2012

FINANCE LAW CHANGES

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2012 Finance Law Changes

Extend Tax Provisions.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-36	**HB 1025**	**Rep. Howard, Starnes**

AN ACT TO EXTEND THE SUNSET OF CERTAIN TAX PROVISIONS.

OVERVIEW: This act extends several preferential tax provisions.

FISCAL IMPACT: The act will reduce General Fund revenues by $0.8 million in fiscal year 2012-20113. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 20, 2012.

ANALYSIS: North Carolina typically imposes a sunset on its tax credits, deductions, and refunds so they may be periodically reviewed to ensure they continue to achieve the policy goals intended. It is anticipated that major tax modernization will be undertaken during the 2013 session of the General Assembly. This act extends several preferential tax provisions through 2013 in order to maintain the current state of the North Carolina tax code until comprehensive tax modernization can be considered. The only credits extended beyond the 2013 taxable year were the income tax credits for rehabilitating historic structures and historic mill property[1] and the film credit,[2] which were extended through the 2014 taxable year.

Specifically, the act extends the tier one designation for seafood industrial parks through July 1, 2013. It extends the following income tax credits through January 1, 2014:

- Tax credit for renewable fuel facilities.
- Tax credit for biodiesel producers.
- Work opportunity tax credit.
- Article 3J tax credits.
- Tax credit for recycling oyster shells.
- Tax credit for premiums on long-term care insurance.
- Refundable earned income tax credit.
- Tax credit for adoption expenses.
- Tax credit for qualified business ventures.

[1] Section 12 of the act.
[2] S.L. 2012-194.

Lastly, it extends the following sales tax refunds through January 1, 2014:

- Passenger air carriers.
- Machinery and equipment place in a tier 1 county.
- Aviation fuel for motorsports team of sanctioning body.
- Analytical services.
- Certain industrial facilities.

Expedited Rule Making for Forced Combination.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-43	**SB 824**	**Sen. Rucho, Hartsell**

AN ACT TO REQUIRE THE SECRETARY OF REVENUE'S INTERPRETATION OF THE LAW CONCERNING THE SECRETARY'S AUTHORITY TO ADJUST NET INCOME OR REQUIRE A COMBINED RETURN BE MADE THROUGH RULE MAKING AND TO PROVIDE AN EXPEDITED PROCESS FOR RULE MAKING ON THIS ISSUE.

OVERVIEW: This act requires the Department of Revenue to adopt rules regarding its interpretation of the statute enacted in 2011[3] that gives the Secretary of Revenue the authority to force combination of separate entity returns. The act provides an expedited rule-making process for these rules. The legislation was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 14, 2012.

ANALYSIS: The issue of forced combination of separate entity returns began as a dispute between taxpayers and the Department of Revenue. Taxpayers have argued that the Department offered little to no guidance on how it interpreted the statutes that authorized it to force combination of separate entity returns. The N.C. Court of Appeals affirmed the Department's authority to force combination of separate entity returns in *Wal-Mart Stores East, Inc. v. Hinton*.[4] Although the Business Court upheld the Department's combination assessment against Delhaize in 2011, it struck the penalties imposed by the Department on the taxpayer for failure to file the combined return because it noted that the Department

[3] G.S. 105-130.5A.
[4] 197 N.C. App. 30 (2009).

"worked actively to conceal the standards its decision makers were using when exercising their authority to combine returns."[5]

Largely in response to this litigation, the General Assembly enacted legislation in 2011 repealing the statute upon which the Department derived its authority to force combination of separate entity returns and replaced it with more limited statutory authority.[6] The Department issued the first Corporate Tax Directive[7] it has issued since 2008 on the Secretary's authority to require a corporation to file a combined return under the new statute. The Revenue Laws Study Committee discussed the directive and how the Department administers its discretionary authority.[8] Throughout the hearings, the Committee expressed strong concerns on the need for the Department to provide clarity on the law for taxpayers and a belief that the guidance should be provided through the rulemaking process, especially on the issue of forced combinations. The Department voiced strong concerns about its ability to effectively and efficiently administer the tax laws if it had to undertake rulemaking for all of the guidance it provides. In the debate, the Committee identified three goals:

- The need for taxpayer certainty about the tax laws.
- The need for an outside determination as to whether the Department has exceeded its statutory authority in its interpretation of the law.
- The opportunity for public notice and comment on the Department's interpretation of the law.

This act seeks to balance these three goals. It requires the Secretary to adopt rules providing guidance to taxpayers on its administration of G.S. 105-130.5A, the newly enacted law regarding the Secretary's ability to redetermine a corporation's State net taxable income by adjustment or by forced combination. The act does not extend the rulemaking requirement to all interpretations of the tax laws by the Department because the Revenue Laws Study Committee did not have time to resolve the issues a larger proposal would entail; however, legislators have expressed a desire to consider a more far-reaching rulemaking requirement.

The act provides that the rulemaking procedure for the interpretation of G.S. 105-130.5A will follow the timetable for temporary rulemaking. This process may be completed in less than two months. This process allows 15 days for notice and comment from outside parties. Anyone may object to a proposed rule during the notice and comment period or within three business days of the adoption of the rule by requesting review by the Rules Review Commission (RRC). To ensure that all parties have knowledge of the adoption of a rule, the act requires the Department to provide electronic notification of its adoption of a rule to persons who are on the mailing list, who were originally given notice of the rulemaking, and who provided comment on the rule. If no one requests review by the RRC, the adopted rule may be delivered to the Codifier of Rules and entered into the Code. If the Department receives a written objection to the rule and a request that the rule be reviewed, then the RRC must review the rule within 15 days. The RRC may not extend the period of time for review.

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[5] *Delhaize America Inc. v. Lay,* 06 CVS 08416 (Wake County Superior Court, Jan. 12, 2011), on appeal as, *Delhaize America, Inc. v Hoyle*, NC Ct of Appeals Docket No. 11-868.

[6] S.L. 2011-390, G.S. 105-130.5A.

[7] Corporate Income Tax Directives Table of Contents

[8] Revenue Laws Study Committee Report (2012), see "Combined Reporting and Interpretation of Tax Laws" beginning on page 6 of the report.

As provided in G.S. 150B-21.9, the RRC does not consider questions relating to the quality or efficacy of the rule, but limits its review to the following:

- Is the rule within the authority delegated to the agency?
- Is it clear and unambiguous?
- Is it reasonably necessary to implement or interpret an act of the General Assembly or of Congress or of a regulation of a federal agency?
- Was it adopted in accordance with G.S. 105-262.1?

The act changes the fiscal note requirement for rulemaking to allow the Department to prepare its own fiscal note. It will not need to submit the fiscal note to the Office of State Budget and Management. The fiscal note must be submitted with the proposed rule to the Codifier of Rules and posted on the Internet. A person may comment on the fiscal note in the same manner a person may comment on a proposed rule. Section 4 of the act provides that the Department does not need to prepare a fiscal note for a proposed rule submitted to the Codifier of Rules prior to December 31, 2012. The reason for this waiver is that any rule submitted before the end of this calendar year under the statute created by this act is limited to the Department's application of G.S. 105-130.5A. The subject of the rule has been debated in the General Assembly during the 2011 session, where the Fiscal Research Division prepared a fiscal memo, and it has been the subject of four Revenue Laws Study Committee meetings in 2011 and 2012. The fiscal issues surrounding this particular rule appear to be well-known and understood by all the parties.

The act exempts rules proposed by the Department from the delayed effective date provisions that apply whenever the RRC receives 10 or more objections to a rule requesting review by the legislature. A rule adopted under this expedited process becomes effective on the last day of the month the Codifier of Rules enters the rule in the Code. This effective date provision differs from the general effective date provision in Chapter 150B and enables the rule to become effective a month earlier. Section 6 of the act clarifies that the Secretary's authority under G.S. 105-130.5A exists continuously for taxable years beginning on or after January 1, 2012. After a rule becomes effective, the Secretary may issue a proposed denial of a refund or a proposed assessment under the authority of G.S. 105-130.5A for any taxable year that beginning on or after January 1, 2012.

The act only applies to G.S. 105-130.5A. It does not apply to the Secretary's interpretations of the repealed statutes that continue to be applicable for taxable years beginning before January 1, 2012: G.S. 105-130.6, 105-130.15, and 105-130.16. The Department has issued a directive offering guidance on its interpretation of those laws, CD-12-01, and the directive appears to set forth the Department's application of the law as upheld by the North Carolina Courts. The Department has also issued a directive offering guidance on its interpretation of the newly enacted law, G.S. 105-130.5A, in CD-12-02. Section 5 of the act provides that a taxpayer who relied upon the interpretation in that Directive and whose North Carolina taxable income for the 2012 taxable year is less under the Directive's interpretation than under an interpretation adopted through the rulemaking process may rely on the interpretation under the Directive for the 2012 taxable year.

Appraisal Mgmt Co Reported to Dept of Revenue.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-65	**HB 1028**	**Rep. Howard, Starnes**

AN ACT TO REQUIRE THE NORTH CAROLINA APPRAISAL BOARD TO REPORT THE RECORDS OF APPRAISAL MANAGEMENT COMPANIES TO THE NORTH CAROLINA DEPARTMENT OF REVENUE.

OVERVIEW: This act requires the North Carolina Appraisal Board to report annually to the North Carolina Department of Revenue the following information about registered appraisal management companies: name; address; process agent, if any; type of entity; employer identification number or social security number; and North Carolina Secretary of State identification number, if any. The legislation was a recommendation of the Revenue Laws Study Committee.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 26, 2012.

ANALYSIS: The North Carolina Appraisal Board regulates real estate appraisal management companies, which are defined as entities that use a network of licensed appraisers who are independent contractors to perform appraisals. Federal regulations adopted in response to the housing crisis led to the growth of appraisal management companies. The appraisal management companies are intended to increase the quality and reliability of appraisals to prevent another housing crisis. The State began requiring appraisal management companies to register with the Appraisal Board in January 2011.[9] The Board has approximately 140 registered appraisal management companies. Only six of the 140 are North Carolina companies.

Although the out-of-state companies owe State income tax on the appraisal work conducted within the State, the Revenue Laws Study Committee questioned whether the companies were reporting the income and paying the tax. The purpose of the act is to insure out-of-state appraisal management companies are complying with North Carolina tax law. This act requires the Appraisal Board to report annually to the Department of Revenue information collected from appraisal management companies during a registration process. All of the information this act requires the Appraisal Board to report is already disclosed when an appraisal management company registers. The Department of Revenue will be able to use the information from the Appraisal Board to check the filing status of registered appraisal management companies.

[9] S.L. 2010-141, Article 2 of Chapter 93E of the General Statutes.

RTP District Amendments.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-73	**HB 391**	**Rep. Avila, Torbett**

AN ACT TO REVISE THE LAWS RELATING TO COUNTY RESEARCH AND PRODUCTION SERVICE DISTRICTS TO REFLECT CHANGED CIRCUMSTANCES, TO ALLOW FLEXIBILITY IN PROVISION OF SERVICES IN URBAN AREAS OF SUCH DISTRICTS, AND TO AMEND THE COUNTY SERVICE DISTRICT ACT OF 1973 RELATING TO APPROVAL OF PROPERTY TAXES IN MULTIJURISDICTIONAL INDUSTRIAL PARK DISTRICTS.

OVERVIEW: This act amends the authorizing statutes for county research and production districts to allow for additional permitted uses in the districts, including mixed-use development that combines residential, retail, and business use. The act also allows each county in which a multijurisdictional industrial park is located to levy a tax in the portion of the park in that county and increases the property tax limit in multijurisdictional industrial parks.

FISCAL IMPACT: This act has no fiscal impact at the State level.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 26, 2012.

ANALYSIS: In 1985, the General Assembly authorized counties to establish county research and production districts. Under this authority, a board of commissioners may, by resolution, establish a research and production district for any area of the county if the area meets the statutory standards. Prior to passing a resolution creating the district, the board of county commissioners must publish a report outlining the district and hold a public hearing on the formation of the district. Multi-county districts are also authorized. For multi-county districts, the boards of county commissioners may pass concurrent resolutions. A county may levy property taxes within the district in addition to those levied throughout the county with a cap of 10¢ on each $100 value of taxable property.

The original standards for a research and production service district limited real property in the district to use for research or scientifically-oriented production or for associated commercial or institutional purposes. The original standards also included acreage requirements, employment requirements, and a restriction on the number of permanent residents in the district. The standards also provided that no part of a district could be within the boundaries of any incorporated city or town. At the time the county research and production service district legislation was enacted it was assumed that the Research Triangle Park would be the only district created under the act due to the acreage and employment level standards need to qualify for the creation of a district.

In 2009, the General Assembly amended these standards to allow for the creation of a district if all of the real property in the district is part of a multijurisdictional industrial park.[10] The maximum property tax rate for a district in a multijurisdictional industrial park is 15¢ on each $100 value of taxable property. Currently, there is one multijurisdictional industrial park, Triangle North, located in Franklin, Granville, Vance, and Warren Counties.

This act broadens the permitted uses in county research and production districts to allow for mixed-use development that combines residential, retail, and business use. The expansion of the permitted uses was requested by the Research Triangle Foundation. The Foundation sought to expand the purposes in county research and production service district to adapt to changing business models and remain competitive in attracting new tenants.

Specifically, real property in a district may be used for the following additional purposes:

- Scientifically-oriented technology and education.
- Residential purposes associated with scientifically-oriented production, technology, or education.
- Any other purpose specifically authorized in the covenants adopted to restrict the use of the real property.

To finance the increase in services that must be provided in areas with residential development, the act also authorizes a board of county commissioners (board) to establish urban research service districts (URSD) within existing county research and production districts. The method of formation and governance of URSDs are substantially similar to provisions for county research and production service districts.

A URSD must be wholly located within a county research and production service district, must be wholly located within the county that establishes the URSD, and may not be contained in any other URSD. Prior to establishing a URSD, the board must receive a petition requesting creation of the URSD from 50% of the owners of real property in the proposed URSD that own at least 50% of the total area of the real property in the proposed URSD.

The board must provide an advisory committee for each URSD. The advisory committee will consist of owners and tenants of the URSD, an appointee of the developer of the district in which the URSD is located, and appointees of the board. The committee will advise the board on the services, facilities, and functions of the URSD.

To extend an URSD, the board must find the following: (1) the covenants restricting the use of real property will apply to the extension area; (2) 100% of the owners of real property in the extension area request to be added to the URSD; (3) the extension area is contiguous to the URSD; and (4) the extension area requires the additional services, facilities, or functions served by the USRD.

To remove area from an USRD, the Board must find the following: (1) the removal is recommended by a vote of two-thirds of the owners and tenants association and requested by 100% of property owners in the area to be removed; (2) the area to be removed no longer requires the additional services, facilities, or functions served by the USRD; and (3) the county has not financed any project for which taxes are levied on the area.

[10] S.L. 2009-523.

The board must provide services for which the URSD is being taxed in a reasonable time. The board may also authorize the developer of the county research and production service district in which the URSD is located to contract with any local government for services within the URSD.

The board may levy taxes in the URSD to finance and maintain services within the URSD. The taxes levied in the URSD are in addition to the taxes levied at the county level and the taxes levied in the research and development district. The rate of the tax in the URSD may not exceed the rate levied in the city with the largest population that is 1) contiguous to the county research and production service district in which the URSD is located, and 2) located primarily with in the same county as the URSD.[11] The taxes levied may be used for services in the URSD and debt service for debt incurred by the county for capital projects in the URSD.

This act also allows each county in which a multijurisdictional industrial park is located to determine whether or not to levy a tax in the portion of the park in that county. This change was requested by the existing multijurisdictional industrial park, Triangle North. Unlike Research Triangle Park, Triangle North does not consist of one contiguous tract of land. Due to the separation of the tracts, each county with a portion of the park in its jurisdiction requested the flexibility to levy taxes appropriate to the level of service required in the portion of the park in that county. The act also increases the property tax limit in multijurisdictional industrial parks from 15¢ on each $100 value of taxable property to 20¢ on each $100 value of taxable property.

Economic Devpt. & Finance Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-74	**HB 1015**	**Rep. Howard, Starnes**

AN ACT TO SET THE REGULATORY FEES AND TO ENHANCE ECONOMIC DEVELOPMENT.

OVERVIEW: This act does the following:

- Sets the rates for the public utility regulatory fees and the insurance regulatory charge for FY12-13 that are necessary to fund the Public Utilities Commission and the Department of Insurance. The rates for this year are the same as the rates for the prior fiscal year. The utility regulatory rates are expected to generate $14.2 million, and they became effective July 1, 2012. The insurance regulatory charge is expected to generate $29.98 million, and it became effective when the Governor signed it into law on June 26, 2012.

[11] There are three cities contiguous to RTP that could potentially meet this definition: Cary (tax rate of 33¢ per $100 value of taxable property); Durham (tax rate 55¢ per $100 value of taxable property); and Morrisville (tax rate 36¢ per $100 value of taxable property).

- Creates an individual income tax deduction for educator expenses to ensure that North Carolina educators will continue to receive the same tax benefit they have received since 2002, regardless of whether Congress extends the federal educator expense deduction. The deduction will reduce General Fund revenue by $1.8 million for FY 2012-13. The provision is effective for taxable years beginning on or after January 1, 2012.

- Clarifies and extends the time to apply for a sales tax refund of aviation fuel for FY 2010-11 and FY 2011-12. The refund will reduce General Fund revenues by $3.15 million for FY 2012-13 and it will reduce local government revenues by $2.72 million.[12] The provision became effective when the Governor signed it into law on June 26, 2012.

- Permits the use of Industrial Development Fund moneys for sewer infrastructure projects in adjoining counties. This provision has no General Fund impact; the IDF does not receive General Fund appropriations, it is funded by loan repayments only. The provision became effective when the Governor signed it into law on June 26, 2012.

- Temporarily allows a 20-year carryforward period under Article 3J for a taxpayer who makes an investment of $100 million in a tier one county. The change may decrease General Fund revenues by $2.4 million over the 20-year lifetime of the credit. The temporary change is effective for taxable years beginning on or after January 1, 2012, and expires for taxable years beginning on or after January 1, 2013.

- Makes a technical correction to the definition of a port enhancement zone. This change has no fiscal impact. The correction becomes effective for taxable years beginning on or after January 1, 2013; this effective date is the same effective date applicable to the 2011 legislation that this provision clarifies.

- Accelerates the sales tax relief enacted in 2011 for purchases of specialized equipment used at State ports by providing a one-year sales tax refund for these purchases made in FY 2012-13. This provision is expected to decrease General Fund revenues by $58,000 to $64,000 in FY 2013-14. The provision became effective when the Governor signed it into law on June 26, 2012.

FISCAL IMPACT: The fiscal impact of the changes is included in the Overview. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: The effective date of the changes is included in the Overview.

ANALYSIS: The act makes several changes necessary to balance the FY 2012-13 budget, enhance economic development projects, and clarify existing economic development statutes.

Set Regulatory Fees

In 1989, the General Assembly made a policy decision to finance the costs of the Utilities Commission and Public Staff through the imposition of a regulatory fee imposed on the entities regulated by the Commission. The General Assembly made a similar policy decision in 1991 to defray the State's cost of regulating the insurance industry through a regulatory

[12] The local government revenue loss would be felt primarily in Forsyth and Mecklenburg Counties.

charge imposed as a percentage of each insurance company's gross premiums tax liability. The General Assembly sets the rates for each fiscal year as provided in the statutes. The rates may not exceed the amount necessary to generate funds sufficient to defray the estimated cost of operating these agencies for the upcoming fiscal year, including a reasonable margin for a reserve fund. The revenues generated are credited to an interest-bearing, nonreverting special revenue fund and may only be expended upon appropriation of the General Assembly.[13] Section 1 sets the rates for FY 2012-13; the rates are the same as the rates for the prior fiscal year.

Regulatory Fee for Utilities Commission. – Subsection (a) sets the rate for the public utility regulatory fee for FY 2012-13 at 0.12%.[14] The rate has not changed since FY 2004-05. The utility regulatory fee is a tax that was first imposed in 1989. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating public utilities. The regulatory fee is imposed on all utilities that are subject to regulation by the North Carolina Utilities Commission. The fee is a percentage of the utility's North Carolina jurisdictional revenues. In general, jurisdictional revenue is derived from providing utility service in North Carolina.

Regulatory Fee for Electric Membership Corporation. – Subsection (b) sets at $200,000 for FY 2012-13 the annual public utility regulatory fee imposed on electric membership corporations whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale. The rate must be established by the General Assembly each year. The rate has not changed since the General Assembly enacted it in 1999. The proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to defray the State's cost in regulating electric membership corporations. The 1999 General Assembly enacted S.L. 1999-180, which authorized electric membership corporations to form subsidiary corporations that may provide energy services and products, telecommunications services and products, and water and wastewater collection and treatment. The subsidiary must fully compensate the electric membership corporation for its use of the corporation's personnel, services, equipment, and property. The Utilities Commission is charged with regulating this aspect of the subsidiary's business and, to pay for this regulation, S.L. 1999-180 levied a flat-rate regulatory fee to be paid annually by the North Carolina Electric Membership Corporation.[15] Thus, the fee imposed on the North Carolina Electric Membership Cooperation will be passed on to its member electric membership corporations.

Insurance Regulatory Charge. – Subsection (c) sets the insurance regulatory charge at 6% for the 2012 calendar year, the same as the rate set for the 2011 and 2010 calendar years. The insurance regulatory charge was first enacted in 1991 to defray the State's cost of regulating the insurance industry. The rate of the regulatory charge must be established by the General

[13] G.S. 58-6-25(d) provides that the money credited to the Insurance Regulatory Fund is used to reimburse the General Fund for the appropriations made for specified purposes.

[14] G.S. 62-302(b) provides that the rate for each fiscal year is the greater of the rate established by the General Assembly or $6.25 each quarter. The General Assembly has always established the rate.

[15] The North Carolina Electric Membership Corporation is the only electric membership corporation whose principal purpose is to furnish or cause to be furnished bulk electric supplies at wholesale as provided in G.S. 117-16. It is a "generation and supply cooperative" owned by its members. Its members are all but one of the existing North Carolina electric membership corporations, which are "distribution cooperatives."

Assembly. The charge is a percentage of each insurance company's gross premiums tax liability.[16]

Continue Educator Expense Deduction[17]

Section 2 of this act allows an individual income tax deduction for teachers in elementary or secondary education of up to $250 for unreimbursed expenses paid or incurred for school supplies. Congress enacted a tax benefit to help K-12 teaches defray some of the expenditures they voluntarily make to enhance the quality of their students' education. The deduction has been available for tax years 2002-2011. Since North Carolina begins its calculation of taxable income with federal AGI, teachers in North Carolina have been allowed the deduction at the State level as well.

Congress has not extended the tax deduction beyond the 2011 taxable year. This section allows North Carolina teachers to continue deducting up to $250 for unreimbursed expenses paid or incurred for school supplies for taxable years beginning on or after January 1, 2012. If a taxpayer files a joint return and both spouses are eligible educators, then they both may claim up to $250 of expenses for a $500 total on a joint return. If Congress extends the federal tax deduction beyond taxable year 2011, then this provision will not be needed. However, if it does not, this provision ensures that North Carolina educators will continue to receive the same tax benefit they have received since 2002.

Clarify and Extend the Time to Apply for a Sales Tax Refund of Aviation Fuel[18]

Since 2005, an interstate passenger air carrier has been allowed an annual refund of the sales and use tax paid by it on fuel in excess of $2,500,000. The only taxpayer that currently qualifies for this credit is U.S. Airways. Section 3 of the act ensures that the taxpayer may receive the refund for purchases made between January 1, 2010, and June 30, 2011.

To receive the refund, a taxpayer must apply for it; a refund applied for after the due date is barred. Prior to 2010, the refund period covered purchases made during a calendar year, and the refund application was due within six months after the end of the calendar year. In 2010, the General Assembly enacted legislation, S.L. 2010-166, that consolidated and made uniform sunset and reporting features and requirements across the State's various economic incentives. Among the changes, the due dates of the sales tax refunds were standardized to apply to a fiscal year. The effective date of the legislation specifically provided that, "The first claim for refund by a taxpayer whose sales tax refund period is changed by this act is due within six months after July 1, 2010, and applies to purchases during the time period not covered by the taxpayer's last claim for refund."

There was some confusion associated with the 2010 legislation. During the same session, there was another bill,[19] which passed first, extending various sunsets from January 1, 2011, to January 1, 2013. S.L. 2010-166 failed to take into account the extension of the sunsets enacted by the other bill. When S.L. 2010-166 was enacted, it unintentionally nullified the sunset extensions because it was enacted after the first one passed. This error was later corrected in 2011 technical corrections legislation.[20]

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[16] Medical service corporations and health maintenance organizations began paying the charge in 2000.
[17] This provision was included in Senate Bill 795 and House Bill 950, v.4.
[18] This provision was included in House Bill 142.
[19] S.L. 2010-31.
[20] S.L. 2011-330.

In the midst of the confusion, the transition from filing for a refund on a calendar year basis to a fiscal year basis, which should have occurred in 2010, was overlooked by both U.S. Airways and the Department of Revenue. In February of 2011, U.S. Airways filed for a refund for calendar year 2010 and received it. In January of 2012, U.S. Airways filed for a refund for calendar year 2011 but was told that the claim for the first six months of 2011 was barred due to an untimely application, and the refund request for the second six months of 2011 was not yet due.

Section 3 of this act does two things. First, it validates the 2010 refund application and payment issued by the Department of Revenue and second, it provides for the transition from a calendar year refund period to a fiscal year refund period. Subsection (a) validates the 2010 refund payment made on a calendar year basis; this subsection became effective when the act became law on June 26, 2012. Subsection (b) allows the taxpayer to apply for a sales tax refund for aviation fuel purchased by it in excess of $1,250,000 between January 1, 2011, and June 30, 2011, so long as the application is made before October 1, 2012. The State refund amount is capped at $3,150,000. The cap is reduced to reflect the fact that the refund would only be for a six-month period. Without the cap, the taxpayer would have been entitled to a State sales tax refund amount of $6,340,000.[21] The provision has a fiscal impact because the taxpayer is not entitled to the refund under current law since it filed an untimely application. This subsection became effective January 1, 2011, and applies to purchases made on or after that date.

Industrial Development Fund Changes[22]

The Industrial Development Fund (IDF)[23] provides funds to assist economically distressed counties[24] and cities located in those counties with creating new jobs. The funds must be used for an infrastructure project[25] located on the site of an eligible industry[26] or, if not located on the site, must be directly related to the operation of the specific eligible industrial activity. The funds must be expended at a maximum rate of $10,000 per new job created up to a maximum of $500,000 per project.

Section 4 of the act allows the IDF funds to be used by an economically distressed county for a sewer infrastructure project even though the project is located in an adjacent county that is not economically distressed. The act does not change the requirement that the infrastructure project must be directly related to the operation of an eligible industrial activity located in an economically distressed county. This change helps facilitate an economic development project in Davie County. Ashley Furniture is currently upfitting an existing building in Davie County that requires additional sewer capacity. Forsyth County operates

[21] The taxpayer will also receive a local sales tax refund amount of $2.71 million.

[22] This provision was included in House Bill 142.

[23] IDF is currently funded by loan repayments only; there is no longer a General Fund appropriation for IDF. Loan repayments average around $50,000 annually. The fund is within the Department of Commerce.

[24] "Economically distressed county" is defined as a county that has one of the 65 highest rankings under the development tier designation. Under the development tier designation, the 40 most distressed counties are designated as tier 1, the next 40 as tier 2 and the 20 least distressed as tier 3.

[25] The IDF funds must be used for (i) installation of or purchases of equipment for eligible industries; (ii) structural repairs and renovations of buildings for expansion of eligible industries; or (iii) construction of or improvements to new or existing utility lines or equipment or transportation infrastructure for existing or new building for the eligible industries.

[26] An eligible industry is defined as a company or person engaged in the business of air courier services, information technology and services, manufacturing, or warehousing and wholesale trade.

the water and sewer system that serves Davie County. While Davie County is an economically distressed county, Forsyth County is not. As applied to this project, the change made by this act enables IDF funds to be used to improve sewer infrastructure located in a county that is not economically distressed to the extent the improvement is directly related to the operation of an eligible industrial activity in an economically distressed county. Forsyth County has indicated that the improvements to the sewer system for purposes of serving the Ashley Furniture site will not enhance sewer service in Forsyth County.

Temporary Expansion of 20-Year Carryforward Provision under Article 3J

Article 3J[27] of the tax statutes provides a tax credit for making an investment in business property that the taxpayer places in service in connection with an eligible business during the taxable year.[28] The investment must exceed a minimum threshold amount; the threshold amount varies based upon a county's tier designation from $0 for a tier one county to $2 million for a tier three county. Any unused portion of the credit may be carried forward for the succeeding five years.[29] If the Secretary of Commerce makes a written determination that a taxpayer is expected to invest at least $150 million worth of business and real property in a two-year period, then the carryforward period of any unused portion of a credit is extended to 20 years.

Section 5 of the act provides a temporary, one-year expansion of the 20-year carryforward provision. To be eligible for the 20-year carryforward, a taxpayer must receive a written determination from the Secretary of Commerce during the 2012 taxable year that the taxpayer is expected to purchase or lease, and place into service in connection with an eligible business, at least $100 million worth of business and real property. The investment must be made within a two-year period, and it must be made in a tier one county. If the taxpayer fails to make the necessary investment within the two-year period, the expanded carryforward provision will not apply. There is at least one potential project that may benefit from this change; this project is expected to be located in Halifax County.

Port Enhancement Zone Technical Correction

Under Article 3J of the tax statutes enhanced incentives are available to tier 1 counties. Those same enhanced incentives are available to a taxpayer located in an urban progress zone (UP zone) or an agrarian growth zone (AG zone). Last year, in S.L. 2011-302, the General Assembly created a new type of zone eligible for enhanced credits under Article 3J known as a "port enhancement zone."[30] The enhanced incentives for a port enhancement

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[27] 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 or zone in which 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.

[28] G.S. 105-129.88.

[29] G.S. 105-129.84(c).

[30] The enhanced credits available to an UP zone, an AG zone, and a ports enhancement 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 ; and the amount of the credit is increased by $1,000 per job. 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

zone become effective for taxable years beginning on or after January 1, 2013. Section 6 of the act makes a change to the conditions that create a port enhancement zone in order to cover the areas the original legislation intended to include.

A port enhancement zone is 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 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.

The act changes the conditions to say that the zone may be comprised of *part or all* of one or more contiguous census tracts, census block groups, or both, in the most recent federal decennial census. Without this language, the areas intended to be covered by this provision would not meet the definition because the relevant tract exceeds the 5% limitation. This change would also make the port enhancement zone definition consistent with the UP zone definition.

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.

One-Year Sales Tax Refund for Purchases of Specialized Equipment used at State Ports

Last session, the General Assembly expanded the 1%, $80 preferential tax rate to include specialized equipment used at a port facility to unload or process bulk cargo to make it suitable for delivery to and for use by manufacturing facilities.[31] The change in the law becomes effective July 1, 2013; the reason for the out-year effective date was to ensure the provision did not impact the current fiscal biennium. At the time the legislation was enacted, there were no known projects that would benefit from the preferential tax rate. Today, it appears there is at least one taxpayer considering a project at the one of the State ports that would benefit from the preferential tax rate. To advance the benefit of the incentive, without impacting the current fiscal biennium, Section 7 of the act provides a full refund of local sales taxes and a portion of State taxes for purchases of specialized equipment used at a port facility made between July 1, 2012, and June 30, 2013. 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

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amount of the investment tax 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.

[31] S.L. 2011-302.

to purchases made during this fiscal biennium, it is not payable until FY 2013-14, thus ensuring that the provision does not impact the current fiscal biennium.

Revenue Laws Tech., Clarifying, & Admin Chngs.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-79	**SB 826**	**Sen. Rucho, Hartsell**

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

OVERVIEW: This act, which was a recommendation of the Revenue Laws Study Committee, includes several technical, administrative, and clarifying changes to the revenue laws and related statutes. Most of the changes were suggested by the Department of Revenue.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: Except as otherwise stated in the Analysis below, this act became effective when the Governor signed it into law on June 26, 2012.

ANALYSIS:

Section	Explanation
PART I: TECHNICAL CHANGES	
1.1	A taxpayer is allowed a deduction for the amount by which the basis of a depreciable asset is required to be reduced under the Code for federal tax purposes because of a *tax credit* allowed against the corporation's federal taxable income. Section 1603 of ARRTA[32] directs the Treasury to provide cash payments, or grants, to eligible persons who place in service specified energy property and apply for the payments. The purpose of section 1603 is to reimburse eligible applicants for a portion of the expense of such property. A section 1603 grant recipient is required to reduce the basis of the asset. This section allows a taxpayer to reduce his or her State taxable income if the taxpayer receives a section 1603 *grant payment* rather than a credit under sections 45 or 48 of the Code.
1.2	This section deletes the word "adjusted" as used in the definition of North Carolina taxable income for nonresidents and part-year residents.

[32] The American Recovery and Reinvestment Tax Act of 2009 (P.L. 111-5).

	In 2011, the General Assembly changed the starting point for calculating NC taxable income from federal taxable income to federal adjusted gross income.[33] This change simplified the calculation of NC taxable income because taxpayers no longer have to make adjustments to reduce the federal standard deduction and exemption amounts to determine the State deduction and exemption amounts. The intent was not to change the end result or impact the amount of NC taxable income. For purposes of prorating NC taxable income for nonresidents and part-year residents, the relevant fraction should only refer to "gross income," which was how the proration was computed prior to the 2011 change. Using "adjusted gross income" could produce a different result, changing the amount of NC taxable income, which was not the intent of the 2011 change.
1.3	This section clarifies that the standard deduction amount for individual income tax purposes is the *lesser* of the amount set out in the statute or the amount allowed under the Code. The current law refers only to the "standard deduction amount listed in the table below." However, there are instances where the North Carolina standard deduction is zero[34] or less than is shown in the table. This is another technical change identified by the Department as the result of the passage of Section 31A.1 of S.L. 2011-145.
1.4	This section makes changes to the sales and use tax exemption statute with regard to motor fuels and installation and delivery charges. Motor fuels are subject either to the motor fuels tax or to the sales tax, but not both. Dyed diesel and dyed kerosene are examples of motor fuels that are subject to the sales tax, but are nevertheless defined as motor fuels. This change in the sales tax exemption statute makes it clear that, to the extent a motor fuel is taxed under Article 36C (Gasoline, Diesel, and Blends), it is exempt from sales and use tax. This section also amends the sales tax exemptions for delivery and installation charges so that the language is parallel. It adds the phrase "similar billing document," which currently appears in the exemption for delivery charges, to the exemption for installation charges. It adds the phrase "at the time of sale," which currently appears in the exemption for installation charges, to the exemption for delivery charges.
1.5	This section removes the words "manufacturing fuel" from the heading of Article 5F of Chapter 105 because the tax on manufacturing fuel was repealed, effective July 1, 2010.
1.6	This section corrects the catchline for G.S. 105-187.70 because it refers

[33] Section 31A.1 of S.L. 2011-145.

[34] If a taxpayer is (1) married filing a separate return for federal income tax purposes and the taxpayer's spouse itemizes deductions; (2) a nonresident alien; or (3) filing a short-year return because of a change in the taxpayer's accounting period, the taxpayer is not entitled to the standard deduction.

	to an Article that does not exist.
1.7	This section updates from January 1, 2011, to January 1, 2012, the reference to the Internal Revenue Code. This change keeps the statute up to date, but does not result in any substantive changes because there have not been any federal tax law changes since January 1, 2011, that impact the calculation of North Carolina taxable income.
1.8	This section adds an additional Code reference to the statute that governs when a return, report, payment, or any other document that is mailed to the Department is timely filed. Code section 7503 addresses when the due date falls on a Saturday, Sunday, or a holiday.
1.9	This section corrects a statutory reference.
1.10	This section conforms the statute on the scope of the local use tax so that it is consistent with the parallel statute for the State use tax, which was amended during the 2011 session. The 2011 change[35] was a clarifying change.
1.11	S.L. 2011-72 authorized certain cities to establish a municipal service district for the purpose of converting private residential streets to public streets. The act was designed to address 14 residential developments in the Town of Morrisville that were seeking to convert private streets to public streets. After the bill passed, it was discovered that some of the developments were created under the Condominium Act rather than the Planned Development Act, which the bill amended. This section makes the necessary conforming changes.
1.12	This section corrects several errors in the 2011 special license plate act.[36] It adds the "Mountains-to-Sea Trail" plate to the list of plates that may be on a background other than the First in Flight background, which was the original intent. Under current law, the authorization for the plate states that it "shall bear the phrase 'Mountains-to-Sea Trail' with a background designed by the Friends of the Mountains-to-Sea Trail," suggesting that the organization may design its own background. However, in order for an organization to have a background other than First in Flight, it must be authorized in G.S. 20-63. This section also corrects errors with regard to the fees for the Sustainable Fisheries and the Morgan Horse Club plates.
1.13	This section allows a taxpayer to claim an Article 3J credit that the taxpayer would have been ineligible for prior to 2010 because it failed to meet the environmental impact standard, which was loosened

[35] S.L. 2011-330, s. 25(a).
[36] S.L. 2011-392.

	retroactively that year. In 2010, the General Assembly changed the environmental standard for Article 3J retroactively to 2007.[37] By loosening the standard and making the change retroactive to 2007, the General Assembly intended to allow certain taxpayers to file for an Article 3J credit. However, the 2010 change failed to make a corresponding change to the statute of limitations, which requires claims to be filed within six months of the due date of the return. Therefore, a taxpayer who did not claim the credit when the original standard was in effect would be unable to take advantage of the retroactive change which loosened the standard. This change does not have a fiscal impact.
1.14	This section makes changes required by the fact that G.S. 105-130.6, which dealt with forced combinations, was repealed last year and replaced with a new statute. The definitions are the same definitions that were in G.S. 105-130.6, except for "parent," which was not defined.
PART II: CLARIFYING AND ADMINISTRATIVE CHANGES	
2.1	This section allows a wholesale or retail dealer of other tobacco products to provide security to the Secretary in the form of an irrevocable letter of credit as an alternative to a bond. An irrevocable letter of credit is typically used by a foreign company that is unable to obtain a bond because it does not have assets in this country. This form of security is consistent with what is currently allowed under the motor fuels tax statutes.

[37] Sec. 1.3 of S.L. 2010-147 (*Various Economic Incentives).* Prior to the 2010 change, a taxpayer was eligible for certain economic incentives if the taxpayer had no pending administrative, civil, or criminal enforcement actions based on alleged *significant* violations of any DENR-implemented programs and had no final determination of responsibility for any *significant* administrative, civil, or criminal violation of any DENR-implemented program within the prior five years. Article 3J had a definition of what constituted a "significant violation" but there was some confusion as to whether certain violations met the definition. At the time, the Department made no distinction between civil and criminal violations or on the basis of whether the violation was knowing and willful. The 2010 clarification was designed to ensure that minor violations do not disqualify a taxpayer that would otherwise be eligible for a tax incentive. The current definition of an "environmental disqualifying event," as enacted by S.L. 2010-147, is as follows:

(9a) Environmental disqualifying event. – Any of the following occurrences:

a. During the tax year in which the activity occurred for which a credit is being claimed, a civil penalty was assessed against the taxpayer by the Department of Environment and Natural Resources for failure to comply with an order issued by an agency of the Department to abate or remediate a violation of any program administered by the agency.

b. During the tax year in which the activity occurred for which a credit is being claimed or in the prior two tax years, any of the following:

1. A finding was made by the Department of Environment and Natural Resources that the taxpayer knowingly and willfully, as defined in G.S. 143-215.6B, including all limitations thereto, committed a violation of any program implemented by an agency of the Department.

2. An assessment for damages to fish or wildlife pursuant to G.S. 143-215.3(a)(7) was made against the taxpayer.

3. A judicial order for injunctive relief was issued against the taxpayer in connection with a violation of any program implemented by an agency of the Department of Environment and Natural Resources.

c. During the tax year in which the activity occurred for which the credit is being claimed or in the prior four tax years, a criminal penalty was imposed on the taxpayer in connection with a violation of any program implemented by an agency of the Department of Environment and Natural Resources.

2.2	S.L. 2011-12 added synthetic cannabinoids to the list of controlled substances. No corresponding changes were made to the unauthorized substance tax laws. Therefore, without this change, they would be grouped with "other controlled substances" and be subject to tax at a rate of $200 per gram. However, synthetic cannabinoids are most analogous to marijuana, which is taxed at $3.50 per gram. This section taxes synthetic cannabinoids at the same rate as marijuana, effective when the S.L. 2011-12 became law.
2.3	Holding companies are subject to an annual franchise tax, which is capped at $75,000. A holding company is currently defined as one that receives more than 80% of its gross income from corporations in which it owns, directly or indirectly, more than 50% of the outstanding voting stock or capital interests. However, a corporation whose only asset is an investment in subsidiaries and has no income cannot meet the 80% test because the denominator would be zero. This section expands the definition of a holding company to address this situation. The Department has indicated that this is a clarifying change, not a substantive one. A question has arisen about this specific fact pattern where a taxpayer is clearly a holding company, in that all of its assets are investments in subsidiaries. For the year in question, the holding company had no income. Therefore, there would be $0 in income from subsidiaries and $0 in total income. Under a strict application of G.S. 105-120.2, $0 divided by $0 would result in an undefined mathematical value. Because it is undefined, it cannot be determined if it exceeds 80%. Alternatively, if one of the subsidiaries of the holding company had issued a dividend of as little as one cent, then 100% of the income would be coming from investments in subsidiaries. The Department believes that this interpretation is not what the General Assembly intended. The Department's interpretation is that it was a holding company and subject to the cap of $75,000 on franchise tax.
2.4	This section makes the definition of business property in Article 3J consistent with the definition of business property in Article 3B[38] and the old provisions for eligible machinery and equipment in Article 3A.[39]
2.5	This section provides that a taxpayer may qualify for innocent spouse relief at the State level if the taxpayer would have qualified for relief at the federal level even if the taxpayer does not have a federal tax liability. North Carolina follows federal law with regard to a taxpayer's eligibility for innocent spouse relief. Prior to this change, a taxpayer would have had to have a federal tax liability that he or she was relieved of in order to qualify for relief at the State level. With this change, if the taxpayer would have qualified for innocent spouse relief had the taxpayer had a federal tax liability, the taxpayer is eligible for relief at the State level.

[38] G.S. 105-129.15(1).
[39] G.S. 105-129.9(a).

2.6	This section adds the education expenses credit to the list of credits that are not allowed to be claimed by an estate or trust. In 2011, the General Assembly enacted the Tax Credit for Children with Disabilities.[40] This is a conforming change that should have been made at the time and is consistent with the other credits that are not eligible to be claimed by an estate.
2.7	This section makes three changes to sales tax definitions in order to conform them to the definitions in the Streamlined Sales and Use Tax Agreement, and it updates the reference to the most current version of the Agreement dated December 19, 2011.
2.8	This section clarifies the general sourcing provisions to conform to the requirements in the Streamlined Sales and Use Tax Agreement. It was noted during the 2011 Annual Compliance Review that the existing statute was not consistent with the Streamlined requirements.
2.9	This section restores language stating that sales tax must be stated and charged separately that was inadvertently stricken from the statute.[41]
2.10	This section restores language relating to the application of use tax to items given away by merchants, which was inadvertently deleted in a 2009 budget provision. The language was originally added to the definition of "sale or selling" in 1996 as the result of a court case.[42] The language was intended to restrict the application of that case, a broad application of which could be interpreted in such a way so as to eliminate

[40] S.L. 2011-395. The credit allows an individual income tax credit for 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.

[41] S.L. 2009-451, s. 27A.3(j).

[42] The use tax, first enacted in 1939, is the complement to the sales tax and applies to the storage, use, or consumption in this State of tangible personal property. Use tax accounts for approximately 5% of total sales and use tax collections. A merchant is liable for use tax on property it ***uses*** in its business, such as furniture, equipment, décor, or promotional giveaways. Items ***sold*** by the merchant, however, are not subject to use tax because sales tax will apply when the items are sold at retail. With regard to items given away free of charge, the general rule in this State, and virtually all states, is that a retailer is liable for sales and use tax on those items. Until 1993, the following items were considered used, not sold, and thus subject to use tax: meals provided free to a merchant's employees, food given away to the merchant's patrons, and matches given away to patrons, other than matches given away along with the sale of cigarettes. A group of restaurants appealed the assessment of the tax, claiming that the items should be considered sold. In *Matter of Rock-Ola Café*, 111 N.C.App. 683 (1993), the North Carolina Court of Appeals agreed with the restaurants that these items should be considered sold along with the food the restaurant sold as part of its business. However, the Revenue Laws Study Committee, in its report to the 1996 Regular Session, concluded that the Court's opinion was overly broad in its rationale. The rationale, that the cost of these items is recovered by the sales of other items, taken literally and if applied broadly, could be interpreted to eliminate the use tax altogether in that the cost of all of a merchant's purchases are ultimately covered by the price of sold items. The Committee recommended, and the General Assembly enacted, the language in this section to limit the application of the court's opinion to the facts of that case, which dealt specifically with restaurants. Under this language, property given away by a merchant is exempt from use tax only in the case of restaurants that provide free meals to employees or free bar food to patrons. The bill that was ultimately enacted added language to exempt items of inventory given away to a customer free of charge on the condition that the customer buy similar property ("buy one, get one free").

	the use tax. In 1996, the Revenue Laws Study Committee recommended limiting the application of the decision to the facts of that case, which involved food given away by restaurants. In 2009, a number of sales tax statutes were amended to address digital property. While amending those statutes, a number of stylistic and technical changes were also made. The language dealing with items given away by merchants was removed with the intent that it be located elsewhere in the sales and use tax statutes as a technical change. However, it was never relocated. This section restores the language by placing it in a new statutory section, effective the date that the 2009 deletion became effective since there was no intent to remove it.
2.11	This section makes two changes related to sales tax refunds for interstate carriers. First, it modifies the reference to "them" to make it clear that, for purposes of calculating a refund on certain cars, parts, fuel, and repair parts, an interstate carrier must include all motor vehicles, railroad cars, locomotives, and airplanes that the applicant owns or leases and that are operated both inside and outside the State in the denominator. Second, it clarifies that airplane miles are not in this State if the airplane only flies over North Carolina but does not take off or land in the State.
2.12	A direct pay permit authorizes the holder to purchase property that is subject to sales and use tax without paying the tax to the seller. A person who purchases an item under a direct pay permit is liable for use tax, which is payable when the property is placed in use or the service is received. A person can apply for a direct pay permit if the person purchases an item whose tax status cannot be determined at the time of purchase, and either: • The place of business where the item will be used is not known at the time of purchase and a different tax consequence applies depending on where the item is used, or • The manner in which the item will be used is not known at the time of purchase and one or more of the potential uses is taxable but others are not taxable. Generally speaking, a direct pay permit is not intended to allow purchasers to "shop" for a lower tax rate. It was originally designed to address situations where a purchaser of machinery, for example, did not know at the time of purchase how the machinery was going to be used and, therefore, whether it would be subject to sales tax at the general rate, exempt from tax, or subject to the 1%/$80 rate. In those cases, however, the property was always going to be used in North Carolina. The Department is aware of a situation where a retailer that has purchased items from NC vendors and has taken delivery of those items in NC wants to use a direct pay permit arguing that the items may be shipped out of state at some later date for use in another state. This section adds the words "for storage, use, or consumption in this State" to make it

	clear that a direct pay permit may not be used to avoid paying NC sales tax in this way. A person who purchases telecommunications service under a direct pay permit must file a return and pay the tax due monthly to the Secretary. This section adds the word "quarterly" so that the filing frequency is consistent with the filing frequency for general State and local sales tax remitters.[43] By providing for quarterly filing, this change conforms the statute to current practice at the Department.
2.13	There is an excise tax imposed on piped natural gas received for consumption in this State, which is in lieu of the sales and use tax. The tax is payable on a monthly basis. Under prior law, a taxpayer who was consistently liable for at least $10,000 of tax a month must make a monthly prepayment of the next month's liability. This section changes from $10,000 to $20,000 the prepayment threshold for the tax on piped natural gas, the purpose of which is to be consistent with the prepayment threshold for retailers required to remit sales and use tax.[44] This change does not change the amount of excise tax revenue remitted to the General Fund, but it does change by one month the timing of the payment for the year of the transition to the higher threshold. The Department indicates that it knows of only one company that would be affected by increasing the threshold to $20,000.
2.14	Generally speaking, the State may not contract with foreign vendors that refuse to collect use tax, where applicable, on sales delivered to North Carolina. G.S. 143-59.1 requires the Department to periodically provide to the Secretary of Administration a list of ineligible vendors based on this requirement. This section provides that the Department of Administration may not enter into a contract with a vendor if the Department of Revenue has determined that the vendor or an affiliate of the vendor refuses to collect use tax. This language has been agreed to by both the Department of Revenue and the Department of Administration.
2.15	This section conforms the statute to current practice at the Department. If a taxpayer files a return electronically, then the taxpayer must pay the tax due before the taxpayer may submit the return.

[43]A taxpayer who is consistently liable for less than $100 a month in State and local sales and use taxes must file a return and pay the taxes due on a quarterly basis. A taxpayer who is consistently liable for at least $100 a month but less than $20,000 a month in State and local sales and use taxes must file a return and pay the taxes due on a monthly basis. (G.S. 105-164.16.)

[44]For sales and use tax, the threshold limit of $10,000 was enacted in 2001 as a means to accelerate the payment of sales and use tax dollars into the General Fund for fiscal year 2001-02. Prior to this change, the threshold amount for making bimonthly payments was $20,000. In the years following 2001, the sales and use tax rate, at its highest, reached 7.75%. The lowering of the threshold amount along with the increase in the tax rate subjected more retailers to the most extensive sales tax remittance requirements. Consequently, many small retailers expressed a cash flow hardship with the pre-payment requirement. In 2010, the General Assembly phased in a restoration of the $20,000 prepayment threshold. The change decreased the number of retailers required to submit a prepayment of 65% of the amount of sales tax revenue to be remitted for the following month.

2.16	S.L. 2011-296 changed the fees collected by register of deeds for the purpose of simplifying their collection and remittance. As part of the legislation, a new fee became applicable to the indexing and filing of "subsequent instruments." Several registers of deeds have questioned how to apply the new fee applicable to subsequent instruments that contain references to multiple recorded documents, such as cancellations of multiple deeds of trust or substitution of trustee in multiple documents. This section removes the confusion caused by the new fee applicable to the recording of subsequent instruments by eliminating the fee and imposing a $10 fee for an instrument that assigns more than one security instrument by reference to a previously recorded instrument.
2.17	This section makes conforming changes to the statutes dealing with the State Home Foreclosure Prevention Project (SHFPP). The SHFPP was created by the General Assembly in 2008[45] as an emergency program and was expanded and extended in 2010[46] to cover all homeowners. The program is an effort to reduce unnecessary foreclosures providing homeowners with free resources, such as counseling, as they work with servicers to create alternatives to foreclosure. In 2011, the administration and staffing of SHFPP homeowner and counseling activities was transferred to the NC Housing Finance Agency, effective July 1, 2011.[47] Under that legislation, the Office of the Commissioner of Banks retained administration of the pre-foreclosure filings database, servicing invoicing, and the granting of 30-day extensions. This section completes the transfer of all program activities to the NC Housing Finance Agency and removes the program sunset.
2.18	This section removes the $5 minimum penalty amount for failure to file a return or failure to pay tax when due, effective January 1, 2014. This change was requested by the Department because TIMS, its new computer system that is not up and running yet, will not be able to compute the minimum penalty well. It will require a work around and likely an addition to the current contract. This has no impact on the General Fund and a negligible impact on the Fines & Forfeiture Fund.
2.19	This section provides that the portion of the Register of Deeds fees that are remitted to Cultural Resources for archives and records management shall be placed in a special revenue fund. This change will prevent unspent monies from reverting to the General Fund at the end of a fiscal year, thus ensuring the monies will be used for their intended purpose.

[45] S.L. 2008-226.
[46] S.L. 2010-168.
[47] S.L. 2011-288.

PART III: COMBINED MOTOR VEHICLE REGISTRATION/PROPERTY TAX CHANGES	
In 2005, the General Assembly created a framework establishing a combined system for motor vehicle registration renewal and property tax collection. Originally, the act was to become effective the earlier of January 1, 2009, or the date that the Department of Revenue and the Division of Motor Vehicles certified that an integrated computer system is in operation. The effective date has since been extended and is currently set to go into effect July 1, 2013. Under the new system, the taxpayer/motor vehicle owner will receive one bill for property taxes and the DMV license renewal, and DMV will be the collecting authority. Counties will still determine the value and the taxability situs of motor vehicles. A number of conforming changes are needed to fully implement the combined system, which goes into effect July 1, 2013. Part III of this act consists of those changes.	
3.1	Current law permits the governing body of a taxing unit to pass a resolution directing its tax collector not to collect minimal taxes, defined as up to $5.00, charged on tax records and receipts. This section exempts taxes on registered motor vehicles for two reasons: (1) a minimum of $28 is collected for motor vehicle registration; and (2) DMV, not the counties, will be the collecting authority. Therefore, the minimal tax provision is not applicable with regard to combined motor vehicle and property tax collection.
3.2	A taxpayer may appeal motor vehicle taxes on a number of grounds: the valuation by the county, the denial of an application for exemption or exclusion, and on the grounds that the county does not have authority to tax the vehicle because the situs of the vehicle is in another taxing district. The term "taxability" in the appeal statutes has been used to refer to both exemption status and situs, but because there are different time periods that apply depending on the basis of a taxpayer's appeal, the Department recommends separating the statutory provisions.[48] Therefore, this section strikes the term "taxability" from G.S. 105-330.2(b1) so that, as amended, this subsection would apply only to appeals based on valuation. It also creates a new subsection (b2) to address appeals based on an application for exemption or exclusion. Appeals based on a county's authority to tax are covered under current law in G.S. 105-381.

[48] A taxpayer has 30 days to appeal a determination of value or eligibility for an exemption or exclusion. However, there is a five-year period to appeal an "illegal" tax under G.S. 105-381.

3.3	This section establishes a process for the collection of property tax on an unregistered vehicle. The objective of the process is to ensure that the taxpayer is not double-taxed and that property taxes are paid on motor vehicles that a person owns even if it is not registered. If a person does not register or renew registration, then the person would be required to list the vehicle with the county assessor. The listing will generate a tax bill. However, if the person subsequently registers or renews the tag for the vehicle, then DMV will charge the person for the registration plus the property tax. This provision allows a county to ignore the listing to the extent the person registered or renewed within the same year.
3.4	This section clarifies that counties would have authority to use collection remedies for unpaid motor vehicle taxes that were billed prior to the effective date of the combined motor vehicle/property tax system. The August 1 date is used because the tax year for July renewals begins August 1. It allows 45 days before the second month's interest begins. This is needed due to DMV's business process which DOR thinks may cause some taxpayers who pay by mail to get caught in a loop of sending in the payment after the due date, and the payment would be rejected. Without this change, the next month's interest would start before they got the correct amount mailed back in to DMV. This section also changes the term "tax collector" to "collecting authority" because under the new system, DMV and not the county tax assessor or tax collector will be the collecting authority.
3.5	This section repeals an unnecessary statute that relates to small underpayments and overpayments of motor vehicle taxes. Specifically, if a taxpayer fails to remit the additional $1.00 charged for payments that are mailed rather than paid in-person, the collecting authority is not permitted to bill or attempt to collect the additional $1.00. However, there is no longer a $1.00 charge for mailed in payments so the provision is unnecessary.
3.6	This section is a conforming change to the effective date. When the effective date for the implementation of the combined system was changed, this particular session law was missed.

Expand Setoff Debt Collection Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-88	**HB 605**	**Representative McElraft**

AN ACT TO EXPAND THE DEFINITION OF LOCAL AGENCY FOR PURPOSES OF THE DEBT SETOFF COLLECTION ACT.

OVERVIEW: This act allows counties that jointly operate a solid waste facility as a regional solid waste management authority the same collection tool that would be available to them if they operated the facility individually. It does so by adding a regional solid waste management authority to the list of local agencies authorized under the Setoff Debt Collection Act to collect debts owed to them by obtaining a setoff against a debtor's North Carolina tax refund.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act becomes effective January 1, 2013, and applies to tax refunds determined by the Department of Revenue on or after that date.

ANALYSIS: This act allows a regional solid waste management authority created under Article 22 of Chapter 153A of the General Statutes to participate under the Setoff Debt Collection Act in the same manner as counties and cities.

The Setoff Debt Collection Act authorizes State and local agencies to collect debts by diverting part or all of a debtor's North Carolina tax refund to pay a debt that an individual or a business owes to a particular agency. Before January 1, 2001, the setoff program was open only to State agencies. Now, counties and municipalities participate through a clearinghouse.[49] While the use of debt setoff for State agencies is mandatory, usage by local agencies is optional. The Act only applies to debts that are at least $50 and to a refund that is at least this same amount. Local agencies are required to give written notice to the debtor of the intent to submit the debt for setoff, explaining the basis for the agency's claim, that the agency intends to apply the debtor's refund against the debt, and that an administrative fee of $15 will be charged.

Most counties operate their own landfill and recycling operations, and as such may use the Setoff Debt Collection Act. However, ten counties came together for economies of scale to provide these services as a regional authority. This act allows the counties that operate their solid waste management services collectively to have the same collection tool available that would be available to them if they operated the service individually. Currently, there are only two regional authorities:

- Coastal Regional Solid Waste Management Authority, which is comprised of Carteret, Craven, and Pamlico Counties.
- Albemarle Regional Solid Waste Authority, which is comprised of Perquimans, Chowan, Gates, Dare, Currituck, Hyde, and Tyrell Counties.

[49] Because there are so many local agencies, funneling their claims through a clearinghouse avoids an undue administrative burden on the Department of Revenue. A $15.00 collection assistance fee is added to each local agency debt submitted for setoff, which is remitted to the clearinghouse that submitted the debt. The fee does not, however, apply to child support debts.

Unemployment Insurance Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-134	**SB 828**	**Sen. Rucho, Hartsell**

AN ACT TO MAKE CHANGES TO THE UNEMPLOYMENT INSURANCE LAWS.

OVERVIEW: This act includes several changes to the unemployment laws that fall within the following categories:

- The extension of the three-year look-back period from January 1, 2012, to January 1, 2013. The extension became effective when the Governor signed the act into law on June 29, 2012, and applies retroactively to January 1, 2012.
- The resolution of outstanding issues associated with S. L. 2011-401, Senate Bill 532. These changes became effective November 1, 2012.
- The statutory changes required to comply with the federal Trade Adjustment Assistance Extension Act of 2011. The changes to the New Hire Directory became effective when the Governor signed the act into law on June 29, 2012. The remaining two changes become effective October 1, 2013.
- The recommendations of the House Unemployment Fraud Task Force. The criminal law changes become effective December 1, 2012. The reporting requirements became effective when the Governor signed the act into law on June 29, 2012. The remaining changes become effective October 1, 2012.
- Administrative changes requested by the Division of Employment Security (DES). These changes became effective when the Governor signed the act into law on June 29, 2012.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: The effective dates are included in the Overview.

ANALYSIS:

Part I: Change in the Law to Continue the Three-Year Look-Back Trigger for Extended Benefits

There are two permanent benefit programs required by federal law: regular unemployment insurance (UI) benefits and extended benefits. Regular UI benefits are fully funded by the State through its State Unemployment Insurance Trust Fund and claimants in North Carolina are eligible to receive benefits for up to 26 weeks under it. Extended benefits are available in a state when the state is experiencing high levels of unemployment. The program is funded 50% by state contributions and 50% by the federal government. However, the federal government has paid 100% of the extended benefit claims since February 22, 2009.

Extended benefits are triggered in a state when the unemployment rate is at least 6.5% and at least 10% higher than it was at the same time in either of the past two calendar years. This two-year window is known as the "two-year look-back." In the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Congress enabled more states to offer extended benefits by allowing the states to amend their laws to temporarily increase the

two-year look-back period to a three-year look-back period. Under the 2010 federal legislation, the temporary measure ended December 31, 2011. Congress extended the temporary measure twice. It is currently set to expire December 31, 2012.

The language of the federal law clearly states that a "State may by law" provide for the temporary look-back extension. However, the Governor acted unilaterally through executive orders to extend the look-back period on two different occasions. Section 1 of the act does two things:

- It calls attention to the Governor's lack of authority to make the UI law changes by executive order and states that any executive order on this issue would be void unless the order is issued upon authority that is conferred expressly by an act of the General Assembly or granted specifically to the Governor by Congress.
- It acknowledges that the General Assembly validated the effects of Executive Order 93 when it enacted S.L. 2011-145, Section 6.16; and that it is validating the effects of Executive Order 113 by the extension of the three-year look-back sunset from January 1, 2012, until January 1, 2013. As a practical matter, extended benefits will not be allowed in North Carolina for claim weeks later than May 12, 2012, because the State's unemployment rate fell below the three-year look-back trigger.

Part II: Resolution of Outstanding Issues from S.L. 2011-401, Senate Bill 532

The General Assembly enacted Senate Bill 532[50] on July 26, 2011, over the Governor's veto of the legislation on June 30, 2011.[51] In the Governor's Objections and Veto Message, she stated the U.S. Department of Labor (USDOL) informed the administration that a lack of conformity between the bill and federal law could result in a loss of money for the State's UI program and a reduction in the FUTA tax credit.[52] After the General Assembly overrode the Governor's veto, the Employment Security Commission informed the General Assembly by a letter dated October 12, 2011, of its intention to suspend the provisions of the act determined by the USDOL to be noncompliant with federal law. G.S. 96-19(b) gives the DES the authority to suspend enforcement of a provision upon receiving notification from USDOL that a provision is noncompliant with the requirements of federal law. The suspension may be in effect until the Legislature next has an opportunity to reconsider the provisions purported to be noncompliant with federal law.

Part II of S.L. 2012-134 addresses the areas of concern noted by USDOL. The changes were shared with USDOL and have been found to be in compliance with federal law. The following changes became effective November 1, 2012:

Payment of UI benefits with the greatest promptness that is administratively feasible. - Senate Bill 532 expanded from 10 days to 30 days the time for an employer to provide information required to protest a claim. The USDOL noted that the extension of time would make it virtually

[50] Senate Bill 532 created DES within the Department of Commerce and transferred the functions of ESC to DES; it made DES subject to rulemaking; and it made substantive and conforming changes to the UI laws.
[51] The Senate passed the bill on June 2, 2011, by a vote of 43 to 5. The House passed the bill on June 15, 2011, by a vote of 104 to 12.
[52] A state's law must conform to the provisions of the federal unemployment compensation laws in order for employers in the state to be eligible for a credit against the FUTA tax and for the state to be eligible to receive an administrative grant to operate its unemployment compensation programs.

impossible for the agency to make timely determinations under the standards set by federal regulations. The act provides that an employer has 10 days from the delivery of notice of the filing of a claim against the employer's account to protest the claim.

Misconduct connected with work and total reduction of benefit rights. - An individual is totally disqualified from receiving benefits if the DES determines the individual was discharged for misconduct connected with the work. Senate Bill 532 expanded the definition of "misconduct connected with the work" to include both of the following:

- *Arrest for or conviction of certain criminal offenses.* – USDOL noted that the new definition did not require that the criminal conduct be connected with the individual's work. The act provides that the offense must be related to the employee's work with the employer or in violation of a reasonable work rule or policy. It also amends a previous provision in North Carolina's law concerning the conviction of a person for drug offenses to make the same clarification that the offense be related to the employee's work with the employer or in violation of a work rule or policy.
- *Failure to adequately perform employment duties after being warned by three written reprimands within a 12-month period.* – USDOL noted that, in order to be the basis for a disqualification to receive UI benefits, unsatisfactory job performance must be the result of intentional behavior or gross negligence and must be egregious. The act provides that three written reprimands within a 12-month period is prima facie evidence of an employee's failure to adequately perform employment duties; this presumption may be rebutted by the claimant.

Stipulation of the issues and the methods of administration requirement. - Senate Bill 532 allowed the parties to tender stipulation of the ultimate issues in cases pending on appeal to the agency and provided that the stipulation did not have to be recorded. USDOL noted that while a stipulation of facts might be acceptable, a stipulation of the issues vitiates the agency's federally-mandated responsibility to apply the unemployment law to specific facts. USDOL also recommended that any procedure or process by which an appeals referee or hearing officer accepts a stipulation of fact should be recorded. The act allows parties to agree to a stipulation of facts. The appeals referee or hearing officer may accept the stipulation if the stipulation provides sufficient information to make a UI benefit decision. If the stipulation does not provide sufficient information, the appeals referee or hearing officer must reject the stipulation. The decision to accept or reject the stipulation of facts must occur in a recorded hearing.

Salaries for Board of Review. – Senate Bill 532 created a Board of Review to determine appeals policies and procedures and to hear appeals arising from the decisions and determinations of the Employment Security Section and the Employment Insurance Section. The annual salaries of the three-person board are to be set by the General Assembly in the current Operations Appropriations Act. The Current Operations and Capital Improvements Appropriations Act of 2011 did not set the salaries for the members of the Board of Review. The act states that the current Operations Appropriations Act of 2012 must provide for the annual salaries of the Board of Review. S.L. 2012-142, The Current Operations and Capital Improvements Appropriations Act of 2012, set the salaries of the Board of Review: an annual salary of $120,737 for the two members and an annual salary of $122,255 for the chair.

Part III: Compliance with the Trade Adjustment Assistance Extension Act of 2011

In 2002, the United States General Accounting Office issued a report on the UI program and the need for an increased focus on program integrity. The focus of President Obama's Executive Order 13520, issued November 23, 2009, was the reduction of improper payments in major programs administered by the federal government, including the UI program. In response to the level of improper payments in the UI program, the USDOL developed a strategic plan to address the root causes of improper payments. The plan involves new performance measures for the states; increased funding of new tools and technology; and a focus on the root causes leading to improper payments. The three identified root causes leading to improper payments are:

- A gap in employment service registration.
- Untimely and insufficient separation information from employers and third party administrators.
- Claimants continuing to claim benefits after returning to work.

As part of the increased focus on program integrity, USDOL recommended legislative language to Congress in June of 2011. In October 2011, three key integrity provisions recommended by USDOL were enacted as part of the Trade Adjustment Assistance Extension Act of 2011. The act includes the statutory change North Carolina must make to be in conformity with the program integrity provisions this year as well as the statutory changes for the two provisions that must be enacted prior to October 21, 2013.

New Hire Directory. – The New Hire Directory was created years ago to assist states with the collection of child support payments. The Directory is administered by the Department of Health and Human Services. The directory is also a valuable tool for UI programs because it allows an agency to cross-check claimants with new hires. This information assists the agency with the detection of overpayments being made to individuals who have returned to work. To address the gap in employment service registration, the Trade Adjustment Assistance Extension Act of 2011 requires states to expand the definition of a "newly hired employee" to include a rehired employee who was separated for at least 60 days. It also requires employers to enter the start date of employment when the employer submits the information to the New Hire Directory. States are required to make the necessary statutory changes to its New Hire Directory provisions within two months after the latest legislative session ends. The act includes the necessary changes, effective July 1, 2012.

Prohibition on Non-Charging of Employer Accounts. – To address the untimely and insufficient separation information provided by employers and third party administrators to the state unemployment agencies, the federal law requires states to enact a provision prohibiting the non-charging of an employer's UI account when an improper payment is made because of the employer's failure to respond timely or adequately to a written request for separation information. In most states, an employer's state unemployment tax rate is based upon an experience rating whereby employers that have more claims or charges against their UI account have a higher tax rate. Under current law, benefits paid to a claimant erroneously may not be charged to the employer's account. Under this provision, the benefits would be charged to the employer's account if the erroneous payment is made because the employer failed to respond timely and adequately to the agency. This provision points to a trend whereby employers are expected to improve the quality of information provided to state

employment agencies at the front end of the UI claim process, rather than waiting until a hearing to provide details. The act makes the necessary changes to impose the federally-mandated penalty; it does not impose a larger state penalty. The changes become effective October 1, 2013, and apply to an overpayment established on or after that date.

Monetary Penalty Assessment. – To address claimants who fraudulently continue to accept UI benefits after returning to work, the federal law requires states to impose a penalty on the claimant equal to 15% of the amount of erroneous overpayment if the agency determines that the overpayment is due to fraud. Under G.S. 96-18(a), a fraudulent overpayment is one that results from a person's false statement or representation knowing it to be false or from a person knowingly failing to disclose a material fact to obtain or increase a benefit received. The money collected from the penalty is payable to the State Unemployment Trust Fund and its use is limited to the payment of UI benefits. States may enact a larger penalty amount and may use the additional amount for whatever purpose it desires. The act makes the necessary changes. They become effective October 1, 2013, and apply to a fraudulent overpayments on or after that date.

Part IV: Enhance Unemployment Compensation Fraud Detection and Recovery, as Recommended by the House Unemployment Fraud Task Force

The House Unemployment Fraud Task Force met three times and spent time considering the differences between overpayments and fraudulent overpayments. An overpayment may occur when funds go to the wrong recipient; when the right recipient receives the wrong amount; and when documentation is not available to support a UI claim. Not all overpayments are fraudulent. An overpayment is considered fraudulent when the claimant makes a false statement or representation knowing it to be false or knowingly fails to disclose a material fact to obtain or increase any UI compensation benefit.

One of the leading causes of overpayments is a person continuing to claim benefits after returning to work. The Task Force learned that proving a person knowingly made a false statement is sometimes difficult when the overlap of benefits and earnings is for a limited period of time. Claimants who return to work, but don't receive a paycheck for a period of two to four weeks after starting employment, sometimes fail to correctly answer the question asked regarding weekly earnings.

The implications of an overpayment versus a fraudulent overpayment are as follows:

- A person who has been found to have obtained a benefit fraudulently is not entitled to receive benefits for a period of 52 weeks.
- A person who has been found to have obtained a benefit fraudulently is guilty of a Class 1 misdemeanor.
- DES has 10 years to recover a fraudulent overpayment; it has only three years to recover an overpayment.
- DES may recover a fraudulent overpayment by deducting 100% of the overpayment from future benefits payable to the person; it may deduct only 50% from future benefits for a non-fraudulent overpayment.

The act makes the following changes to enhance DES's ability to recover overpayments:

- Makes it a Class I felony to wrongfully obtain or increase an UI benefit if the amount wrongfully obtained exceeds $400. The felony penalty provision mirrors the current criminal provision for wrongfully obtaining a benefit under the Medicaid Program. This change becomes effective December 1, 2012, and applies to offenses committed on or after this date. Under current law, it is a Class 1 misdemeanor.
- Removes the statute of limitations for recovering any overpayment. This change becomes effective October 1, 2012, and applies to an overpayment established on or after this date. Under current law, the statute of limitations for recovering on overpayment is three years and for recovering a fraudulent overpayment is 10 years.

The Task Force learned about the Unemployment Insurance Compensation Debt of the Treasury Offset Program (TOP-UIC). The TOP compares payee names and taxpayer identification numbers on federal payment certification vouchers to names and taxpayer identification numbers in TOP's debtor database. When a match occurs, TOP intercepts, or "offsets," all or part of a payee's eligible Federal or state payments. Congress first permitted UI compensation debts and uncollected contributions to be recovered under TOP in 2008. The initial legislation limited the types of UI debts that could be recovered through TOP. However, in December 2010, Congress removed many of the limitations. Today, the definition of "covered unemployment compensation debt" is no longer limited to overpayments due to fraud and any associated penalties or interest may be recovered through TOP if the UI compensation debt is due to a person's failure to report earnings or delinquent contributions. In addition, the term is no longer limited to debts that remain uncollected for 10 years.

To participate in the TOP-UIC, a state must have a Safeguards Procedure Report approved by the IRS, must send debtors 60 days-notice of the State's intent to send the debt to TOP-UIC, and must complete several forms required by the Financial Management Service of the US Treasury Department. As of April 16, 2012, 14 states are participating in the TOP-UIC. Those states have recovered more than $140.6 million in tax refund payment offsets since February 2011.

Assistant Secretary for the DES, Dempsey Benton, indicated DES was pursuing the implementation of the TOP-UIC for North Carolina. The act notes the desire of the General Assembly that DES participate in the refund offset program on or before January 1, 2013. To that end, the act requires DES to report on its implementation of the program to the House Unemployment Fraud Task Force on September 1, 2012, November 1, 2012, and January 1, 2013.

Part V: Technical Changes Requested by the Division of Employment Security

Last session, as part of the reorganization of the Employment Security Commission, the information management system was placed under the Labor and Economic Analysis Division of Commerce. The act notes this change of responsibility in Article 4 of Chapter 96 of the General Statutes. The changes became effective when signed into law on June 29, 2012.

Part VI: NC Facts Program

The House Unemployment Fraud Task Force learned the importance of using cross-matching to discover and recover UI benefit overpayments. Cross-matching is a key tool in overpayment prevention, detection, and recovery. The act makes the necessary changes to enable DES to participate in NC FACTS by insuring that any disclosure made must conform to the confidentiality requirements of federal law. The changes became effective when signed into law on June 29, 2012.

NC FACTS is the North Carolina Financial Accountability and Compliance Technology System. It is a program designed to identify fraud, waste, and improper payments across State agencies. In 2007, the General Assembly directed the Office of the State Controller (OSC) to develop a strategic plan for the integration of databases and sharing of information among State agencies and programs. Since 2008, OSC has managed the Statewide Data Integration Program, including the design, development and statewide implementation of Criminal Justice Law Enforcement Automated Data Services (CJLEADS) criminal justice data integration program. Last year, in S.L. 2011-145, the General Assembly directed OSC to expand the data integration program by developing an enterprise process to detect fraud, waste, improper payments across State agencies. OSC has contracted with SAS to design, develop, and host NC FACTS.

Modify 2011 Appropriations Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-142, as amended by S.L. 2012-145	**HB 950**	**Representative Brubaker**

AN ACT TO MODIFY THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 2011 AND FOR OTHER PURPOSES.

OVERVIEW: This act caps the motor fuel tax rate at 37½¢ cents a gallon for one year, July 1, 2012, through June 30, 2013, and it authorizes the Secretary of Revenue to enter into a public-private partnership for the purpose of expanding the implementation of the Tax Information Management System (TIMS).[53]

FISCAL IMPACT: The cap on the motor fuel tax rate reduces Highway Fund revenues by $46.65 million in FY 2012-13 and reduces Highway Trust Fund revenues by $15.55 million in FY 2012-13. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

[53] Section 24.21 of the act prohibits DOT from establishing or collecting tolls on I-95 prior to July 1, 2014. Originally, Section 24.18 of the act required DOT to collect the increased tolls on various ferry routes. However, Section 6.2 of S.L. 2012-145 reversed this provision by prohibiting DOT from collecting the increased ferry tolls during FY 2012-13.

EFFECTIVE DATE: This act became effective on July 1, 2012, when the General Assembly overrode the Governor's veto on July 2, 2012.[54]

ANALYSIS: This act contains the following finance-related provisions:

Reduce Motor Fuel Excise Tax Rate.[55] – Section 24.11 effectively reduced the motor fuel excise tax rate for the period July 1, 2012, through June 30, 2103, by placing a cap on the rate of 37.5¢ per gallon. With a cap, the rate may fall below 37.5¢ per gallon for the period July 1, 2012, through June 30, 2013, but it may not exceed it. Without this change the rate would have decreased from 38.9¢ per gallon to 37.7¢, effective for the period July 1, 2012, through December 31, 2012; however, without this change, it is projected that the rate would have increased to 38.8¢ a gallon for the period January 1, 2013, through June 30, 2013.

A motor fuel excise tax is imposed on all motor fuel sold, distributed, or used in the State. The motor fuel tax rate has two components: a flat rate of 17.5¢ and a variable rate that may change every six months.[56] The variable rate is equal to 7% of the wholesale price of gasoline based on a weighted average price of gasoline and diesel, as reported by the US DOE Energy Information Administration. The variable rate decreased from 21.4¢ to 20.2¢, effective July 1, 2012, based on the six-month period that ended March 31. However, it is projected that the variable rate effective January 1, 2013, would be higher based on the wholesale price of gasoline over the last few months. The variable tax rate effective January 1, 2013, would be based on the wholesale price of gasoline during the period April 1, 2012, through September 30, 2012.

The revenue generated by the motor fuel tax is distributed as set forth in G.S. 105-449.125. One-half cent of the excise tax on each gallon of gas is distributed to funds for underground tank storage cleanup water and air quality. The remaining excise tax revenue is allocated as follows:

- 75% to the Highway Fund and used for maintenance, transit, rail, State Highway Patrol, DMV, some secondary road improvement, Powell Bill distribution to local governments, and some other administrative needs. G.S. 105-449.126 credits 1/6 of 1% of this amount annually to the Wildlife Resources Fund to be used for the boating and water safety activities described in G.S. 75A-3(c).[57]

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[54] The failure of the act to be enacted on or before July 1, 2012, created initial uncertainty about the motor fuel excise tax rate. Section 61.2 of S.L. 2012-194 contained a savings clause to relieve a taxpayer from liability if the taxpayer over-collected or under-collected the excise tax on motor fuel if the taxpayer made a good faith effort to comply with the law.

[55] The House passed a similar provision in House Bill 645 during the special session held in November, 2011, and in House Bill 142 earlier this session.

[56] The variable rate component was introduced in 1986 as part of legislation that increased funding for road construction. In addition to the introduction of a 3% variable rate, which equated to 1.5¢ per gallon at that time, the legislation increased the flat rate from 12¢ per gallon to 14¢ per gallon. The General Assembly incorporated the variable rate in part as recognition that the cost of road construction increases as the cost of motor fuel increases because of the petroleum products used in road construction. In 1989, the General Assembly increased the flat tax rate to 17¢ per gallon and increased the variable component from 3% to 7% of the average wholesale price. In 1992, the tax rate was changed to the current rate of 17.5¢ per gallon plus 7% of the average wholesale price (S.L. 1991-538).

[57] The reduction in the motor fuel tax rate reduces the amount credited to the Wildlife Resources Fund by $197,000 for fiscal year 2012-13.

- 25% to the Highway Trust Fund and used for construction of the intrastate system, some secondary road improvement, and Powell Bill distribution to local governments.

Tax Information Management System/Additional Public-Private Partnership Authorized. – Section 6A.3 authorizes the Secretary of Revenue to enter into an additional public-private arrangement in order to expand the implementation of TIMS.

For the last several years, the Department of Revenue has been in the process of implementing a new computer system known as the Tax Information Management System, which is designed to manage all tax schedules administered by the Department under one computer system. The new system will be phased in over a period of time as information is transferred from the current tax systems to TIMS.

This provision is an extension of authority that has been authorized each year since 2009, and all arrangements under this authority must terminate on June 30, 2018. The section appropriates additional sums from increased revenues or cost savings generated by the project under the public-private arrangement to cover the payment of internal costs and new resources necessary to provide additional electronic services, including the processing of payments and returns. The Department is required to report quarterly to the Chairs of the Appropriations Committees, the Joint Legislative Oversight Committee on Information Technology, and to the Fiscal Research Division of the General Assembly on the details of each public-private contract, the benefits from each contract, and a comprehensive forecast of using public-private agreements to implement TIMS.

Contingency Contracts for Audits/Assessments.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-152, as amended by S.L. 2012-194	**HB 462**	**Representative McCormick**

AN ACT TO LIMIT USE OF CONTINGENT-BASED CONTRACTS FOR AUDIT OR ASSESSMENT PURPOSES.

OVERVIEW: This act prohibits the Department of Revenue, local governments, and the State Treasurer from using third-party contractors paid on a contingent fee basis for audit and assessment purposes. The State Treasurer retains the authority to use a contingent fee contract with a maximum compensation of 12% of the final assessment for audits of unclaimed death benefits and unredeemed bond funds.

FISCAL IMPACT: This act has no fiscal impact at the State level.

EFFECTIVE DATE: The portion of the act relating to the Department of Revenue and the State Treasurer becomes effective October 1, 2012. The portion of the act relating to local governments becomes effective July 1, 2013, and expires July 1, 2015.

ANALYSIS: Local governments and the State Treasurer currently contract with third-party auditors to search for unpaid taxes and other collectable funds. The contracts between the governmental entities and third parties may compensate the third-party auditors

on a contingency fee based on the amount assessed or collected. The purpose of the act is to remove any conflict of interest between the correct assessment of liability and the third parties' financial interest in maximizing compensation under the contract.

State Government. – Section 1 of the act prohibits the Department of Revenue from contracting with an entity paid on a contingent fee basis to determine the tax liability of any taxpayer. The Department is authorized to outsource the collection of tax debts under G.S. 105-243.1, but the Department does not use third-party contractors to determine tax liability. The Department does use third-party contractors to collect tax debts from out-of-state taxpayers. The Department does not anticipate any changes in operation based on section 1 of this act.

Section 3 of the act prohibits the State Treasurer from contracting with entities paid on a contingent fee basis for administration of the Unclaimed Property Act. G.S. 116B-8 authorizes the State Treasurer to employ persons with specialized knowledge such as consultants and real estate managers. Section 3 contains an exemption to the prohibition for audits of life insurance companies where the audit is being conducted for the purpose of identifying unclaimed death benefits or to conduct audits of holders of unredeemed bond funds. These auditors may be paid on a contingent fee basis, but the contingency fee may not exceed 12% of the final assessment.[58] This exception allows the State Treasurer to participate with other states to use national firms to audit the voluminous records of life insurance companies.

Section 3.1 of the act allows the State Treasurer to use funds from the Escheat Fund to pay for consultants possessing specialized skills or knowledge to conduct audits for the administration of the Unclaimed Property Act. This authority allows the State Treasurer to continue to use third-party auditors paying the auditors from the Escheat Fund.

As originally enacted, these sections would have become effective July 1, 2012. Section 61.5 of S.L. 2012-194 changed the effective date. As amended, these three sections become effective October 1, 2012, and the Treasurer may not renew any contingency fee-based contracts for these services after October 1, 2012. Furthermore, the Treasurer may not assign further audits on a contingency fee basis to an auditing firm under a contract that meets both of the following conditions: (i) the contract would have been prohibited under this act had the contract been entered into after October 1, 2012, and (ii) the contract allows the assignment of audits on a discretionary basis by the Treasurer.

Local Governments. – Section 2 of the act prohibits counties from employing entities paid on a contingent fee basis to assist a county tax assessor. The board of county commissioners has the authority under G.S. 105-299 to use third parties to assist the assessor in the performance of the assessor's duties.

Section 4 of the act prohibits counties from employing agents paid on a contingent fee basis to determine the tax liability of any taxpayer when imposing taxes. This prohibition limits the authority under G.S. 153A-146 for counties to impose taxes and administer tax collection.

Section 5 of the act prohibits cities from employing agents paid on a contingent fee basis to determine the tax liability of any taxpayer when imposing taxes. This prohibition limits the authority under G.S. 160A-206 for cities to impose taxes and administer tax collection.

[5858] The contingency fee cap of 12% was removed from the statute by this act and restored by Section 61.5 of S.L. 2012-194.

As originally enacted, these sections would have become effective July 1, 2012. Section 61.5 of S.L. 2012-194 changed the effective date. As amended, these three sections become effective July 1, 2013, and expire July 1, 2015. During this two-year time period, a city or a county may not renew any contingency fee-based contracts for these services. Furthermore, a city or a county may not assign further audits on a contingency fee basis to an auditing firm under a contract that meets both of the following conditions: (i) the contract would have been prohibited under this act had the contract been entered into after July 1, 2013, and (ii) the contract allows the assignment of audits on a discretionary basis.

Public Finance Laws/Municipal Service Dists.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-156	**SB 426**	**Senator Clodfelter**

AN ACT TO MAKE CLARIFICATIONS AND MODIFICATIONS TO THE PUBLIC FINANCE STATUTES OF NORTH CAROLINA FOR THE IMPROVEMENT OF VARIOUS FINANCING STRUCTURES AND THE TERMS AND PROVISIONS OF THE FINANCING STRUCTURES AND TO AUTHORIZE A RESOLUTION ESTABLISHING A MUNICIPAL SERVICE DISTRICT TO BECOME EFFECTIVE UPON A DATE SPECIFIED IN THE RESOLUTION IF SPECIAL OBLIGATION BONDS ARE ANTICIPATED TO BE AUTHORIZED FOR A PROJECT.

OVERVIEW: This act does two things:

- It makes changes to the local government bond statutes designed to improve their efficiency.
- It authorizes a resolution establishing a municipal service district to become effective upon a date specified in the resolution, as opposed to July 1.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on June 28, 2012.

ANALYSIS:

Bond Statute Changes. – Under the Local Government Budget and Fiscal Control Act, an obligation may not be incurred by a city or county unless there has been an approved appropriation authorizing the payment of the obligation. For an obligation evidenced by a contract, an agreement, or a purchase order, the finance officer must have a certificate attached to the appropriate instrument stating the instrument has been pre-audited to assure that the obligation is an approved appropriation. An obligation incurred in violation of this

requirement is invalid and may not be enforced. Section 1 of the act eliminates the need for the pre-audit certificate if the document has been approved by the Local Government Commission (LGC). The LGC approves all contractual obligations related to the financing of capital projects, including bond purchase agreements, credit facilities, repayment agreements, remarketing agreements, interest swap agreements, and installment purchase contracts. The approval by the LGC provides a "check" as a preaudit certification.

Under prior law, the Local Government Bond Act had a three-step process for adopting a bond order:

1. The governing body of a local government unit authorizes the filing of an application to issue general obligation bonds with the LGC in a formal meeting.
2. The LGC approves the application for the issuance of the revenue bonds. The governing body cannot adopt a bond order until the LGC has received and acknowledged receipt of the application requesting approval to issue GO bonds.
3. The governing body introduces a bond order in a formal meeting. The bond order is the formal resolution which specifies the details of the bonds being put to a vote: the purpose of the bond, the amount of the bond, the source of revenues for repayment of the bond, etc. The law then requires other meetings after the bond order is introduced, such as a public hearing.

Sections 2 and 3 of the act make this a two-step process by removing the restriction that the LGC must acknowledge receipt and approval of the bond application before the governing body may adopt a bond order[59] thus allowing a governing body to adopt the bond order at the same meeting in which it initiates the bond process with the application.[60]

Municipal Service District Changes. – 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. The purposes for which a service district may be created are: beach erosion control and flood and hurricane protection works; any service which the municipality 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 improvement projects.

Based on that provision, Article 23 of Chapter 160A authorizes a city to define a municipal service district and to levy a property tax in that district that is in addition to those levied through the city. A city may also incur debt, as allowed under general law, to finance services within a service district and may allocate any other revenues whose use is not otherwise restricted by law. When there is no longer a need for the service district, the district may be abolished.

To create a 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

[59] Section 3.
[60] Section 2.

than the remainder of the city. Under prior law, a resolution establishing a municipal service district could only become effective either (1) at the beginning of the next fiscal year,[61] or (2) immediately, if it is anticipated that general obligation bonds will be issued for a project.

Section 4 of this act authorizes a resolution establishing a municipal service district to become effective upon a date specified in the resolution if special obligation bonds are anticipated to be authorized as funding for a project, as opposed to property tax revenues. North Topsail Beach would like to create a municipal service district for the purposes of beach erosion control. It plans to issue special obligation bonds. Under the prior law, it would have to have waited until July 1, 2013, to form the district. This change in the law enables the Town to proceed more quickly because it allows the Town, and any other city, to create a service district that could become effective upon a date set in the resolution creating the district.

Modify Taxation of HOA Property.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-157	**HB 1105**	**Representative Justice**

AN ACT TO SIMPLIFY THE COLLECTION OF PROPERTY TAXES THAT ARE DUE ON PROPERTY OWNED BY CERTAIN NONPROFIT HOMEOWNERS ASSOCIATIONS.

OVERVIEW: This act simplifies the collection of property taxes due on extraterritorial common property owned by nonprofit homeowners associations (HOA). The legislation is based upon a recommendation of the House Select Committee on Homeowners Associations.

FISCAL IMPACT: This act has no fiscal impact at the State level.

EFFECTIVE DATE: This act became effective for taxes imposed for taxable years beginning on or after July 1, 2012.

ANALYSIS: G.S. 105-277.8 provides that the value of real and personal property owned by a HOA must be included in the appraisals of property owned by members of the HOA and not be assessed against the HOA if each of the following requirements are met:

- All property owned by the HOA is held for the use, benefit, and enjoyment of all members of the HOA equally.
- Each member of the HOA has an irrevocable right to use and enjoy all the property owned by the HOA subject to the rules, regulations or bylaws of the HOA.
- Each irrevocable right to use and enjoy all the property owned by the HOA is appurtenant to taxable real property owned by a member of the HOA.

The genesis for this act is because instances have arisen where HOAs purchased or were formed with property meeting these requirements but located in a separate taxing jurisdiction than the jurisdiction in which the HOA members reside. This property is defined

[61] No ad valorem tax may be levied for partial fiscal year.

by the act as "extraterritorial common property." Under prior law, the tax on the value of extraterritorial common property was incorporated into the members' residential property and remitted to the county of residence. This was problematic in that (1) if applied, counties would receive property taxes for property not located in the county, and (2) the assessor of the county with extraterritorial common property did not know the HOA membership.

This act modifies the property tax treatment of extraterritorial common property. Under the act, HOA extraterritorial common property is taxed in the jurisdiction in which it is located and to the HOA owner of record, which, in turn, recoups the taxes paid from its members. In order to ensure that developers do not use bylaws or covenants to escape paying taxes on portions of communities not yet sold, the act requires recoupment to be pro rata, based on the number of lots or units in the association. The value of extraterritorial common property is not included in the appraisals of property owned by the members of the HOA.

Nonappropriated Capital Projects.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-164	**SB 444**	**Senator Hartsell**

AN ACT TO AUTHORIZE THE CONSTRUCTION AND THE FINANCING, WITHOUT APPROPRIATIONS FROM THE GENERAL FUND, OF CERTAIN CAPITAL IMPROVEMENTS PROJECTS.

OVERVIEW: This act authorizes the following capital projects:

- The construction of numerous projects by The University of North Carolina (UNC) to be financed through revenue bonds and special obligation bonds, not appropriations from the General Fund.
- Thirty-five capital projects to be financed with receipts or from other non-General Fund sources.

FISCAL IMPACT: The act authorizes $225,194,410 in new debt at the UNC campuses. It is expected that there will be an increase in operating requirements and associated positions at the campuses. These operating impacts are commonly referred to as building reserves. The act authorizes $27,851,143 in projects to be funded from non-General Fund sources at the various State agencies, should the funding become available. Various agencies listed insignificant increases to operating budgets as a result of the projects; fiscal research assumes the agencies can absorb costs from current budgeted sources. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 12, 2012.

ANALYSIS: This act authorizes the following capital projects:

UNC Capital Improvement Projects. – The act authorizes the construction and financing of 16 capital improvement projects on eight campuses of UNC. The projects authorized by the act are not financed with funds appropriated from the State's General Fund but may be financed

with gifts, grants, receipts, self-liquidating indebtedness, Medicare reimbursements for education costs, other funds available to the constituent institutions, or a combination of any of those financing methods. The projects include academic, research, clinical and administrative space and improvements to student services, residential living, dining, recreation, and athletics facilities. Once approved, a detailed financial plan will be developed in consultation with financial advisors and bond counsel for each project. The plans must be approved by the Chancellor, the Boards of Trustees, the President, and the Board of Governors before construction contracts may be awarded and bonds issued.

Under Article 8 of the State Budget Act, no State agency may expend funds for the construction or renovation of a capital improvement project unless authorized to do so by the General Assembly. The UNC Board of Governors may approve expenditures for projects that are to be funded entirely with non-General Fund money. However, under Article 3 of Chapter 116D, the General Assembly must approve the issuance of special obligation bonds for UNC projects. This act provides the necessary authorization and approval.

There are two types of self-liquidating bonds that may be issued by the UNC Board of Governors.

- Article 21 of Chapter 116 of the General Statutes authorizes the Board of Governors to issue revenue bonds for the types of projects enumerated in the Article. The types of projects for which revenue bonds may be issued include educational buildings, dormitories, recreational facilities, dining facilities, student centers, health care buildings, parking decks, etc. for the educational institutions, the University of North Carolina Health Care System, the University of North Carolina General Administration, and the University of North Carolina Hospitals at Chapel Hill. The revenue bonds are payable from rentals, charges, fees, and other revenues generated by the facility. The bonds are not payable from tax revenues.
- Article 3 of Chapter 116D of the General Statutes authorizes the Board of Governors to issue special obligation bonds payable with any sources of income or receipts of the Board of Governors or a constituent or affiliated institution, but not including tuition payments or appropriations from the General Fund from State revenues. The bond proceeds could be used for construction, improvement, and acquisition of any capital facilities located at UNC constituent and affiliated institutions. The project must be approved by the board of trustees for the respective institution for which the project is authorized and the General Assembly must approve the project and the maximum aggregate principal amount for the project. The bonds are not payable from tax revenues.

The self-liquidating projects the Board of Governors plans to finance with revenue or special obligation bonds are listed in Section 2 of the act. Section 3 authorizes the Board of Governors to expend non-General Fund money to plan six capital projects on four campuses. The Chancellors and Boards of Trustees for the listed campuses, as well as the President and the Board, have approved these projects. Support from General Fund sources for operating costs will be required only for facilities used for academic programs. Section 5 of the act expressly states that the maximum principal amount of special obligation bonds to be issued shall not exceed the amounts listed in Sections 2 and 3 of the act plus 5%. The

additional 5% may be used for related additional costs for which bond proceeds are routinely used, such as issuance expenses, funding of reserve funds, and capitalized interest.

Sections 6 and 7 authorize UNC-Chapel Hill and Winston-Salem State University to construct and finance projects through lease arrangements to, from, and with named entities. Once constructed and approved by state reviewing agencies, the improvements would transfer to the respective institutions. The two projects are:

- Chilled Water Infrastructure Improvements capital project at UNC-Chapel Hill. The school will partner with the Orange Water and Sewer Authority.
- New Student Housing Building capital project at Winston-Salem State University. The school will partner with Winston-Salem State University Foundation, Inc. and Winston-Salem State University Housing Foundation, LLC.

Non-General Fund State Agency Capital Improvement Projects. – Section 8 authorizes the construction of 35 capital projects to be funded with non-General Fund sources totaling $27,851,143. These projects must be approved by the General Assembly each year. Section 9 directs the Division of Veterans Affairs of the Department of Administration to report on or before January 1, 2013, to the Joint Legislative Commission on Governmental Affairs on the status of the Committal Structure project located at the Sandhills Cemetery.

PPP Pilot Toll Project/Ferry Tolls.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-184	**HB 1077**	**Rep. Frye, Mills**

AN ACT TO ALLOW THE DEPARTMENT OF TRANSPORTATION TO ENTER INTO A PILOT PUBLIC-PRIVATE PARTNERSHIP TOLL PROJECT AND TO REALLOCATE THE MONEY APPROPRIATED FOR STUDIES RELATED TO THE MID-CURRITUCK BRIDGE PROJECT TO THE DEPARTMENT OF TRANSPORTATION, FERRY DIVISION.

OVERVIEW: This act makes changes to the public-private partnership authority granted to the Department of Transportation (DOT) in 2006 to enable it to more effectively enter into such an agreement. The act is drafted to apply the changes to one project, the I-77 High Occupancy Toll Project.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 16, 2012.

ANALYSIS: In 2006, the General Assembly authorized DOT to enter into partnership agreements to finance transportation projects.[62] As part of this authority, DOT may finance the projects by tolls, contracts, and other financing methods authorized by law. Under

[62] S.L. 2006-230.

Article 6H of Chapter 136, DOT has toll-setting authority for the projects specifically identified for The Turnpike Authority and on any existing interstate highway for which the US DOT has granted permission by permit to do so.

This act places some restrictions on DOT's authority to enter into partnership agreements to finance transportation infrastructure.[63] A financing agreement that extends beyond 18 months requires approval of the agreement by the Local Government Commission (LGC). The approval of the LGC is also required for contracts that commit DOT to make nonretainage payments for undisputed capital costs of a completed transportation infrastructure project later than 18 months after final acceptance by DOT of the infrastructure.

The changes below apply to a public-private partnership agreement that is a candidate for funding under the Mobility Fund, that is planned for construction through a public-private partnership, and for which a Request for Qualifications has been issued by the DOT no later than June 30, 2012. The only project that meets these requirements is the I-77 High Occupancy Toll project. This project runs from the junction at NC-150 at Exit 36 to I-277 at Exit 9B.

- Allows DOT to accept performance and payment security from a private entity to an agreement in a form and an amount that DOT determines is sufficient, rather than as provided under the generally applicable payment and performance bond statutes.[64]
- Allows the private entity to an agreement to transfer some or all of its interest under the agreement to a lender, bondholder, or any other party. In no event shall the assignment create additional debt or debt-like obligations of the State, DOT, or other subdivision of the State to any other party providing financing or funding of the project subject to the agreement. This provision would apply in lieu of the State's general law on assignments of claims against the State.[65]
- Gives DOT the power to transfer its authority to fix, revise, charge, and collect tolls and fees with respect to a transportation infrastructure project to a private entity through an agreement.
- Allows DOT to act as a conduit issuer for private activity bonds. The issuance of private activity bonds would be governed by the State's revenue bond statutes[66] and the State's general law on adoption of a revenue bond order[67] if the bonds are obligations secured by a pledge of revenues allocated to a private entity under G.S. 136-18(39) and (39a).

[63] G.S. 136-18.
[64] Article 3 of Chapter 44A of the General Statutes.
[65] G.S. 143B-426.40A.
[66] Article 5 of Chapter 159 of the General Statutes.
[67] G.S. 159-88.

Study Municipal Local Option Sales Tax.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-189	**HB 1181**	**Representative McElraft**

AN ACT TO AUTHORIZE THE REVENUE LAWS STUDY COMMITTEE TO STUDY WHETHER MUNICIPALITIES SHOULD HAVE THE AUTHORITY TO LEVY A LOCAL OPTION SALES TAX FOR BEACH NOURISHMENT AND TO STUDY THE TAXATION AND VALUATION OF LEASEHOLD INTERESTS IN EXEMPT REAL PROPERTY.

OVERVIEW: This act authorizes the Revenue Laws Study Committee to study two different issues: (1) whether municipalities should have the authority to levy a local option sales tax for beach nourishment, and (2) the taxation and valuation of leasehold interests in exempt real property.

FISCAL IMPACT: This act has no fiscal impact.

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 16, 2012.

ANALYSIS: This act authorizes the Revenue Laws Study Committee to study two different issues. The first issue is whether municipalities should be granted the authority to levy a local option sales tax for the purpose of providing dedicated funding for beach nourishment and other natural resources preservation. The Committee may report its findings, together with any recommended legislation, to the 2013 Regular Session of the General Assembly upon its convening.

Counties and cities are created by the State and have only the authority given to them by the State. The General Assembly has authorized counties to levy a local option sales tax on at least four different occasions. The counties must distribute a portion of the 2% local sales tax revenues to the cities. The distribution between the county and its municipalities is based upon one of two methods: ad valorem or per capita. Cities may use this revenue for any public purpose, including beach nourishment.

The General Assembly has not authorized any cities to levy a city-only sales tax. Cities do have general authority to levy local privilege license taxes and vehicle taxes. Many cities have also obtained local legislation authorizing the levy of a room occupancy tax. A portion of those proceeds may be used for beach nourishment. Cities also receive a distribution of beer and wine excise taxes, electric franchise taxes, piped natural gas excise taxes, telecommunications taxes, and video programming taxes.

The second issue is the taxation and valuation of leasehold interests in exempt real property. North Carolina imposes a property tax on a leasehold interest in real property where the real property is exempt from property tax. The property tax on a leasehold interest in exempt real property applies when a unit of government leases property to a private business and

when the payments under the lease are below the value of the interest in the real estate.[68] Most county assessors value these leasehold interests as the difference between the fair market value of the leasehold interest and the rent paid under the lease. For example, if the private tenant is paying market rate for the exempt real property owned by a local government, then the leasehold interest has no value because similar leases can be obtained at the same price. If the tenant is paying a bargain rate under the lease, the leasehold interest has value because a similar lease would cost more.

This topic received attention during this session because there were reports of inconsistent application of the law by different counties. However, there was not adequate time to address it during session. The Committee may report its findings, together with any recommended legislation, to the 2013 Regular Session of the General Assembly upon its convening.

GSC Technical Corrections/Other Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2012-194	**SB 847**	**Senator Hartsell**

AN ACT TO MAKE TECHNICAL CORRECTIONS TO THE GENERAL STATUTES, INCLUDING SPECIFICALLY AUTHORIZING THE REVISOR OF STATUTES TO PRINT DRAFTERS' COMMENTS TO THREE ACTS ENACTED IN 2011 IN WHICH THIS AUTHORIZATION WAS INADVERTENTLY OMITTED, AS RECOMMENDED BY THE GENERAL STATUTES COMMISSION, AND TO MAKE OTHER AMENDMENTS.

OVERVIEW: This act consists of technical corrections recommended by the General Statutes Commission and miscellaneous conforming and substantive changes. There are only two sections that are finance-related, one of which is a conforming change related to the cap on the motor fuel tax[69] and the other is an extension of the film credit. This Analysis addresses the extension of the film credit only.

FISCAL IMPACT: In recent years, the film credit has resulted in an annual loss to the General Fund of almost $36 million. The fiscal impact of the extension is estimated to cost $60 million and will occur in FY 2014-15. *(For a more complete fiscal analysis, see Finance Committee Highlights, 2012 Session, available online at www.ncleg.net.)*

EFFECTIVE DATE: This act became effective when the Governor signed it into law on July 17, 2012.

ANALYSIS: Section 79.10 of this act extends the expiration of the refundable film production tax credit from January 1, 2014, to January 1, 2015.

[68] The only other form of intangible property subject to property tax is certain computer software.
[69] For an explanation of Section 61.2 of this act, see the Analysis for S.L. 2012-142.

During the 2012 Session, the General Assembly enacted S.L. 2012-36 (House Bill 1025)[70] which extended for one year a number of tax provisions that were scheduled to expire in 2013. The film credit was not included in that bill because it was not scheduled to expire until 2014. During hearings on House Bill 1025, the sponsors of the bill indicated that only those tax provisions scheduled to expire in 2013 were included since the General Assembly intends to undertake comprehensive tax modernization efforts in 2013 that may significantly alter the tax structure and potentially eliminate those tax credits altogether.[71]

In 2005, the General Assembly replaced the film industry development grant program with a refundable income tax credit calculated based on the qualifying expenses spent by a production company in connection with a production.[72] The credit amount is equal to 25% of the production company's qualifying expenses, which must exceed $250,000 and may not include any amount in excess of $1 million in compensation paid to an individual. The refundable film credit is capped at $20 million. The credit is claimed for the taxable year in which the production activities are completed. The credit is computed based on all of the taxpayer's qualifying expenses incurred with respect to the production, not just the qualifying expenses incurred during the taxable year. If the credit exceeds the amount of tax imposed for the taxable year reduced by the sum of all credits allowable, the Secretary must refund the excess to the taxpayer. A pass-through entity is considered a taxpayer for purposes of claiming this credit. In 2010, the General Assembly clarified[73] that purchases of cameras, film, props, building materials used in construction of sets, and chemicals/equipment used to develop and edit film do not fall within the scope of mill machinery for privilege tax purposes and are, therefore, subject to the general rate of sales tax beginning January 1, 2011.

[70] This bill was a Revenue Laws Study Committee recommendation.
[71] However, during a Finance Committee meeting, the bill was amended to include an extension for the tax credits for rehabilitating historic structures and historic mill property, which were extended through the 2014 taxable year.
[72] Section 39.1 of S.L. 2005-276.
[73] S.L. 2010-147.

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