map as a special class of property and provides that it is taxable at 50% of its appraised value.

A transportation corridor map may be adopted by the governing body of a local government as part of a comprehensive plan for streets and highways or by the Department of Transportation for part of the State highway system. Once a transportation corridor official map is filed with the register of deeds, no building permit may be issued for any building or structure on the property for up to three years.[53] If a building or structure exists on the property at the time the map is recorded, a permit may be issued provided the size of the building or structure is not increased.

There is no limit on how long the filer of a transportation corridor map may keep a proposed route on a map without purchasing the property. Although a proposed route does not prevent the sale of the property, it does affect the salability of the property because lenders and purchasers may not want to purchase property that may eventually be part of a highway corridor. A property owner may petition the filer of the map for acquisition of the property due to an undue hardship on the affected property owner.[54]

The Department of Transportation's ability to purchase property in recent years has been hampered by fiscal constraints. This constraint has placed a hardship on some property owners located in a transportation corridor. The reduction in the property tax assessment is one way to ease the financial burden on the property owners. However, the reduction in the property's tax value reduces the property tax revenue available to the counties in which these corridors lie. The Department of Transportation identified the roadway corridors that are not scheduled for near-term right-of-way acquisition. The corridors included six projects located in five counties: Currituck, Forsyth, Johnston, Pitt, and Wake. The cumulative revenue loss for the improved property located in these five counties is just over one-half million dollars.

The 10-year sunset provided in the act recognizes that it addresses a State issue, namely the length of time between when property is marked on a transportation corridor map and when it is purchased by the State, with a property tax expenditure that reduces local tax revenues.[55] The sunset gives the General Assembly an opportunity to review

[53] G.S. 136-44.51.

[54] G.S. 136-44.53. In the last nine years, 684 hardship advance acquisition requests in protected corridors have been received with approximately 500 receiving approval. Most hardship requests are related to financial or medical difficulties.

[55] In Forsyth County, the Winston-Salem Beltway has over $80 million in previously purchased right-of-way; however, there is another $360 million in right-of-way that will need to be acquired to complete

the policy in the future. The Department of Transportation began addressing some of the issues associated with property located in a protected corridor with changes to its current process: proposed evaluation of each protected corridor every 10 years; establishment of key criteria to aid in determining whether a corridor official map should be filed; and greater flexibility within existing law as to allowable property/home improvements.

Municipal Service District/Streets.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-72	**SB 281**	**Senator Stein**

AN ACT TO AUTHORIZE CITIES TO ESTABLISH A MUNICIPAL SERVICE DISTRICT FOR THE PURPOSE OF CONVERTING PRIVATE RESIDENTIAL STREETS TO PUBLIC STREETS AND TO AUTHORIZE RELATED COMMUNITY ASSOCIATIONS TO TRANSFER PLANNED COMMUNITY PROPERTY TO CITIES.

OVERVIEW: This act expands the purposes for which a city may create a municipal service district to include the conversion of private streets to public streets. The scope of the act is written to effectively limit its applicability to the following municipalities: Durham, Morrisville, and Raleigh.

FISCAL IMPACT: A city may impose a higher property tax rate on the taxpayers within a municipal service district to pay for the additional services received in that district. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on May 12, 2011.

ANALYSIS: Article V, Sec. 2(4) of the North Carolina Constitution allows the General Assembly to enact *general* laws authorizing the governing board of a local governmental unit to define territorial areas and to levy additional taxes within those areas to finance a service that is provided to a greater extent in that area than is provided to the entire area of the governmental unit. Article 23 of Chapter 160A provides the general law authorization that allows a city to establish a municipal

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the project. The fiscal constraints delaying the acquisition of the property have meant that the owners of this property have few options for the use of the property. The owners of this property understand it may be as much as 20 years before the beltway is built. The fiscal loss to Forsyth County of this act is $385,714.

service district and to levy a property tax in that district that is in addition to the property tax levied in the city as a whole. Article 23 specifies the purposes for which a municipal service district may be created.[56] This act expands the list of purposes to include the conversion of private streets to public streets, but the expansion only applies to the cities of Durham, Morrisville, and Raleigh.

This legislation addresses an issue specific to the Town of Morrisville. There are 14 residential developments in the Town of Morrisville that were constructed with private streets.[57] The private streets were constructed to a lesser standard than public streets. Of these 14 neighborhoods, five have submitted petitions to the Town Council signed by more than 60% of the residents requesting the town to upgrade and convert the streets to publicly maintained streets.[58] The Town does not have the authority to expend public funds for private streets.[59] To address the issue brought to the Town by its residents, the Town sought authority from the General Assembly to create a municipal service district for the purpose of converting the private streets to public streets. The conversion would include the transfer of ownership of the streets, an evaluation of the condition of the streets, and the design and construction costs related to improving the private streets to meet public streets standards.

Article XIV, Sec. 3 of the North Carolina Constitution prohibits local acts where general laws are directed; however, the Constitution does allow for classification by population. Not all municipalities wanted the ability to create special tax districts for the purpose of converting private streets to public streets. Therefore, the legislation is limited to a city that meets one of the following population classifications:

- Located primarily in a county with a population of 750,000 and also in a county with a population of 250,000. The only two cities that meet this classification are Morrisville and Raleigh.
- Located primarily in a county with a population of 250,000 and also in a county with a population of 750,000. The only city that meets this classification is Durham.

The act also creates the following limitations upon the creation of a district for this purpose:

- The private road must be non-gated.

[56] Beach erosion control; flood and hurricane protection works; a service which a city may by law provide, such as placing utility wiring underground; downtown revitalization projects; transit-oriented development projects; drainage projects, sewage collection and disposal systems; lighting at interstate highway interchange ramps; off-street parking facilities; and watershed improved projects.

[57] These 14 developments comprise about one-third of Morrisville's homes.

[58] Three neighborhoods are continuing to collect petitions; the remaining seven have indicated no interest in pursuing the issue.

[59] G.S. 153A-205 gives counties the authority to expend funds for the cost of improvements needed to bring residential streets up to State standards so they may become part of the State-maintained system. An argument may be made that cities have authority under Article 10A of Chapter 160A of the General Statutes to impose a special assessment for this purpose, but it is not clear.

- A city must receive a petition signed by 60% of the lot owners of the area to be included within the special district requesting the city to establish the district.
- A city must be willing to accept the converted streets for perpetual public maintenance.
- The additional tax rate levied in the special district may not exceed 30% of the property tax rate currently imposed in that district in the fiscal year prior to the establishment of the district.
- After the private streets have been upgraded to meet public street standards and all of the costs have been recovered, the district must be abolished.

To create a municipal service district, a city must hold a public hearing on a proposed resolution. The resolution must define the service district and find that the area defined is in need of one or more of the services for which a district may be created to a demonstrably greater extent than the remainder of the city. The resolution may become effective at the beginning of a fiscal year. Once a district is created, the city must provide or let contracts for the service for which the residents of the district are being taxed within one year of the effective date of the district. A city may incur debt, as allowed under general law and supported by the property tax levy, to finance services within a service district. When there is no longer a need for the service district, the district must be abolished.

Level Playing Field/Local Gov't Competition.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-84	**HB 129**	**Rep. Avila, Howard, Carney, Wainwright**

AN ACT TO PROTECT JOBS AND INVESTMENT BY REGULATING LOCAL GOVERNMENT COMPETITION WITH PRIVATE BUSINESS.

OVERVIEW: This act creates new requirements for cities and joint agencies that operate a communications service that is offered to the public for a fee.

FISCAL IMPACT: General Fund revenue for new cities that elect to operate communications service is estimated at $18.98 per subscriber. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on May 21, 2011.

ANALYSIS: Under G.S. 160A-311, cities are authorized to operate and finance a number of public enterprises, including cable television systems. A North Carolina Court of Appeals case, *BellSouth Telecommunications, Inc. v. City of Laurinburg*, 168

N.C. App. 75, 606 S.E. 2d 721 (2005), interprets the statutory authority to operate a cable television system to include operation of a fiber optic network. Morganton (CoMPAS Cable TV), Salisbury (Fibrant), Wilson (Greenlight), and Mooresville and Davidson (MiConnection) currently offer cable and internet service as a public enterprise.

The cities that currently operate cable and internet systems financed their systems through the installment purchase contract method authorized by G.S. 160A-20. This financing mechanism is commonly known as certificates of participation. Under this financing method, a city enters into an installment contract secured by a security interest in the system that is constructed. Unlike the issuance of general obligation bonds, installment purchase financing is not subject to a vote of the people. The Local Government Commission must approve a local unit's use of certificates of participation and the unit must give notice and hold a public hearing before it can enter into certificates of participation involving real property.

This act created a new Article 16A in Chapter 160A of the General Statutes. The new Article provides the following:

Communications Service Definition: "Communications service" is defined as the provision of cable, video programming, telecommunications, broadband, or high-speed internet access service to the public for a fee. A "city-owned communications service provider" includes cities that offer the service through an interlocal agreement or joint agency. Data sharing between governmental entities for internal governmental purposes and service offered to the public for free are not included in the definition of "communications service" and therefore, not subject to the limitations in this act.

High-speed Internet Access Service Definition: "High-speed internet access service" is defined as service with transmission speeds equal to or greater than the basic broadband service as defined by the FCC for broadband tier 1 service for broadband data gathering and reporting.

Requirements for City-owned Communications Providers: City-owned communications service providers, unless otherwise exempt, must fulfill all of the following requirements:

- Comply with all State, local, and federal laws and regulations a private company providing the same communications service is subject to.
- Establish separate enterprise funds for the communications service and conduct annual audits of the communications service. The annual audit conducted under G.S. 159-34 satisfies this requirement.
- Limit the provision of service to the jurisdictional boundaries of the city.
- Provide nondiscriminatory access of the city's rights-of-way, poles, or conduits to other service providers.

- Remit to its General Fund an amount equal to all the taxes and fees a private provider would pay if the private provider supplied the service.

City-owned communications service providers are prohibited from engaging in any of the following:

- Using the city's authority to require individuals or developments to subscribe to the communications service.
- Pricing the service below the cost of providing the service. The cost of providing the service must include the cost of capital components that would be equal to the cost of capital components a private provider would incur and an amount equal to all taxes a private provider would pay.
- Providing advertisements of the city-owned communications service on PEG channels of competing providers if the PEG channel is required to be carried on the system of another service provider. The use of funds not allocated to the communications service for advertisement is also prohibited.
- Subsidizing the provision of the communications service with other revenue.

Cities that choose to sell or discontinue a city-owned communications service are not required to hold a referendum prior to sale or discontinuation of the service.

Public Hearings: Prior to offering communications service, cities are required to hold at least two public hearings for comment on the service. The cities are required to provide notice for the hearings in the local newspaper and with the Utilities Commission. Private communications providers must be allowed to participate in the hearings. Feasibility studies, business plans, and public surveys for the communications service are deemed public records and must be available to the public prior to the hearings. The public hearing requirement does not apply to the repair or upgrade of an existing service.

Financing: Cities and joint agencies are prohibited from incurring debt, including installment purchase contracts and certificates of participation, for a communications system unless a special election is held. The question to be posed in the special election is whether or not the city may offer the communications service. The referendum requirement does not apply to repairs or improvements of an existing system.

Taxes, Payments in Lieu of Taxes: Cities and joint agencies operating a communications service will not receive a sales tax refund for purchases related to the provision of the communications service and are required to make the following payments in lieu of taxes:

- To the applicable county, a payment of the amount of property taxes that would be due if the communications system was subject to the property tax.

- To the State, an amount set by the Department of Revenue that approximates the amount of income, franchise, vehicle, motor fuel, and other taxes that would be due for a communications system subject to these taxes. Cities subject to this provision must provide information to the Department of Revenue necessary for the calculation of the payment. The amount of the assessment is set by January 1 of each year, and due by March 15 of each year.

Public-Private Partnerships for Communications Service: Cities are required to solicit proposals from private providers before constructing a communications network. Cities must issue request for proposals and provide notice to the public of the request for proposals. The city may consider any relevant factors, including system design, system reliability, operational experience, operational costs, compatibility with existing systems and equipment, and emerging technology. If the city in unable to negotiate terms with the two most responsive proposers, the city may proceed with offering communications service.

Designation as Public Utility: Cities and joint agencies that provide telephone service are included in the term "public utility" as defined by Chapter 62 of the General Statutes. Telephone service provided by these entities would be subject to oversight by the Utilities Commission.

Additional Financing Requirements: The Local Government Commission (LGC) must conduct additional review of applications to finance the construction, operation, expansion, or repair of a communications system by a city or joint agency. As part of the review, the following apply:

- The public hearings required by Article 16A of Chapter 160A must be held before an application for financing may be submitted.
- A copy of the application for financing must be given to private communications providers that serve the city and areas adjacent to the city. The LGC must accept written and oral comments from private providers as a part of the application review.
- The LGC must consider and make written findings regarding the reasonableness of the revenue projections of the service in light of the current and projected competitive environment, the impact of innovation, and the level of community support for the project.

Revenue Bonds: The act authorizes cities to issue revenue bonds to finance a cable television system. Although a referendum is not normally required for revenue bonds, cities that offer communications service as defined in G.S. 160A-340.1 are subject to the requirements of G.S. 160A-340.4(b) to hold a referendum before incurring debt to construct a communications system.

Exemptions: There are two exemptions from the provisions of the act. Cities that provide service to "unserved areas" are exempt from certain provisions of the act.

Cities providing service as of January 1, 2011, are exempt from the entirety of the act, provided those cities limit service to certain areas.

Unserved Areas: The provision of communications service in an area that has been established by order of the Utilities Commission to be an "unserved area" is exempt from certain provisions of the act. For the purposes of this determination, whether an area is unserved area is determined by census block, and is an area in which 50% of the households have no access to high-speed internet, or only access to high-speed internet from a satellite provider. The provision of communications service in an unserved area is exempt from the following provisions in Article 16A in Chapter 160A:

- Requirements for city-owned communications providers.
- The requirement to hold a special election prior to financing.
- The requirement of payments in lieu of taxes.

Existing providers: Cities that offered communications service as of January 1, 2011, are exempt from all of the provisions in the act provided the city limits the provision of service to the following:

- Persons within the corporate limits of the city providing the service. For the purposes of this section, the corporate limits include areas in the corporate limits as of April 1, 2011, and any later annexed areas.
- Existing customers of the service as of April 1, 2011, provided contracts for service outside the service area provided in the act are subject to public bidding upon expiration.
- Persons within the service areas provided in the act. A city that is subject to a service area boundary will have 30 days from discovery or notice of providing service outside of the boundary to cease providing service outside the boundary without losing the exemption.

Prepaid Wireless/Point of Sale Collection.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-122	**HB 571**	**Rep. Sager, Justice, Bryant, Brawley**

AN ACT IMPOSING A SERVICE CHARGE ON EACH RETAIL TRANSACTION OF PREPAID WIRELESS TELECOMMUNICATIONS SERVICE FOR ANY PURPOSE OTHER THAN RESALE OCCURRING IN THIS STATE, REQUIRING THAT THE SERVICE CHARGE BE COLLECTED BY THE SELLER OF PREPAID WIRELESS

TELECOMMUNICATIONS SERVICE AND REMITTED TO THE DEPARTMENT OF REVENUE, AND PROVIDING THAT THE DEPARTMENT OF REVENUE SHALL TRANSFER ALL SERVICE CHARGES COLLECTED, MINUS THE COSTS OF COLLECTION, TO THE 911 FUND TO SUPPORT 911 SERVICES IN THE STATE.

OVERVIEW: This act provides for the collection of the 911 service charge on prepaid wireless service at the point of retail sale.

FISCAL IMPACT: There is no fiscal impact on General Fund revenues. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The repeal of the current methods of collection the 911 service charge from prepaid wireless service was effective when signed by the Governor on June 9, 2011. The remainder of this act is effective July 1, 2013 and applies to retail transactions on or after that date

ANALYSIS: Prior to 2007, North Carolina local government entities collected a 911 service charge from subscribers of local telephone providers, and the Wireless 911 Board collected a monthly service charge from subscribers of wireless providers. In 2007, the local 911 service charge was eliminated, and a new statewide administrative system was adopted for collection and distribution of the 911 service charge.

The intent of this legislation was to collect a uniform fee from all providers, including the collection of the charge from prepaid wireless customers. Providers of prepaid wireless service were authorized to collect the 911 service charge using either of the following methods:

- Decrement – The monthly charge is collected by decrementing the service charge from each active prepaid wireless customer with an account balance equal to or greater than the amount of the service charge.
- Average Rate Per User - The monthly payment for 911 service charges for each provider of prepaid wireless service is determined based on its sales of prepaid revenue in the State during the month.[60]

Due to concerns regarding the methods of collection, the original legislation provided a moratorium on the collection of the 911 charge from prepaid customers for one year after. The moratorium has been extended three times and is in effect through calendar year 2011.[61]

This act repeals the current method of collection and provides for the retail collection of the 911 service charge for prepaid wireless service. The 911 service charge for

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[60] The provider's prepaid revenue in the state is divided by the "average revenue per user" and then multiplied by the amount of the service charge. The average rate per user in the statute is currently $50.
[61] Section 1 of S.L. 2008-134, Section 1 of S.L. 2009-90, and Section 43 of S.L. 2010-95.

prepaid wireless must be the same as the monthly charge for 911 service imposed on all other phone subscribers. The service charge will be collected by retailers and administered by the Department of Revenue. The 911 service charge for prepaid wireless service will be the same charged for postpaid service, 70¢ on each retail transaction of prepaid wireless service, or a lower amount set by the Board.

Each seller of prepaid wireless will collect the 911 service charge and remit the charge to the Department of Revenue. A seller must remit the charges either monthly, or semiannually. For administrative costs, each retailer is allowed to retain all of the 911 service charges for prepaid wireless that it collects in the first three months after the effective date of the act, and 5% of the charges thereafter.

The Department of Revenue will collect the 911 service charge for prepaid wireless from the retailers and remit the charges collect to the 911 Board each month within 45 days of the end of the month. The Department may retain the cost of collection not to exceed $700,000 for the first year after the effective date of this act and not to exceed $500,000 each year thereafter.

The funds remitted to the 911 Board from prepaid service will be distributed for the administration of 911 service as provided in the statutes for postpaid service. Currently a portion of the 911 service charges is allocated to reimburse wireless providers to pay for upgrades to their system necessary for the implementation for enhanced 911. The upgrades allow the wireless phone systems to provide address and location information to the 911 call centers. The remainder of the 911 service charges is distributed to public safety answering points (PSAPs) for 911 service. This section clarifies that the 911 service charge from prepaid wireless service will be not allocated for reimbursements for wireless providers. All 911 service charges collected at retail from prepaid wireless transactions will be distributed to PSAPs.

Modify Property Tax Base Exclusions.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-123	**HB 206**	**Rep. Ross, Jackson, Gill**

AN ACT TO MODIFY THE PROPERTY TAX BASE EXCLUSIONS.

OVERVIEW: This act excludes from property tax a contiguous tract of commercial property that is significantly damaged by fire or explosion and donated to a nonprofit corporation.

FISCAL IMPACT: Due to the narrow circumstances under which a property may qualify for this exclusion, the revenue impact is expected to be minimal. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

<u>EFFECTIVE DATE:</u> The act is effective for taxes imposed for taxable years beginning on or after July 1, 2011, and expires for taxable years beginning on or after July 1, 2016.

<u>ANALYSIS:</u> All real and personal property is subject to property tax unless it is excluded or exempted from the tax base. Article V, Sec. 2(2) of the North Carolina Constitution provides that the power to classify property for taxation lies with the General Assembly and must be exercised on a State-wide basis and made by general law uniformly applicable in every county and city.

This act designates property meeting the following requirements as a special class of property under Article V, section 2(2) of the North Carolina Constitution and excludes it from property taxation:

- The property must be a contiguous tract of land previously used primarily for commercial or industrial purposes and damaged significantly as a result of a fire or explosion.
- The property must have been donated to a nonprofit corporation by an entity other than an affiliate.
- The property must not have been leased or sold by the nonprofit corporation.

This legislation addresses an issue specific to the Town of Garner. The ConAgra plant in Garner was damaged significantly as a result of a fire or explosion in June 2009. ConAgra wanted to donate the property to the Town of Garner so the Town could redevelop and market the property. The Town believed this task could be handled more efficiently by a private corporation. The Garner Economic Development Corporation was formed on November 22, 2010, as a nonprofit corporation. One of its stated purposes is to acquire funds and real property related to the ConAgra plant and to maintain, develop, and market the property for economic development.

Although the property would be exempt from taxation if held by the Town, the property is subject to tax since it is owned by a nonprofit corporation. G.S. 105-278.7 provides a property tax exemption for property used for educational, scientific, literary, or charitable purposes. In 2002, the Attorney General's office issued an opinion that property owned by the Charlotte/Mecklenburg Development Corporation was not entitled to a charitable exemption where the corporation's goal was to undertake site development and sell the property to businesses. Although the property was owned by a nonprofit entity, it was not held for a charitable purpose.

Since the nonprofit corporation created for the purpose of redeveloping and marketing the property in the Town of Garner does not have an initial cash flow, the Town sought legislation exempting the property from taxation. The language in the act is crafted to apply only to the property donated to the nonprofit corporation by the ConAgra plant, and the exclusion only applies for five years.

Appropriations Act of 2011.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-145, as amended by S.L. 2011-330	**HB 200**	**Representative Brubaker**

AN ACT TO SPUR THE CREATION OF PRIVATE SECTOR JOBS; REORGANIZE AND REFORM STATE GOVERNMENT; MAKE BASE BUDGET APPROPRIATIONS FOR CURRENT OPERATIONS OF STATE DEPARTMENTS AND INSTITUTIONS; AND TO ENACT BUDGET RELATED AMENDMENTS.

OVERVIEW: This act, known as the Current Operations and Capital Improvements Appropriations of 2011, contains a $19.7 billion budget for fiscal year 2011-12 and a $19.9 billion budget for fiscal year 2012-13.[62] The act also contains a finance package that allows a $50,000 personal income tax deduction for net business income, changes the starting point for calculating North Carolina taxable income from federal taxable income to federal adjusted gross income, and exempts from the franchise tax base reserves for amortization of intangible assets.

FISCAL IMPACT: The act reduces budget availability by $131.6 million in fiscal year 2011-12 and by $335.6 million in fiscal year 2012-13 for a total finance package of $467.2 million for the biennium. This tax relief is in addition to the $1.3 billion in expiring tax revenue.[63] The act generates State and county revenues of $100.9 million in fiscal year 2011-12 and $101.4 million in fiscal year 2012-13 by increasing various fees. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The two income tax provisions become effective for taxable years beginning on or after January 1, 2012. The franchise tax provision became effective retroactively for tax years beginning on or after January 1, 2007.

ANALYSIS: Part XXXI-A of the act contains three finance provisions.

Personal Income Tax Exemption for Business Income.[64] – Section 31A.1 adds a new deduction for "net business income" when calculating North Carolina taxable income

[62] This document does not summarize the budget expenditure provisions; it only summarizes the finance law provisions.
[63] The 1% State sales tax rate expires July 1, 2011; the corporate and individual income surtaxes expire for taxable years beginning on or after January 1, 2011.
[64] This provision originated in the Senate Finance Committee Substitute, HB 200, Version 5. The provision in Versions 5 and 6 of HB 200 limited the deduction to a business whose cumulative gross receipts from all business activity in a taxable year did not exceed $825,000; and it sunset the deduction

for personal taxes. The deduction allows an individual taxpayer to exclude the first $50,000 of net business income received during the taxable year. To qualify, the income must be subject to personal tax and be business income from an activity where the taxpayer actively participates. Business income is defined to exclude income deemed passive under the federal tax rules.

There is no limit on the size of the business. The business must be subject to personal taxes. Businesses subject to personal taxes on individual taxpayer's returns include sole proprietorships, partnerships, S corporations, and limited liability companies.[65] Very large businesses tend to be taxed at the corporate level under Subchapter C of the Internal Revenue Code - referred to as "C corporations." These C corporations do not qualify for the deduction.

Typically, non-passive business income would appear on an individual taxpayer's federal income tax return on schedules C, E, and F. Schedule C reports income from sole proprietorships. Schedule E reports income from partnerships and S corporations. Schedule F reports income from farming. Any income deemed passive under federal tax rules would not qualify. For example, rental income is generally considered passive.

Using Federal AGI as the Starting Point for State Taxable Income. [66] – Section 31A.1 changes the starting point for calculating NC taxable income from federal taxable income to federal adjusted gross income. This change did not change the tax base or increase North Carolina tax in any way. All current deductions and credits remain.[67]

The switch to federal adjusted gross income (AGI) as the starting point simplifies the calculation of North Carolina taxable income because North Carolina taxpayers no longer have to make adjustments to reduce the federal standard deduction and federal exemption amounts to determine the applicable State deduction and exemption amounts.[68] Now, taxpayers may start with federal AGI and deduct the State personal

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for taxable years beginning on or after January 1, 2014. The provision as enacted is not limited to businesses of a certain size and it does not sunset.

[65] Assuming the LLC has not elected to be taxed at the corporate level.

[66] This provision originated in the Senate Finance Committee Substitute, HB 200, Version 5. The provision in Versions 5 and 6 of HB 200 would have also reduced each of the personal income tax rates by ¼%. To help offset the revenue loss from the rate reductions, the bills would have eliminated the personal income tax deductions for severance wages and qualified sales of a manufactured home community and the tax credit for oyster shell recycling; they also would have eliminated the sales tax exemption for nutritional supplements sold by a chiropractor at a chiropractic office and the sales tax holiday for certain energy star products.

[67] Section 12 of S.L. 2011-330 amended this section of the budget to ensure that the changes made by it did not inadvertently change the existing tax base in ways that were not intended

[68] In 1989, when North Carolina first began using federal taxable income as its starting point, the federal and State personal exemption and standard deduction amounts were the same. Since 1989, the federal amounts have been indexed and the State amounts have not.

exemption amounts and, if the taxpayer does not itemize deductions,[69] the State standard deduction amounts, to calculate State taxable income.

Of the 35 states that begin their calculation of state taxable income with federal law, 29 use federal adjusted gross income while only six use federal taxable income. Federal taxable income is income after all federally allowed deductions; it includes the deductions from gross income to determine adjusted gross income and the deductions from adjusted gross income to determine taxable income. The primary differences between federal taxable income and adjusted gross income are the personal and dependency exemptions and the subtraction of either the standard deduction amount or the itemized deductions amount.

North Carolina began using federal taxable income as the starting point for this calculation in 1989. At the time, this change significantly simplified North Carolina's individual income tax by eliminating 30 individual income tax exclusions and reducing 47 deductions and exemptions to seven. [70] Since that time, however, the number of adjustments a taxpayer must make to federal taxable income to determine North Carolina taxable income has increased from 11 to more than 40. North Carolina's current system of additions and subtractions is confusing to taxpayers and complex to administer.

Franchise Tax Base Modification.[71] – Section 31A.2 provides an exemption of reserves for amortization of intangible assets from surplus and undivided profits, thus excluding them from the franchise tax capital base. Examples of intangible assets include goodwill, patents, copyrights, franchises, trademarks and trade names, as well as going concern value.

Some taxpayers deducted reserves for amortization of intangible assets prior to the law change because it is an allowable deduction under Generally Accepted Accounting Principles (GAAP). The Department disallowed the deduction and collected additional tax on taxpayers that elected to participate in the Department's Resolution Initiative. The law change was made retroactive to allow these taxpayers the benefit of the deduction.

[69] More than 70% of North Carolina taxpayers claim the standard deduction amount rather than itemize their deductions.
[70] Chapter 728 of the 1989 Session Laws.
[71] This provision first appeared in the Senate Appropriations/Base Budget Committee Substitute, HB 200, Version 7.

Facilitate Electronic Listing.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-238	**HB 896**	**Representative Brubaker**

AN ACT TO FACILITATE ELECTRONIC LISTING OF PERSONAL PROPERTY FOR PROPERTY TAX PURPOSES.

OVERVIEW: This act authorizes the Department of Revenue, in consultation with the counties, to establish standards and requirements for the electronic listing of personal property allowed by counties.

FISCAL IMPACT: This act has no General Fund impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 23, 2011.

ANALYSIS: All property, real and personal, within the jurisdiction of this State is subject to property tax unless it is excluded by statute or exempted by the Constitution. The property must be listed annually. Under prior law, a board of county commissioners could, by resolution, provide for electronic listing of personal property. If a county allows the electronic listing of personal property, the assessor must publish this information, including the timetable and procedures for electronic listing.

This act repeals the existing statutory authority that allows counties to provide for electronic listing of personal property and creates a new statute in its place that allows counties to provide for electronic listing of personal property only after the Department of Revenue has established standards and minimum requirements, in consultation with the counties. Once the standards have been established, a county may, by resolution, provide for electronic listing. A county may also delegate this authority to the county tax assessor.

The act also makes other procedural changes related to electronic listing. Section 3 of the act provides that a resolution that includes a general extension of time for the electronic listing of personal property continues to be in effect until the resolution is revised or rescinded. It further provides that if a board grants an individual taxpayer an extension for good cause shown for the electronic listing of personal property, the extension may not extend beyond June 1. Under prior law, the period for electronic listing may only be extended to June 1, both generally and in individual cases. Other individual extensions could not extend beyond April 15. The act also eliminates the requirement that a person with a duty to list property appear before the assessor and substitutes a requirement to file a completed abstract along with the required affirmation.

Government Reduction Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-266	**SB 593**	**Sen. Clary, Brock, Soucek**

AN ACT REDUCING STATE GOVERNMENT BY ABOLISHING CERTAIN STATE BOARDS, COMMISSIONS, AND COMMITTEES.

OVERVIEW: Section 1.15 of S.L. 2011-266 repeals G.S. 120-70.108 that required the Revenue Laws Study Committee to establish a Property Tax Subcommittee.

FISCAL IMPACT: This section has no fiscal impact.

EFFECTIVE DATE: This section became effective July 1, 2011.

ANALYSIS: Section 1.15 of S.L. 2011-266 abolishes the Property Tax Subcommittee of the Revenue Laws Study Committee. The Property Tax Subcommittee formerly studied and, if necessary, recommended changes to the property tax system. The current jurisdiction of the Revenue Laws Study Committee under G.S. 120 70.106 includes the study of all the revenue laws of North Carolina.

Property Tax Uniformity for Conservation Land.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-274	**HB 350**	**Rep. McGrady, Starnes, Brubaker, Harrison**

AN ACT TO MODIFY WHEN LAND USED FOR CONSERVATION PURPOSES IS TO BE EXCLUDED FROM THE PROPERTY TAX BASE.

OVERVIEW: This act does the following:

- Clarifies and modifies the tax exemption for real property for educational and scientific purposes as a protected natural area[72] by listing certain, enumerated conservation purposes.
- Creates a 5-year rollback for avoided taxes if conservation property is no longer used for conservation purposes, is used to generate income inconsistent with conservation, or is sold or transferred without an

[72] A protected natural area is a nature reserve or park in which all types of wild nature, flora and fauna, and biotic communities are preserved for observation and study

easement requiring perpetual use of the listed conservation purposes and without a prohibition on income generation.

- Expressly aligns definitions for educational and scientific purposes with the property tax exemption for property used for educational and scientific purposes.
- Requires that, as does the income tax credit for real property donations for conservation purposes, the entity owning the property must be "organized to receive and administer lands for conservation purposes".
- Adds the requirement that property qualifying under this exemption either not earn income or only earn income that is merely incidental to and not inconsistent with conservation purposes.

FISCAL IMPACT: Because the bill includes provisions which will potentially reduce local revenues (the expansion of qualifying purposes) and increase local revenues (a 5-year roll-back for disqualifying events), it is not clear whether the bill will result in an overall reduction or increase in local revenues. The overall change in revenue is expected to be minimal.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2011.

ANALYSIS: G.S. 105-275 lists classes of property that are authorized by the North Carolina Constitution to be excluded from the property tax base. Under prior G.S. 105-275(12), one of those classes was real property (i) owned by a nonprofit corporation or association and (ii) exclusively held and used by its owner for educational and scientific purposes as a protected natural area. Educational purpose and scientific purpose were not defined as they were elsewhere for property tax benefits in G.S. 105-275(12); property qualifying under G.S. 105-275(12) was excluded from the property tax base and, therefore, escaped property tax liability altogether; and whether the property earned income was not relevant to a determination of the property tax benefit afforded by G.S. 105-275(12).

This act modifies G.S. 105-275 (12) in various ways.

- It clarifies that the definitions for educational purpose and scientific purpose have the same meanings as defined in G.S. 105-278.7 (real and personal property used for, *inter alia*, educational or scientific purposes.)
- It expands the previous qualifying use (that land be used as a protected natural area) with the following, additional conservation purposes:
    - Managed under a written wildlife habitat conservation agreement with the North Carolina Wildlife Resources Commission

   - Managed under a forest stewardship plan developed by the Forest Stewardship Program.[73]
   - Used for public access to public waters or trails.
   - Used for protection of water quality and subject to a conservation agreement.[74]
   - Held by a nonprofit land conservation organization for sale or transfer to a local, state, or federal government unit for conservation purposes.
- Property taxes avoided for up to the preceding 5 fiscal years are no longer eliminated but, instead, are carried forward as deferred taxes that become due and payable if a disqualifying event occurs. The following operate as disqualifying events:
   - The land is no longer used for one of the qualifying conservation purposes or is used to produce income inconsistent with the conservation use/s to which the land is applied.
   - The conservation organization transfers the land without an easement that requires the conservation use/s required for the land to qualify for the property tax benefit will continue to be applied and that prohibits income generation.
- It adds a requirement that property excluded from the tax base for conservation purposes not earn income or only earn income that is both incidental to and not inconsistent with the conservation purpose (e.g., a forest tract could not be managed for the commercial production of timber but some trees could be harvested if the harvesting is incidental and needed to accomplish the overall conservation purposes for which the tract is being managed).

[73] Authorized by the Cooperative Forestry Assistance Act of 1978, this Program provides technical assistance, through State forestry agency partners, to nonindustrial private forest owners to encourage and enable active long-term forest management.
[74] Conservation agreements are governed by the provisions of the Conservation and Historical Preservation Agreements Act, Article 4, Chapter 121 of the General Statutes

Sales & Use Tax Overcollection.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-293	**HB 93**	**Rep. Howard, Setzer, Brubaker, Starnes**

AN ACT TO ALLOW A SELLER TO APPLY OVERCOLLECTED SALES TAX TO OFFSET A USE TAX LIABILITY ON A RELATED TRANSACTION.

OVERVIEW: This act allows a seller to apply overcollected sales tax to offset a use tax liability on a related transaction.

FISCAL IMPACT: There is no fiscal impact because the act has no effect on the amount of sales and use tax due.

EFFECTIVE DATE: This act became effective July 1, 2011, and applies to tax liabilities that accrue on or after that date.

ANALYSIS: Generally speaking, the sales tax that a retailer collects is considered a debt from the purchaser to the retailer until it is remitted by the retailer to the State. The retailer is considered to act as a trustee on behalf of the State when it collects tax from the purchaser of a taxable item. When a seller collects tax in excess of the amount that should have been collected or when a seller collects tax on an exempt or nontaxable sale, the total amount collected must be paid over to the Secretary of Revenue. A retailer is not entitled to a refund of any amount of overcollected sales tax unless the purchaser receives credit for or is refunded the amount of tax overcollected. A cause of action against a seller for overcollected sales or use tax does not accrue until a purchaser has provided written notice to a seller and the seller has had 60 days to respond.

This act arose from a situation where a retailer collected and remitted sales tax on transactions that the Department of Revenue later determined were not subject to sales tax because the property was *used* by the retailer. In that instance, the retailer owed use tax on the property. Specifically, this company is in the business of selling and servicing office equipment, primarily copiers. The company collected sales tax on the sale of its service agreements rather than collecting use tax on the parts and supplies used to fulfill the service agreements. The company sought a credit in the amount of sales taxes it paid against the use tax it owed. Because the retailer could not or chose not to refund the erroneously collected tax to the people who paid it, a refund of the erroneously collected sales tax was not allowed under the existing statute. In this situation, the State effectively collected both sales tax and use tax on the same transactions. The matter was heard by the Business Court, which issued an order in favor of the taxpayer on January 4, 2010. The State has appealed.

This act modifies the statute in such a way that a retailer in the circumstances described above could offset its use tax liability with overcollected sales tax. Specifically, the Secretary of Revenue may take one of the following three actions when he or she determines that a seller has overcollected sales tax on a transaction:

- Allow a refund of the tax if the seller gives the purchaser credit for or a refund of the overcollected tax. However, no refund would be given if the seller has elected to offset a use tax liability on a related transaction with the overcollected sales tax.
- If the seller is liable for use tax on a related transaction, allow the seller to offset the use tax liability with the overcollected sales tax. However, no offset would be permitted if the seller elected to receive a refund of the overcollected sales tax. The fact that a seller is allowed an offset does not affect the liability of the seller to the purchaser for the overcollected tax.
- If neither (1) or (2) apply, retain the total amount collected on the transaction.

Small Business Assist. Records/Tax Payments.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-297	**SB 385**	**Senator Hartsell**

AN ACT TO PROVIDE THAT SMALL BUSINESS ASSISTANCE RECORDS AND FINANCIAL STATEMENTS ARE NOT PUBLIC RECORDS AND TO ALLOW A PASS-THROUGH ENTITY THAT CLAIMS A TAX CREDIT UNDER ARTICLE 3J TO TREAT THE CREDIT CLAIMED AS A TAX PAYMENT MADE BY OR ON BEHALF OF THE TAXPAYER.

OVERVIEW: This act does two things:

- It exempts from the public records law certain documents between an individual and a State entity related to business counseling or technical assistance provided by the entity to the individual.[75]
- It allows the owner of a pass-through entity that claims a tax credit under Article 3J of Chapter 105 of the General Statutes to treat some or all of the credit as a tax payment made by or on behalf of the taxpayer. By treating the credit as a tax payment, the taxpayer would be able to deduct from another state's tax calculation the taxpayer's tax paid to North Carolina, including any amount for which it received a credit.

[75] This document does not summarize this change.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The provisions of the act related to the tax treatment of an Article 3J tax credit is effective for taxable years beginning on or after January 1, 2011.

ANALYSIS: Income may be taxable in more than one state. In those instances, a taxpayer may claim a credit for income tax paid to another state on the tax return the taxpayer files with his home state. The credit for tax paid to another state gives the taxpayer relief from being taxed twice on the same income. The credit is only allowed for tax paid. When a taxpayer receives a tax credit in the other state against the tax owed on that income, such as a credit for job creation or business investment, the credit reduces the amount of tax paid to that state, and effectively reduces the credit that may be claimed on the return due to the home state for tax paid to another state.

This act allows a pass-through entity to treat a tax credit received under Article 3J of Chapter 105 of the General Statutes[76] as a tax payment made by or on behalf of the taxpayer. By electing to treat the credit as a tax payment, nonresident members of a pass-through entity will not have their credit for taxes paid to another state reduced on their home state's return.

Various Economic Development Incentives.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-302	**HB 751**	**Representative McComas**

AN ACT TO EXPAND THE APPLICATION OF THE ONE PERCENT, EIGHTY DOLLAR EXCISE TAX ON CERTAIN MACHINERY AND EQUIPMENT TO SPECIALIZED EQUIPMENT USED AT A PORT FACILITY AND TO MACHINERY USED AT A LARGE MANUFACTURING AND DISTRIBUTION FACILITY; TO PROVIDE TIER ONE TREATMENT FOR PORT ENHANCEMENT ZONES; TO RETAIN AND ENCOURAGE INVESTMENT IN ECONOMICALLY DISTRESSED TIMES TO REMAIN ELIGIBLE TO TAKE AN INSTALLMENT OF A CREDIT EARNED UNDER THE BILL LEE ACT; AND TO AMEND THE AUTHORIZATION TO ISSUE SPECIAL INDEBTEDNESS FOR AN EDUCATIONAL BUILDING AT APPALACHIAN STATE UNIVERSITY.

[76] Article 3J provides tax credits for creating jobs and investing in machinery and equipment.

<u>OVERVIEW:</u> This act does the following[77]:

- It expands the 1%, $80 excise tax applicable to equipment used to manufacture products by adding equipment used to distribute and assemble products.
- It expands favorable tax provisions applicable to a tier one county to areas designated as "port enhancement zones."
- It allows a taxpayer to continue to claim the tax credit for substantial investment in other property even though the requisite number of people employed at the location falls below the statutory requirement so long as the taxpayer has made a substantial investment in the property within two years of the date the employment fell below the requisite number.

<u>FISCAL IMPACT:</u> The provisions in the act that allows a taxpayer to remain eligible for the remaining installments of its Article 3A tax credit will reduce revenue by approximately $400,000 annually for five years, beginning in fiscal year 2010-11. The remaining provisions in the act do not impact revenues in this biennium, but will reduce General Fund revenues by more than $100,000 beginning in fiscal year 2013-14. *(For a more complete fiscal analysis, see Overview: <u>Fiscal and Budgetary Actions</u>, 2011 Session. Available in the Legislative Library.)*

<u>EFFECTIVE DATE:</u> The expansion of the 1%, $80 excise tax to include distribution and assembly equipment becomes effective July 1, 2013. The expansion of the tier one benefits to port enhancement zones becomes effective for taxable years beginning on or after January 1, 2013. The retention of the remaining installments of an Article 3A tax credit becomes effective retroactively for taxable years beginning on or after January 1, 2009.

<u>ANALYSIS:</u> This act amends three different tax incentives: the 1%, $80 excise tax for mill machinery, Article 3J tax credits, and the Article 3A tax credit for substantial investment in other property.

Part I: Expand Excise Tax on Mill Machinery

North Carolina has long provided a preferential sales tax rate for mill machinery of 1% with an $80 cap per article.[78] The 2001 General Assembly enacted the excise tax in Article 5F in response to the requirement of the Streamlined Sales and Use Tax Agreement that states must simplify their sales tax rates.[79] Items subject to the excise tax in Article 5F are exempt from sales and use tax. The current State sales tax rate is 4.75%; the local rates vary from 2% to 2.5% in Mecklenburg County.

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[77] The act allows bond proceeds allocated to Appalachian State University for an educational building to be used for improving property as well as acquiring property. This provision is not summarized in this document.

[78] North Carolina enacted a 3% sales tax rate in 1933. In 1935, the General Assembly enacted a preferential 1% rate for mill machinery. In 1937, the General Assembly enacted a cap per article of $10.

[79] The 2001 legislation, which became effective January 1, 2006, repealed the 1% sales tax rate, with an $80 cap, imposed on mill machinery purchased by a manufacturing industry or plant and replaced it with a privilege tax having the same rate.

The preferential rate applies to a manufacturing industry or plant that purchases mill machinery. The statute does not define "manufacturing," but North Carolina court cases define the term as the making of a new product by the application of skill and labor to the raw materials of which it is composed.[80] Section 57 of the Sales and Use Tax Bulletins and final decision issued by the Department of Revenue in 2003 reiterated that the preferential rate applied only to equipment used in the manufacturing process, not to equipment used in distribution or movement of manufactured products or to equipment used in the administrative work of the taxpayer.

Since 2005, Article 5F has been expanded to apply to purchases of fuel by a manufacturing plant, as well as machinery. It has also been expanded to include the following:

- Certain personal property purchased by a major recycling facility.
- Equipment purchased by a research and development company in the physical, engineering, and life sciences and used by that company in the research and development of tangible personal property.
- Equipment purchased by a software publishing company that is used in the research and development of tangible personal property.
- Equipment purchased by an eligible datacenter.

Specialized equipment used at a port facility.[81] – The act expands the 1%, $80 preferential tax rate to include specialized equipment used at a ports facility to unload or process bulk cargo to make it suitable for delivery to and for use by manufacturing facilities. This change in the law becomes effective July 1, 2013, and applies to purchases made on or after that date. The effective date ensured the provision would not impact the current fiscal biennium. There are no known projects at this point that would benefit from the preferential tax rate, but there have been taxpayers in the past interested in this type of incentive. The fiscal impact of this change is unknown.

Large manufacturing and distribution facility.[82] – The act creates a definition of a "large manufacturing and distribution facility" and expands the preferential 1%, $80 excise tax to include machinery used at the facility for assembling products and distributing finished products. Machinery located at such a facility for manufacturing products is already subject to the excise tax. The Winston Salem Journal reported on June 21, 2011, that Ashley Furniture Industries, Inc. the largest U.S. furniture manufacturer and retailer, was considering Davie County as a possible location for a $200 million complex to serve the East Coast. The facility would receive unassembled product pieces that it would assemble and distribute. This possibility appears to have spurred

[80] *Duke Power Co. v. Clayton,* 274 N.C. 505, 164 S.E.2d 289 (1968); *Sayles Biltmore Bleacheries, Inc. v. Johnson*, 266 N.C. 692, 147 S.E. 2nd 177 (1966); *Master Hatcheries, Inc. v. Coble,* 286 N.C. 518, 212 S.E.2d 150, (1975).

[81] The original bill made a variation of this amendment to Article 5F of Chapter 105.

[82] The House Finance Committee Substitute added this amendment to Article 5F to the bill.

the enactment of the preferential rate; however, unlike past incentive legislation, the minimum investment and employment levels of this incentive could be obtained by other distribution facilities.

A large manufacturing and distribution facility is defined as one for which an investment of private funds of at least $80,000,000 is made within five years after the date on which the first property investment is made and one that will achieve an employment level of at least 550 within five years after the date the facility is placed into service. If the required level of investment or employment is not timely made, achieved, or maintained, then the preferential rate is forfeited and the taxpayer becomes liable for past sales and use taxes that would otherwise have been due. If the rate is forfeited for failure to timely make the required investment or timely achieve the required employment level, then the preferential rate is forfeited on all purchases made. If the rate is forfeited for failure to maintain the required employment level, then the rate is forfeited only on those purchases occurring on or after the date the taxpayer failed to maintain the required employment level.

The preferential rate for distribution equipment purchased by a large manufacturing and distribution facility becomes effective for purchases made on or after July 1, 2013, and expires for sales occurring on or after July 1, 2018. The delayed effective date ensured the provision would not impact the current fiscal biennium. The fiscal impact of this change in future years is unknown.

In addition to the preferential tax rate, the act also provides a sales tax refund to a large manufacturing and distribution facility that purchases distribution equipment on or after July 1, 2012, and before July 1, 2013. The facility would receive a full refund of local taxes and a portion of State taxes. The portion of State taxes refunded is equal to the amount of tax paid less the amount of tax the facility would have paid had it been subject to tax under Article 5F. The taxpayer must make a written request for a refund on or after July 1, 2013, and before January 1, 2014. Although the refund provision applies to purchases made during this fiscal biennium, it is not payable until fiscal year 2013-14, thus ensuring that the provision would not impact the current fiscal biennium. The fiscal impact of this change is unknown.

Part 2: Port Enhancement Zones[83]

North Carolina seeks to incent businesses to create jobs and invest in business property primarily through Article 3J tax credits. A taxpayer's eligibility for a credit and the amount of the credit varies depending upon the county[84] or zone[85] in which

[83] House Bill 903 contained the original contents of this provision. HB 903 remains in House Finance at the end of the 1st regular session of the 2011 General Assembly. The provisions of HB 903 were added to this act by an amendment offered in Senate Finance.

[84] The Department of Commerce annually ranks the State's 100 counties based on economic well-being and assigns a tier designation to each. The 40 most distress counties are designated as tier 1, the next 40 are tier 2, and the 20 least distressed are tier 3.

[85] Urban Progress Zones are defined in G.S. 143B-437.09 and Agrarian Growth Zones are defined in G.S. 143B-437.10.

the jobs are created or the investments are made. These credits may be combined to offset up to 50% of the taxpayer's State income and franchise tax liability, and as a general rule, unused credits may be carried forward for up to five years.[86]

This act creates a new type of zone eligible for enhanced credits under Article 3J, a "*ports enhancement zone.*" North Carolina has two State ports, the Port of Morehead City and the Port of Wilmington. The Port of Morehead City is located in Carteret County; Carteret County is a tier 3 county. The Port of Wilmington is located in New Hanover County; New Hanover County is also a tier 3 county.

A ports enhancement zone is defined as an area that meets the following conditions:

- Is comprised of one or more contiguous census tracts, census block groups, or both, in the most recent federal census.
- All of the area is located within 25 miles of a state port and is capable of being used to enhance port operations.
- Every census tract and census block group in the area has at least 11% of households with incomes of $15,000 or less.

The defining statute stipulates that the area of the county that is included in one or more port enhancement zones may not exceed 5% of the total area of the county. Upon application of the county, the Secretary of Commerce is directed to make a written determination whether the requested area meets the conditions required for the designation. The Secretary must annually publish a list of all port enhancement zones.

The enhanced credits available to an urban progress zone (UP zone) and an agrarian growth zone (AG zone) will be available to a ports enhancement zone. The enhanced credits available to an UP zone or an AG zone under Article 3J are as follows:

- *Jobs tax credit.* – The threshold for new full-time jobs created to qualify for the tax credit for creating new jobs is the same as for a tier 1 county, five[87] and the amount of the credit is increased by $1,000 per job.[88] If the job is filled by a resident of the zone or a long-term unemployed worker, the credit is increased by an additional $2,000 per job.
- *Machinery and equipment investment tax credit.* – The investment threshold requirement to qualify for the tax credit for investing in business property is the same as a tier 1 county, which is none. The amount of the investment tax

[86] Fifteen-year carry-forwards apply to the credit for investing in real property and 20 carry-forwards exist for taxpayers that invest at least $150 million over a two-year period.
[87] The qualifying job threshold for a tier 2 county is 10; and a tier 3 county is 15.
[88] The amount of the jobs credit in a tier 1 county is $12,500 per job; a tier 2 county is $5,000; and a tier 3 county is $750.

credit is also the same as a tier 1 county, 7% of the cost of tangible personal property that is placed in service during the taxable year.[89]

The enhanced credits become effective for taxable years beginning on or after January 1, 2013. The effective date ensures the changes do not have a fiscal impact in this biennium. The fiscal impact of this change is unknown.

Part 3: Encourage Investment to Retain Article 3A Installment[90]

In 2001, the General Assembly created a tax credit under the Bill Lee Act for substantial investment in other real property. To claim the credit for substantial investment in other property, the Secretary of Commerce must make a written determination that the taxpayer is expected to invest at least $10 million in real property at a location within a three-year period and that the location will create at least 200 new jobs within two years of the time that the property is first used in an eligible business. The taxpayer may begin to claim the credit once the property is first used in an eligible business. A taxpayer may not claim both the credit for substantial investment in other property and the credit for investing in central office or aircraft facility property with respect to the same property.

The amount of the credit for substantial investment in other property is equal to 30% of the eligible investment amount and must be taken in installments over a seven-year period. There is no ceiling on the amount of the credit. Any unused credit may be carryforward for 20 years, as opposed to the more standard carryforward period of five years. The Bill Lee tax credits expired for business activities occurring on or after January 1, 2007.

The credit for substantial investment in other property expires if the number of people employed at the location falls below 200. In this case, the taxpayer may not take any remaining installments of the credit but the taxpayer may take the portion of an installment that accrued in a previous year and was carried forward.

This act creates an exception for which a taxpayer may continue to take the remaining installments of the credit for substantial investment in other property even when the number of employees the taxpayer employs at the property falls below 200. Under the law as amended by this act, the taxpayer may continue to claim the remaining installments of the credit if the taxpayer has invested a certain amount in the property within two years of the date the employment fell below 200 and the employment level has not fallen below 125. The amount that must be invested is at least two times the value of the remaining installments of the credit. If the employment level falls below

[89] The threshold for a tier 2 county is $1 million and the credit is 5% of the cost of the property that exceeds the threshold. The threshold for a tier 3 county is $2 million and the credit percentage is 3.5%.

[90] Senate Bill 345 contained the original contents of this provision. The bill received a favorable report from the Senate; however, the bill received an unfavorable report in the House Finance Committee. The Senate Finance Committee adopted an amendment to this bill, HB 751, to incorporate a modified version of the contents of SB 345 – the Senate amendment required the taxpayer to retain an employment level of at least 125; the original bill did not contain a minimum employment level.

125, the taxpayer may not take the remaining installments of the credit, regardless of how much the taxpayer has invested in the property.

This provision is effective retroactively for taxable years beginning on or after January 1, 2009. Fiscal Research is aware of only one taxpayer impacted by the legislation.[91] The act allows the taxpayer to remain eligible to take five remaining credit installments of $424,000 each. Without the changes made by the act, the taxpayer would become ineligible for these five remaining installments and its tax liability would increase accordingly.

Rev Laws Tech, Clarify., & Admin. Chngs.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-330	**SB 267**	**Sen. Clodfelter, Hartsell**

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

OVERVIEW: This act includes several technical, administrative, and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: Except as otherwise stated in the analysis, this act became effective when the Governor signed it into law on June 27, 2011.

ANALYSIS:

Section	Explanation
Business Tax Changes	
1	Changes the effective date for the exclusion of amenities from general admissions receipts. Prior to February 1, 2009, amenities were excluded from admissions receipts. Effective February 1, 2009, with one day's notice, the Department of Revenue issued a directive providing that amenities would be included in admissions receipts. The Revenue Laws Study Committee recommended, and the General Assembly enacted, a restoration of the prior understanding. The effective date of the legislation was August 1, 2010. Companies that paid the tax with amenities included in the admissions receipts sought a refund of the excess tax paid. The Department denied the

[91] The taxpayer appears to be Vantage Foods located in Lenoir, NC. The company is one of four of The Alex Lee Family of Companies located in North Carolina. The other three are Lowe's Foods Stores, Inc. in Winston-Salem, and Institution Food House, Inc. and Merchant's Distributor's, Inc., which are both located in Hickory, NC.

	refund request because the effective date of the legislative change was August 1, 2010, not February 1, 2009 (the day the directive took effect).
2	Modifies the cigarette excise tax payment statute to accommodate operating procedural changes being implemented by certain cigarette manufacturers and their affiliates. It does not change the manufacturer that is responsible for paying the tax.
3	Repeals an obsolete provision. When the General Assembly enacted the qualified business venture tax credits in 1987, they applied to investments in North Carolina companies and to both corporations and individuals. In 1996, the General Assembly revised the tax credit to apply to all investments because the restriction to North Carolina companies was unconstitutional. In the same act, S.L. 1996-14, ES2, the General Assembly also restricted the tax credit to individuals and pass-through entities. The subsection being repealed is a carry-over from the original law as it applied to holding companies.
4	Provides a definition for development tier one area in the tax credit for research and development. The tax credit amount for research performed in a development tier one area is 3.25%.
5	Repeals an obsolete provision. In S.L. 2010-89, the General Assembly provided an alternative apportionment formula for a corporation that signed a letter of commitment by September 15, 2010, certifying that it planned to invest at least $500 million in private funds to construct a facility in a development tier one area. No company signed such a letter. The General Assembly enacted the provision at the request of Microsoft; Microsoft announced in August that it would be locating in Virginia.
6	Repeals obsolete term. S.L. 2005-395 amended the real estate licensing laws to eliminate real estate salespersons licenses, making all licensed real estate agents real estate brokers as of April 1, 2006.
7	Removes reference to repealed statute. The General Assembly repealed G.S. 105-113.81A in the budget bill in 2009, S.L. 2009-451, as part of the special provision on "*Commerce/Enterprise Funds and Special Funds*".
8	Clarifies the franchise tax base.
9	Specifies the statutory reference.

10	Removes reference to obsolete provision. S.L. 2006-196 combined the statewide and local rates for insurance policies providing fire and lightning coverage and established a new statewide rate of 0.85% for the supplemental tax, effective January 1, 2008. The changes effectively replaced the tax on fire and lightening coverage with an additional tax on property coverage contracts.
Personal Tax Changes	
11	Clarifies that the IRC Update bill applies to the estates of decedents dying on or after January 1, 2011.
12	Makes changes to the provisions in the budget bill regarding the move from federal taxable income to adjusted gross income to ensure the bill does not inadvertently change the existing tax base in ways that were not intended.
13f	Ensures that a taxpayer may not take a double deduction for a 2009 net operating loss claimed on a 2006 return.
14	Reserved.
Sales and Use Tax and Article 5F Tax Changes	
15	Clarifies the original intent of the sales tax refund granted to professional motorsports teams for aviation fuel and tangible personal property that comprises part of the racing vehicle. In the last couple of years, the Department of Revenue has changed its interpretation of how the refund is applied. This section modifies the statutes to allow a related entity that pays the tax on behalf of the team to claim the refund and ensures that the refund only applies to professional motorsports teams that compete in at least 66% of the races sponsored in a race series. There are three race series in a season. The narrowing of the refund's applicability becomes effective when it becomes law; the other changes apply retroactively to the date the General Assembly authorized the refunds. Subsection (a) of this section also corrects a reference in the definition of 'over-the-counter drug' and makes conforming changes related to the change made in Section 17 of the act.
16	Clarifies that an accommodation arranged or provided by a school, camp, or similar entity to a person who pays to attend the school or camp is not subject to sales tax. In the past, the Department of Revenue did not consider summer camps, dorm rooms, or similar types of accommodations to be subject to sales tax. Recently, however, there appears to be some uncertainty. This section clarifies

	that there should not be a change in the application of the law in regards to these types of entities.
17	Removes the word "wireline" from the term 'prepaid calling service' at the request of the Streamlined Sales Tax Compliance Review and Interpretations Committee. It makes no substantive change in the law. Section 15 of the act made similar changes in the definitional statute.
18	Clarifies that the sales tax exemption for prosthetic devices is for human use, corrects the name of the agency where the Child and Adult Care Food Program is located, and corrects the name of the federal supplemental food program. This section also makes technical changes requested by the Department of Revenue in subdivisions (33a) and (49).
19	Removes geothermal heat pumps from the Energy Star sales tax holiday because consumers are not able to purchase them. Only a contractor can purchase a geothermal heat pump, which the contractor then sells to a consumer through the contractor's business. The holiday does not apply to the purchase of a product for use in a trade or business. The presence of the item in the list raised many questions and frustrated consumers.
20	Corrects the sunset dates of the sales tax refunds for fuel sold to passenger air carriers and motorsports teams. The General Assembly extended these sunsets from January 1, 2011, to January 1, 2013, in S.L. 2010-31. In a subsequent piece of legislation recommended by the Revenue Laws Study Committee, S.L. 2010-166, these refund provisions were reenacted in a new statute dedicated to economic incentive refunds. The later legislation failed to extend the sunset dates as provided in the previously enacted legislation.
21	Clarifies that use tax is payable by an individual on an annual basis for purchases made outside the State for a nonbusiness purpose of digital property and certain services. In 2009, the General Assembly imposed the State and local general rate of sales tax on certain digital goods, such as downloaded music and books. The legislation also made several conforming changes by adding the term "digital property" to a number of other sales tax statutes. Among them, the term "digital property" was added to the statute that sets out when an individual is required to pay use tax on out-of-State purchases. Since digital property was being subjected to sales tax, a corresponding change was made to subject it to use tax if it is

	purchased out of State. The Department of Revenue is interpreting the statute to exclude digital property and services from the annual use tax reporting requirement. This section clarifies that the "other than" phrase applies only to boats and aircraft. All other tangible personal property, digital property, and taxable services purchased outside the State for a nonbusiness use are subject to the annual reporting requirement for use tax.
22	Removes unnecessary and confusing words. If a datacenter fails to maintain its required levels of investments, it forfeits its incentive and must pay sales tax on its purchases. The statute stated that the sales tax would be calculated "*at the combined general rate*". The words are not necessary and may not correctly reference the right tax rate since the term "combined general rate" does not include the ¼ ¢ local sales tax applicable in some counties and may not accurately reflect the State tax rate in existence at the time of the investment.
23	Provides that a facilitator would not be liable for an over-collection or an under-collection of sales tax or local occupancy tax during the period of January 1, 2011, through April 1, 2011, as the result of the new collection and remittance obligations imposed under Section 31.6 of S.L. 2010-31 as long as the facilitator made a good faith effort to comply with the law and collect the proper amount of tax. During the 2010 Session, the General Assembly established new sales and use tax reporting and remittance obligations on "facilitators," which are entities that enter into a contract with the providers of accommodations to market and collect payment for accommodation rentals. An example of a facilitator is an online travel company, such as Expedia or Travelocity.
24	Gives effect to the changes the General Assembly made last session to the requirements for a datacenter to qualify for the 1% excise tax on the machinery and equipment it purchases. In S.L. 2007-323, the General Assembly created a tax incentive for the construction of datacenters by exempting the purchase of equipment from sales tax and, in its place, substituting the 1% excise tax. To qualify, a taxpayer had to invest $300 million in a NC datacenter over a five-year period. In S.L. 2010-91, the General Assembly reduced the investment threshold from $300 million to $225 million and also allowed taxpayers investing $225 million in one datacenter and $75 million in a second datacenter to pay the

	reduced rate on purchases of equipment for both datacenters. The modification allowed a datacenter to meet its investment threshold for the first facility at a lower threshold amount because the project was completed at a lower cost than originally estimated. It also provided that the initial investment amount would continue to be realized through investment in a second facility. The purpose of the legislation was to preserve the tax benefits for taxpayers who responded to the State's incentive offer in 2007 but whose investment expectations had changed. The 2010 legislation was generally effective July 1, 2010; the Department of Revenue questioned the applicability of the changes as they applied to datacenters already under construction. The Department reasoned that the language could be read to require a taxpayer to forfeit the reduced rate on all datacenter purchases made before July 1, 2010, even if the taxpayer met the investment threshold amounts. This section clarifies that the changes made in 2010 apply to all datacenter purchases made to date.
25	Clarifies that the amount of credit allowed for tax paid to another state is the amount of tax due and paid to that state.
26	Clarifies that a refund of tax allowed under G.S. 105-164.14, 105-164.14A, and 105-164.14B are not an overpayment of tax entitled to interest.
27	Clarifies the effective date of a tax change for services. North Carolina has been notified that it is out of compliance with the Streamlined Sales Tax Agreement on this issue because the Governing Board reads the current law to mean that different rates could apply to items billed in arrears and items billed in advance; the change is needed to comply with the Agreement.
28	Changes the term 'certificate of resale' for 'certificate of exemption' to conform to the name on the certificate.
29	Clarifies that for purposes of digital property, the sale is sourced to the place where the purchaser of the property takes possession or makes first use of the property, whichever comes first. North Carolina has been notified that it is out of compliance with the Streamlined Sales Tax Agreement on this issue; the change is needed to comply with the Agreement.
Excise Tax on Conveyances	
30	Clarifies the refund process for the deed stamp tax.

General Administration Tax Changes	
31	Updates the reference to NAICS and places the definition in the statute applicable to most of Chapter 105. NAICS is the North American Industry Classification System adopted by the US Office of Management and Budget. It is updated every five years. Makes a conforming change to the term "information technology and services" to reflect the changes from the 2002 NAICS to the 2007 NAICS.
32	Clarifies that the higher penalty for failure to obtain a license under the motor fuel statutes only applies after the taxpayer has received written notification from the Department of Revenue to obtain the requisite license.
33	Reconciles two conflicting provisions concerning whether the identity of certain taxpayers is public information. This section also makes conforming changes. The taxpayers affected are those who bring a contested case action at the Office of Administrative Hearings to obtain a review of an assessment or a denial of a refund by the Department of Revenue. Previously, G.S. 150B-31.1(e) stated that the record, proceedings, and decision in a contested case are confidential until the final decision is issued. The Secretary of Revenue makes the final decision and, once that decision issued, the records with the taxpayer name is public. However, G.S. 105-256(a)(9) required the Secretary of Revenue to publish the final decision in a contested case in a format that redacts identifying information. The requirement to redact the identifying information serves no purpose because once the decision is published, the record in the contested case proceeding becomes public in an unredacted form under G.S. 150B-31.1. Subsection (a) reconciles these provisions by amending G.S. 105-269(a)(9) to delete the requirement that the Secretary redact identifying taxpayer information when publishing final decisions. Subsection (b) makes a conforming change to the secrecy statute, G.S. 105-259, to change the word "report" to "publication" to ensure that the final decisions are included within the current exception for reports. G.S. 150B-31.1 and G.S. 105-256(a)(9) were both enacted in 2007 in Senate Bill 242, S.L. 2007-491. Under prior law, the Tax Review Board reviewed administrative decisions of the Secretary and made a decision, called an order, after the review. Orders of the Tax Review Board were published in the North Carolina Register, as required by

	G.S. 150B-21.17(a)(5),and were not redacted. S.L. 2007-491 revised the procedure for the review of contested tax cases and, as part of the revisions, eliminated the Tax Review Board. Subsection (c) makes a conforming change and repeals the obsolete requirement in G.S. 150B-21.17(a)(5) to publish orders of the Tax Review Board in the North Carolina Register.
34	Clarifies that a waiver of a statute of limitations must be executed before the statute of limitations expires.
35	Repeals an obsolete reporting provision. The reporting provisions were consolidated into a single statute in S.L. 2010-166.
36	Conforms the sunset provisions of miscellaneous provisions associated to the tax credit for recycling oyster shells. The General Assembly extended the sunset on this credit from January 1, 2011, to January 1, 2013, in S.L. 2010-147.
37	Ensures that the definition of 'person' for purposes of the Setoff Debt Collection Act of Chapter 105A is the same as the definition of 'person' for tax purposes under Chapter 105.
38	Deletes a statute concerning the procedure for Department initiated refunds of sales and use tax because the procedure applicable for all Department initiated refunds is in G.S. 105-241.7.
39	Reserved.
Property Tax Changes	
40	Clarifies the postmark rule for property taxes on registered motor vehicles. The provision is the same as the rule for other property tax payments and is the same as current administrative practice.
41	Clarifies that the definition of "public service company" in the property tax statutes does not include providers of mobile telecommunication service.
42	Corrects errors in the effective date section of the legislation regarding the change in the collection of motor vehicle property taxes.
43-44	Reserved.
Local Government Sales and Use Tax Changes	
45	Modernizes the local sales tax base to conform to the State sales tax

	base for items taxed at the general rate of tax. This change will remove the need to amend the local sales tax statute whenever an item is added to the State sales tax base and taxed at the general rate of tax. It effectively includes digital products in the local sales tax base, as intended by the General Assembly.
Miscellaneous Changes	
46	Removes the sunset from the provision that allows the Codifier of Statutes to renumber the subdivisions in the special license plates statute in sequential and alphabetical order. Changes the name of the Division of Legislative Drafting and Codification to Legislative Services Office, to conform to the changes made in S.L. 2011-97.
47	Clarifies the fees that should be credited to the Insurance Regulatory Fund.
48-49	Reserved.
Effective Date	
50	Except as otherwise provided, the act became effective when the Governor signed it into law on June 27, 2011.

Extend Sunsets.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-345	**SB 436**	**Senator Hartsell**

AN ACT TO EXTEND THE SALES TAX REFUND ALLOWED TO A JOINT GOVERNMENTAL AGENCY CREATED TO OPERATE A CABLE TELEVISION SYSTEM FOR ONE YEAR.

OVERVIEW: This act extends for one year the sales tax refund allowed to a joint governmental agency created to operate a cable television system.

FISCAL IMPACT: This act reduces General Fund availability by $25,000 for the 2011-12 fiscal year and local revenues by $5,000 per fiscal year. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 27, 2011.

ANALYSIS: Last session, the General Assembly allowed 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.[92] This act extends the refund for one year, for purchases made through June 30, 2011.

The only entity that fits this description is MI Connection. 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 G.S. 105-164.14(c) a city may obtain a sales tax refund of the purchases it makes. Under that authority, a city that operates a cable television system may obtain a sales tax refund; MI Connection was not allowed a refund under that subsection because it was operated as a joint venture, rather than by the cities themselves.

Increase In Rem Foreclosure Fee.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-352	**SB 537**	**Senator Hartsell**

AN ACT TO INCREASE THE IN REM FORECLOSURE FEE.

OVERVIEW: This act increases the amount of the charge for administrative costs that may be added to the tax due as part of the costs of the action in an in rem foreclosure proceeding for delinquent tax.

FISCAL IMPACT: Although no data is available on the number of in rem foreclosure proceedings in the state, this method of foreclosure has become more common in recent years. The $50 fee that is currently charged is not adequate to recover administrative costs to the taxing unit, particularly when a clear chain of title has to be established. The $250 fee would more closely reflect the actual administrative costs associated with in rem foreclosures. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act became effective July 1, 2011, and applies to in rem foreclosure proceedings commenced on or after that date.

ANALYSIS: This act increases from $50 to $250 the charge for administrative costs that may be added to the tax due as part of the costs of the action in an in rem

[92] S.L. 2010-153.

foreclosure proceeding for delinquent tax[93] due. The current administrative cost of $50 has not been increased since it was first allowed in 1987. The in rem procedure is an expedited procedure that permits a taxing unit to docket a judgment against the property in State court and proceed with a foreclosure sale within three months to two years after the judgment is docketed. In an in rem procedure, the costs of mailing and publication plus a $50 charge to defray administrative expenses may be added to the amount of taxes due; if an attorney is used, the attorney fee is paid by the taxing unit and may not be added to the judgment as part of the costs of the action. Much of the administrative time required for an in rem foreclosure is spent researching the property's chain of title.

Extend Time For Site Of Low/Mod. Inc. Housing.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-368	**HB 417**	**Representative McGrady**

AN ACT TO EXTEND THE TIME PERIOD FOR HOLDING REAL PROPERTY AS A FUTURE SITE FOR HOUSING FOR LOW- OR MODERATE-INCOME INDIVIDUALS AND FAMILIES.

OVERVIEW: This act extends from 5 years to 10 years the maximum time period that real property owned by a nonprofit organization as a future site for low or moderate income housing may be exempted from taxation.

FISCAL IMPACT: This act affects property taxes imposed by local governments.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2011.

ANALYSIS: Real property owned by a nonprofit organization providing housing for individuals or families with low or moderate incomes is exempt from property taxation if the owner is not organized or operated for profit and it is actually and exclusively occupied and used. This act provides that real property held for low or moderate income housing may be exempted from taxation for a maximum of 10 years. Under prior law, real property held for low or moderate income housing was exempted from taxation for a maximum of five years. The taxes otherwise due are a lien on the property. The taxes are carried forward to the next year as deferred taxes and are due if the property loses eligibility because of a disqualifying event. A

[93] Taxes become delinquent when interest begins to accrue on January 6 of the year in which the taxes were levied.

disqualifying event occurs when the property is not used for low or moderate income housing.

Forced Combinations.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-390	**HB 619**	**Rep. Howard, McLawhorn, Carney, Ingle**

AN ACT TO SPECIFY THE SECRETARY OF REVENUE'S AUTHORITY TO ADJUST THE NET INCOME OF A CORPORATION OR TO REQUIRE A CORPORATION TO FILE A COMBINED RETURN.

OVERVIEW: This act changes the Secretary of Revenue's authority to adjust the income of a multistate corporation by requiring it to file a combined return when the Secretary determines the corporation conducts its business in a way that fails to accurately reflect its income attributable to North Carolina.[94] Under current law, the Secretary may redetermine the net income of a corporation if the Secretary finds a report by the corporation does not reflect its true earnings from its business carried on in this State. Under the law effective for taxable years beginning on or after January 1, 2012, the Secretary may only make this redetermination if the Secretary finds the corporation fails to accurately report its State net income through the use of transactions that lack economic substance or are not at fair market value. The act also directs the Revenue Laws Study Committee to review the legislation and recommend any needed changes, as well as to determine whether the provisions of the new law should apply to pending assessments.[95]

FISCAL IMPACT: The Department of Revenue believes the changes made by the act will have a significant negative fiscal impact because it may affect agreements the

[94] The Senate removed the original contents of House Bill 619, which were included in S.L. 2011-145, the Current Operations and Capital Improvements Appropriations Act of 2011, and replaced them with the provisions of this act. The House concurred in the Senate Finance Committee Substitute with its four unengrossed amendments.

[95] The Senate Finance Committee Substitute applied to pending assessments. Amendment #2 made the act prospective only and directed the Revenue Laws Study Committee to recommend whether the provisions of the act should apply to pending assessments. The amendment intended to replace Section 7 of the third edition, which extended the time the Department of Revenue had to issue a final determination, with the Revenue Laws Study. However, because of an engrossment error, the act retained that Section 7, which is harmless, as well as a second Section 7 that directs the study. The amendment would have removed the extension because it was no longer needed since the act is effective prospectively and does not apply to pending assessments.

Department has entered into with multistate corporate taxpayers through its resolution initiatives. [96] The Fiscal Research Division noted the act will not increase or decrease revenues above the baseline budgeted amount because the biennial consensus revenue forecast does not include in the tax base any agreements the Department may have entered into with taxpayers. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The act becomes effective January 1, 2012, and applies to proposed assessments for taxable years beginning on or after January 1, 2012.[97]

ANALYSIS: 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 each subsidiary corporation for federal income tax purposes. G.S. 105-130.14 prohibits a corporation from filing a combined return in North Carolina unless specifically directed 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 of Revenue believes the corporation's net income attributable to this State is not accurately reflected on its separate filing return.

A corporation directed to file a combined return has 60 days to file the return before being subject to penalties unless the taxpayer has requested a hearing on the tax liability used as the basis for the penalty. The Secretary was directed in 2010 to adopt rules that describe when the Secretary would require the filing of a combined return.[98] A corporation must file a combined return when the rule adopted by the Department requires or, after a written request from the corporation, the Secretary provided written advice to the corporation stating that the Secretary will require a combined return.

The act repeals G.S. 105-130.6 and replaces it with G.S. 105-130.5A, which provides the following:

- If the Secretary has reason to believe a corporation's business conduct causes it to inaccurately report net income attributable to its business in North Carolina, the Secretary may give notice to and require any information necessary from the corporation to determine whether its intercompany

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[96] The Department of Revenue believes the changes made by Amendments #1 and #3 may have a significant fiscal impact. Amendment #1 prohibits the Secretary from making adjustments that limit a corporation's options for reporting royalty payments; Amendment #3 prohibits a life insurance company or an insurance company subject to tax under Section 831 of the Code from being included in a combined return. The Revenue Laws Study Committee plans to consider these changes as part of its review of the legislation.

[97] The Department of Revenue has requested clarification of the effective date. The repeal of G.S. 105-130.6 on January 1, 2012, appears to leave a window in which no law exists regarding the Secretary's authority to determine the State net income of a corporation who fails to accurately reflect its income attributable to North Carolina. A clearer effective date would have been one that made the act effective for taxable years beginning on or after January 1, 2012.

[98] The Department did not adopt any rules in this area.

transactions have economic substance[99] and are at fair market value between affiliated members.[100] The corporation has 90 days to comply.

- If the Secretary reviews the provided information and finds as fact that the intercompany transactions lack economic substance or were not at fair market value, the Secretary may redetermine the State net income of the corporation by (i) adjusting the intercompany transactions to accurately reflect State net income or (ii) requiring the corporation to file a combined return for all members of its affiliated group conducting a unitary business.[101] If either option is utilized, the Secretary must provide the corporation with a written statement containing details of the rationale supporting the findings of fact as to inaccurate reporting and as to the Secretary's proposed computational method of income.

- If the Secretary finds as fact that a combined return is required, the Secretary may require the submission of a combined return within 90 days of written notice. The submission does not act as an admission of liability, and the Secretary or corporation may propose a combination of fewer members.[102]

- In determining whether transactions between members of the affiliated group of entities are at fair market value, the Secretary must apply the standards contained in Section 482 of the Code.

- If a combined return is required, the combined net income of the corporation and affiliated members must be apportioned in a way that fairly reflects the current apportionment formula applicable to the corporation and each included affiliated member in determining State income tax.

- Properly required returns not timely submitted result in penalties.

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[99] G.S. 105-130.5A(f), as enacted by this act, defines economic substance to require one or more transactions that have both reasonable business purposes and economic effects. Reasonable business purposes and economic effects include any material benefit other than tax benefits, excluding tax benefits consistent with legislative intent. A showing that a transaction has economic effect beyond tax benefit may be satisfied by demonstrating material business activity of the entities involved. Centralized cash management of an affiliated group, alone, is not evidence of an absence of economic substance, and a financial accounting benefit is not a reasonable business purpose, alone, if the origin is a reduction of income tax.

[100] An affiliated group is two or more corporations or noncorporate entities in which more than 50% of the voting stock, including ownership interests for noncorporate entities, of each member is directly or indirectly owned or controlled by a common owner or owners, excluding (i) corporations not required to file a federal income tax return; (ii) certain insurance companies; (iii) certain tax-exempt corporations; (iv) S corporations; (v) foreign corporations under section 7701 of the Code; (vi) a partnership, LLC, or other entity not taxed as a corporation; and (vii) a corporation with at least 80% of its gross income from all sources in the tax from active foreign business income.

[101] This authority exists even if all members of the affiliated group are not doing business in the State.

[102] Senate Amendment #4 increased the time from 60 days to 90 days. Likewise, the amendment imposed a 90-day requirement on the Department of Revenue to provide the taxpayer with a written statement of facts after a proposed assessment.

- A corporation may request in writing specific advice regarding whether a redetermination of net income or a combined return would be required under listed facts, and the Secretary may request additional information. Advice must be provided within 120 days of receipt of the request. The Secretary may charge a fee for providing advice, which are credited to an account in the Department and do not revert to the General Fund. The fee must be between $100 and $5,000 unless waived by the Secretary.
- The Secretary and corporate taxpayers may extend the time limits contained in G.S. 105-130.5A, by mutual agreement.
- Appeals of the Secretary's determination are to the Office of Administrative Hearings. The administrative law judge holds a de novo review of the following issues:
    - Whether the separate income tax returns fail to report State net income property due to transactions that lack economic substance or are not of fair market value between affiliated members.
    - Whether the Department's redetermination of net income is appropriate to properly determine the corporation's income attributable to North Carolina.
    - Where a combined return is required, whether adjustments other than requiring the combined return are adequate to determine State net income.

Tax Credits for Children with Disabilities.

Session Law	*Bill #*	*Sponsor*
S.L. 2011-395	**HB 344**	**Rep. Stam, Randleman, Jordan, Jones**

AN ACT TO ALLOW AN INDIVIDUAL INCOME TAX CREDIT FOR CHILDREN WITH DISABILITIES WHO REQUIRE SPECIAL EDUCATION AND TO CREATE A FUND FOR SPECIAL EDUCATION AND RELATED SERVICES.

OVERVIEW: This act creates a new income tax credit for tuition and special education and related services expenses for a taxpayer's eligible dependent child with a disability who is enrolled in a private school or a public school where tuition is charged for the eligible dependent child's enrollment. The act also creates a Fund for Special Education and Related Services with the monies to be used for special education and related services for children with disabilities. The act requires the Department of Revenue to report on the administration of the credit.

FISCAL IMPACT: Effective for tax years beginning on or after January 1, 2011 and semesters occurring on or after July 1, 2011 the legislation is expected to reduce General Fund availability by $1.4 million in fiscal year 2011-12, and increase General Fund availability in future years. *(For a more complete fiscal analysis, see Overview: Fiscal and Budgetary Actions, 2011 Session. Available in the Legislative Library.)*

EFFECTIVE DATE: The new tax credit is effective for taxable years beginning on or after January 1, 2011, and applies to semesters for which the credit is claimed beginning on or after July 1, 2011. The Fund is effective January 1, 2011, but transfers to the Fund will not be made before the 2012-2013 fiscal year.

ANALYSIS: This act creates a new individual income tax credit of up to $3,000 per semester for tuition and special education and related services expenses for a taxpayer's eligible dependent child with a disability who is enrolled in a nonpublic school or a public school where tuition is charged for the eligible dependent child's enrollment.[103]

Credit. – A taxpayer is allowed an education expenses tax credit for tuition and special education and related services expenses for each "eligible dependent child" who is a resident of this State and who is enrolled for one or two semesters during the taxable year in grades Kindergarten-12 at either a nonpublic school or at a public school for which tuition is charged. The credit amount is $3,000 per semester, up to two semesters a year for a maximum of $6,000 for a full academic or taxable year. For home schools, the credit is equal to the amount the taxpayer paid for special education and related services expenses not to exceed $3,000 per semester.

An eligible dependent child must meet all of the following criteria:

- Is a child with a disability who requires an individualized education program (IEP) under Article 9 of Chapter 115C of the General Statutes[104] and the federal Individuals with Disabilities Education Improvement Act

[103] Approximately five states provide programs for students with disabilities to attend private schools:

- Florida - The John M. McKay Scholarships Program for Students with Disabilities gives parents a voucher to send their child to a private school or another public school of their choice.
- Utah - The Carson Smith Special Needs Scholarship Program awards scholarships to students with disabilities who attend a private school, both secular and non-secular.
- Ohio - The Special Education Pilot Project, also known as the Autism Scholarship Program, is a scholarship awarded to parents of autistic children for services at a public or nonpublic special education program, which includes tuition at a private school.
- Oklahoma - Oklahoma enacted the Lindsey Nicole Henry Scholarship for Children with Disabilities in 2010. The amount of the scholarship would be either the private school's tuition or the amount of state and local money that would be given to the school system where the student is enrolled, whichever is less.
- Georgia - Georgia enacted the Special Needs Scholarship Act in 2007, creating a program which allows children with special needs to attend the public or private school that best meets their educational needs.

[104] Education of Students with Disabilities.

(IDEA).[105] The child must be reevaluated every 3 years by a local educational agency to verify that the child continues to be a child with a disability.

  - Receives special education or related services on a daily basis.
  - Is a child for whom the taxpayer is entitled to deduct a personal exemption under section 151(c) of the Code for the taxable year.

For the initial eligibility for the tax credit during the first five years that the credit is available, the eligible dependent child must have been enrolled for at least the preceding two semesters in a public school or receiving special education or related services through the public schools as a preschool child with a disability. This initial eligibility requirement is reduced to one semester beginning for taxable years on or after January 1, 2016, and applies to semesters for which the credit is claimed beginning on or after July 1, 2016.

For purposes of this credit, there are two semesters during each taxable year with the spring semester being the first 6 months of the taxable year and the fall semester being the second six months of the taxable year. An eligible dependent child is considered to have been enrolled in a school for a semester if the eligible dependent child is enrolled in that school for more than 70 days during that semester.

The tax credit is not refundable but any unused portion of the credit may be carried forward for three succeeding years.

Disqualification. – A taxpayer is not qualified for the education expenses tax credit for any semester if the taxpayer's otherwise eligible dependent child meets any of the following conditions:

- Was placed in a nonpublic school or facility by a public agency at public expense.
- Spent any time enrolled as a full-time student taking at least 12 hours of academic credit at a postsecondary educational institution.
- Was 22 years of age or older during the entire semester.
- Graduated from high school prior to the end of the semester.

Reduction. – The amount of the education expenses tax credit is reduced for any semester in which the eligible dependent child spent any time enrolled in a public school. The amount of the reduction is equal to the percentage of the semester that the eligible dependent child was enrolled in a public school.

Documentation. – To substantiate the credit, a taxpayer must provide all of the following information to the Department of Revenue, if requested by the Secretary of Revenue:

[105] 20 U.S.C. § 1400 et seq.(2004), as amended.

- The name, address and social security number of each eligible dependent child for whom the credit is claimed and the name and address of the school or schools in which the eligible dependent child was enrolled in and attended for more than 70 days of each semester.
- A certification that there were no disqualifying factors.
- The name of the local school administrative unit in which the eligible dependent child resides.
- The amount of the tuition paid to a public school for each semester the eligible dependent child was enrolled in and attended that public school.
- The eligibility determination that the eligible dependent child is a child with a disability who requires special education and related services.
- A listing of the tuition and special education and related services expenses on which the education expenses tax credit is based.
- For home schools, a listing of the special education and related services expenses on which the education expenses tax credit is based.

Fund for Special Education and Related Services. – The act also establishes a Fund for Special Education and Related Services (Fund). At the end of each fiscal year, the Secretary of Revenue must transfer an amount equal to $2,000 multiplied by the number of education expenses tax credits taken during the fiscal year to the Fund from the net individual income tax collections. The Fund is a special revenue fund under the control and direction of the State Board of Education. Interest and other investment income earned by the Fund accrue to it and monies in the Fund do not revert. The revenue in the Fund may only be used for special education and related services for children with disabilities. In addition, the monies in the fund must be used to reimburse local educational agencies for conducting reevaluations for continued eligibility and developing revised individualized education programs for children with disabilities.

Report. – The Department of Revenue must report to the Revenue Laws Study Committee and the Joint Legislative Education Oversight Committee on the administration of the education expenses tax credit by October 1, 2013. The report must include all of the following:

- The number and amount of education expenses tax credits taken.
- Concerns relating to the administration of the education expenses tax credits or taxpayer compliance.
- Any other matter the Department wishes to address with respect to the education expenses tax credit.

The remainder of this act (Sections 4A, 5, and 5A) make necessary budget adjustments to the 2011 Appropriations Act[106] needed for the implementation of this act.

[106] S.L. 2011-145.

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