2013

FINANCE LAW CHANGES

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2013 Finance Law Changes

UI Fund Solvency & Program Changes.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-2	**HB 4**	**Rep. Howard, Warren, Starnes, Setzer**

AN ACT TO ADDRESS THE UNEMPLOYMENT INSURANCE DEBT AND TO FOCUS NORTH CAROLINA'S UNEMPLOYMENT INSURANCE PROGRAM ON PUTTING CLAIMANTS BACK TO WORK.

SUMMARY: S.L. 2013-2, House Bill 4, makes the following changes to the State unemployment insurance program (UI) to accelerate[1] the repayment of the $2.5 billion advance the State borrowed from the federal government to pay UI benefits:

- ***Effective January 1, 2014, the bill makes the following tax rate changes: increase the minimum State unemployment tax (SUTA) rates from 0% to .06%, increase maximum SUTA tax rate from 5.7% to 5.76%; and compute SUTA tax rates based on a formula.***
- ***Effective July 1, 2013, the bill establishes a new trigger for the collection and suspension of the surtax, which is equal to 20% of an employer's SUTA liability.***
- ***Effective July 1, 2013, the bill requires a 1% reserve from all governmental entity and nonprofit employers that elect to finance benefits through reimbursement, and disallow refunds.***
- ***Effective, July 1, 2013, the bill restricts the use of revenues in the Employment Security Commission Reserve Fund and the Special Employment Security Administration Fund.***
- ***Effective July 1, 2013, the bill makes the following benefit changes: reduce the maximum duration of regular benefits from 26 weeks to 20 weeks and tie the duration of benefits to the seasonal adjusted unemployment rate; reduce the maximum weekly benefit amount (WBA) from $535 to $350; and change the calculation of the WBA from a formula based on the high quarter wage in the claimant's base period to the average of the last two quarters of that period.***
- ***Effective July 1, 2013, the bill restricts the optional triggers for the availability of extended benefits to those times when the benefits would be 100% federally funded. It does not change the mandatory trigger for extended benefits.***

[1] Simulations prepared by the Upjohn Institute suggest the UI Fund would have a positive credit balance in 2018 if the State did not change its laws and relied solely on federal tax increases for the payment of the debt. A simulation based on the changes proposed in the bill suggests the UI Fund would have a positive credit balance in 2015.

- ***Effective July 1, 2013, the bill makes the following programmatic changes: require a waiting week for each new benefit claim; repeal substantial fault; eliminate most good cause provisions for leaving work; and redefine suitable work as any work paying 120% of weekly benefit amount after 10 weeks of benefits.***
- ***The bill establishes a Joint Legislative Oversight Committee on Unemployment Insurance.***

BACKGROUND: The Unemployment Compensation Program is a Federal-state partnership created by the federal Social Security Act of 1935 and the Federal Unemployment Tax Act (FUTA). The purpose of the UI program is to provide economic stability to both the unemployed individual and the surrounding community. Federal law requires states to offer temporary unemployment compensation benefits to individuals who lose a job through no fault of their own and are able, available, and actively seeking work. States may design their own UI program so long as the program meets minimal federal coverage and benefit requirements. Employers pay both a federal and state unemployment tax to fund the program. No part of either tax may be deducted from an employee's wages.

The FUTA tax rate is 6% and is applied to a $7,000 taxable wage base. Employers are allowed a credit of up to 5.4% if a state's UI program complies with federal law and regulations, for an effective FUTA tax rate of 0.6% or $42 per employee. This amount is credited to the federal treasury and used to offset the costs of administering the states' UI programs.

If a state does not have sufficient revenues in its Unemployment Trust Fund to pay benefits, the federal unemployment account provides an automatic advance or loan to the state.[2] North Carolina received its first advance in February 2009. The State currently owes the federal unemployment account $2.5 billion.[3] To ensure repayment of the advance, the FUTA tax credit is reduced by 0.3% each year[4] until the debt is repaid; all of the revenue generated by the credit reduction is applied to the principal of the outstanding loan balance. The revenue cannot be used to pay the interest on the debt.[5]

The FUTA tax rate in North Carolina is currently $84 per employee.[6] Under this repayment method, the State is expected to have a positive balance in its Trust Fund account in 2018. Under the current repayment schedule, the FUTA tax rate is anticipated to be $105 per employee in 2014, $126 in 2015, $147 in 2016, $168 in 2017, and $189 in 2018 before returning to $42 in 2019.

CURRENT LAW: Chapter 96 of the General Statutes creates North Carolina's current UI program. The UI program provides coverage and benefits to the employees of private employers, State and local governments, Indian tribes, and nonprofit organizations.

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[2] As of January 3, 2013, 20 states have an outstanding state loan from the Federal Unemployment Account.
[3] NC's debt is the 3rd largest behind California at $10.3 billion and New York at $3.5 billion.
[4] The credit reduction begins when a state has an outstanding federal loan balance 2 consecutive Januarys. The indebtedness must be eliminated by November 10th to restore the full credit for the succeeding calendar year.
[5] North Carolina has used revenue in the Employment Security Commission Reserve Fund to pay the interest payments. Interest payments are due on September 30th of each year. The interest rate is determined annually. The interest rate for 2012 was 2.9%. The interest rate for 2013 is 2.6%.
[6] The FUTA tax credit was reduced from 5.4% to 5.1% in 2012 and to 4.8% in 2013.

Article 2 of Chapter 96 contains the financing system for UI. Under that system, private employers must pay a SUTA tax, or contribution, on the taxable wages of each of their employees. The taxable wage base in North Carolina is equal to 50% of the average yearly insured wage[7] The taxable wage base for 2013 is $20,900.[8] Employers that are governmental or nonprofit organizations must be given the election to finance benefits by making reimbursement payments to the Division in lieu of paying a contribution.

The SUTA contribution rates vary from 0% to 5.7%. The revenue from the contribution is credited to the Unemployment Insurance Fund and used only to fund benefits. An employer's SUTA contribution rate is based on an experience-rated system. The Division of Employment Security, Department of Commerce (Division) annually computes an employer's experience rating based on the contribution credits made to and benefits charges made against the employer's account. A positive experience rating produces a lower SUTA contribution rate and a negative experience rating produces a higher SUTA contribution rate.

An employer who has a SUTA tax liability must also pay surtax equal to 20% of the SUTA contribution liability. The revenue from the surtax is credited to the Employment Security Commission Reserve Fund. The revenue from the surtax may be used for various purposes. It has been used to pay the interest on the outstanding advance and to supplement federal grants from US Department of Labor (US DOL) for local Employment Security Commission offices.

Article 2 of Chapter 96 also contains the benefit system for UI. An employee with an attachment to the workforce, as evidenced by sufficient earnings and duration of employment in a 15-month base period, is entitled to some UI benefits if the employee loses a job through no fault on the part of the employee. The UI system imposes a two-year disqualification for UI benefits if the Division determines an individual lost a job for reasons of misconduct[9] and it imposes lesser periods of disqualification for an individual who lost a job for reasons of substantial fault.[10] The current UI program also allows benefits to employees who leave a job for certain causes unrelated to the job such as relocation of a spouse or health of a relative.

An individual who qualifies for UI benefits is eligible for a weekly benefit amount (WBA). The individual's eligibility is determined on a week-by-week basis. To receive a weekly benefit, an individual must be able to work, available to work, and actively seeking work. An individual who is determined to be ineligible for failure to meet one or more of these work search requirements does not receive a benefit for that week. However, the individual remains eligible for benefits in the remaining weeks if the individual meets the requirements.

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7 The average yearly insured wage = average weekly wage on August 1st divided by 52.

8 Compared to the surrounding states of AL, FL, GA, KY, MS, SC, TN, and VA, North Carolina has the highest taxable wage base. The taxable wage base in most states is in the range of $8,000-$9,000. Data from Upjohn Institute.

9 The two-year period may be reduced if the individual returns to work for at least five weeks, is paid cumulative wages of at least 10 times the individual's WBA, subsequently becomes unemployed through no fault, and meets the work search requirements.

10 An individual found to be in substantial fault is disqualified for a period of nine weeks. The Division may increase or decrease this number of weeks based on aggravating or mitigating circumstances. An employer's account is not charged for benefits paid due to substantial fault.

In addition to UI benefits for an employee who lost a job, an employee may collect UI benefits while remaining on an employer's payroll. An individual who is payroll attached is considered unemployed when the individual works less than the equivalent of three customary scheduled full-time days in the job in which the individual has payroll attachment as a regular employee. An individual who is payroll attached does not have to meet the work search requirements to be eligible to receive benefits. The individual must be able and available to return to work when recalled by the employer. Historically, attached claims account for approximately half of UI claims, although the percentage declined to 40-45% during the recent recession.

An individual's WBA is 50% of the high-quarter wages paid to the individual in the base period, not to exceed the maximum WBA. The maximum WBA is 66 2/3% of the average weekly insured wages. The Division calculates the maximum WBA on August 1st of each year. The maximum WBA for the period August 1, 2012, through July 31, 2013, is $535.

The number of weeks an individual may receive UI benefits is derived from a fraction of the individual's base period wages, with a minimum number of 13 weeks and a maximum number of 26 weeks. In addition to the regular benefit period, which is fully funded by SUTA revenue, the State may be entitled to 13 weeks of extended benefits if the unemployment rate in the State is higher than its two-year average. In some instances of very high unemployment the number of weeks of extended benefits may be as great as 20 weeks. Generally, the federal government pays 50% of the costs of providing extended benefits. During the Great Recession, the federal government fully funded the State's extended benefits. The federal funding for these benefits comes from direct appropriations, not from FUTA revenues. North Carolina triggered "off" extended benefits in May of 2012.

At times, including the recent Great Recession, Congress enacts temporary legislation providing additional weeks of Emergency Unemployment Compensation (EUC). At one point, EUC provided up to 53 weeks of additional benefits. Today, the number of weeks provided through EUC is up to 47. Congress recently extended the time for providing EUC from January 2, 2013, to January 1, 2014. A state does not have to participate in the EUC. To participate in the EUC, a state signs an agreement with the US DOL. A state may terminate the agreement with 30 days' written notice to US DOL. To participate in the current agreement, a state must not reduce the way it calculates benefits in such a way that the average weekly benefit would be less than the average weekly benefit provided by the state in June of 2010. In North Carolina today, an individual may be eligible for up to 73 weeks of benefits.[11]

SECTION-BY-SECTION BILL ANALYSIS: The policy changes to the UI program in House Bill 4 allow the State to accelerate the repayment of its $2.5 billion to the federal unemployment account by approximately three years. The accelerated repayment means the FUTA tax rate borne by NC employers would return to 0.6% in 2016 as opposed to 2019.

SECTION 1: FUND CHANGES

[11] 26 weeks of regular benefits, plus 47 weeks of EUC.

Substantively, section 1 restricts the use of revenue in the Employment Security Administration Reserve Fund (renamed the Unemployment Insurance Reserve Fund) to the payment of benefits, interest payment on federal advances used to pay benefits, and principal payment on federal advances used to pay benefits. Under current law, revenues in the fund may be used to fund local offices. Section 1 also caps the balance in the Fund on January 1 of any year to the greater of $50 million or the amount of interest paid the previous September on federal advances. Any amount in the Fund that exceeds this cap is transferred to the Unemployment Insurance Fund. The amount of interest paid in September 2012 on federal advances was $83.9 million.

Section 1 restricts the use of revenue in the Special Employment Security Administration Fund (renamed the Supplemental Employment Security Administration Fund). Under current law, revenues in the fund may be used for improvements to buildings, the enhancement of the work environment in buildings used by the Division of Employment Security, the acquisition of real estate, buildings, and equipment required for the expeditious handling of Division business, and the temporary stabilization of federal funds cash flow. The bill limits the use of money to the temporary stabilization of federal funds and to payment of costs determined by US DOL to be ineligible for payment from the Employment Security Administration Fund. The restrictions imposed by the bill on the use of money in this fund effectively limits the funds available to administer the State's UI program to the grant monies allocated to the State by US DOL.

Administratively, section 1 moves the definitions from Article 2 of Chapter 96 to Article 1 because the definitions apply throughout the Chapter. The bill puts the definitions in alphabetical order, it cross-references many definitions to their meaning under FUTA, and it removes definitions that are not needed. It renames the four funds used to administer the UI program to more clearly reflect their purpose and it removes antiquated and redundant language:

- Unemployment Insurance Fund. – The revenue for this fund consists of SUTA contributions and it is used to pay benefits. Contributions credited to the Unemployment Insurance Fund are transferred daily to the State's account in the Unemployment Trust Fund. The Trust Fund is held in the federal treasury. Money in the State's account is requisitioned by the State as needed to pay benefits. As the money is requisitioned, it is transferred to the State's Unemployment Insurance Fund to pay benefits. If the State's account in the Unemployment Trust Fund is not sufficient to meet the requisitioned amount needed to pay benefits, then the State receives an advance from the federal unemployment account.

- Unemployment Insurance Reserve Fund. – The revenue for this fund consists of surtax revenue and its use is limited by this bill to the payment of benefits and to payment of interest and principal on federal advances.

- Employment Security Administration Fund. – The revenue for this fund consists primarily of grant money allocated to the State from US DOL for the administration of the State's UI program.

- Supplemental Employment Security Administration Fund. – The revenue for this fund consists primarily of interest paid by employers on past due contributions and its use is limited by this bill to payment of costs determined by US DOL to be ineligible for payment from the Employment Security Administration Fund, temporary stabilization of federal funds cash flow, security for advances, and the repayment of an overpayment of interest previously credited to this fund.

SECTION 2: SUTA CONTRIBUTION AND SURTAX CHANGES RESERVE REQUIREMENTS FOR REIMBURSABLE EMPLOYERS

Substantively, Section 2 does the following:

- Replaces the current tax schedules with a formula.
- Increases the minimum and maximum SUTA contribution rates.
- Changes the trigger that suspends the collection of the surtax.
- Simplifies the reimbursement option for employers that are governmental and nonprofit organization by treating them uniformly. Uniformity means that all of them are required to maintain a reserve account equal to 1% of the taxable wages paid by them to their employees.

Section 2 repeals the current set of stepped tax schedules that determine an employer's SUTA contribution rate and replaces the schedules with an equation based on a reserve ratio. The change results in smoother movement between experience ratings and improves the responsiveness of the system. The contribution rate may change under the equation depending on the balance in the State's account in the federal Unemployment Trust Fund on August 1st. If the amount in the Trust Fund is less than or equal to 1% of the total wages reported by all insured employers in the State for the 12-month period ending on July 31st, then the contribution rate is 2.9% minus the employer's reserve ratio percentage (ERRP). The amount in the Trust Fund is currently less than 1% of total wages.

If the amount in the Trust Fund is greater than 1% of total insured wages but less than or equal to 1.25%, then the contribution rate is reduced to 2.4% minus the ERRP. If the amount in the Trust Fund is greater than 1.25% of total insured wages, then the contribution rate may decline to 1.9% minus the ERRP. The ERRP is the employer's reserve ratio based on the employer's experience rating. The bill does not change how an employer's experience rating is determined. The move from the stepped tax schedules to an equation may result in minor contribution changes for employers between the minimum and maximum contribution rates. The increase in contributions required from employers currently at the minimum and maximum contribution rates is attributable to the increase in the minimum and maximum rates.

Section 2 increases the minimum and maximum contribution rates; it does not change the standard beginning rate of 1%. It increases the minimum contribution rate from 0% to .06%. North Carolina is the only state with a 0% minimum tax rate. Approximately 20% of North Carolina's employers have no SUTA tax liability. Since the surtax is a percentage of SUTA liability, these employers do not have a surtax liability. Under the bill, these employers will pay some SUTA tax and consequently the surtax.[12] The bill

[12] With a taxable wage base of $20,900, an employer's SUTA tax liability with a .06% rate would be $12.54 per employee and the surtax liability would be $2.51.

increases the maximum contribution rate from 5.7% to 5.76%. Approximately 10% of North Carolina employers pay SUTA at the maximum rate.

Section 2 changes the trigger for determining when the surtax must be collected. Under current law, the trigger is based upon how much is in the Employment Security Commission Reserve Fund (Reserve Fund). If the amount in the Reserve Fund equals or exceeds $163,349,000 on August 1st, the collection of the surtax is suspended for the succeeding calendar year. This dollar amount represented 1% of taxable wages in 1984.[13] The bill changes the trigger from an amount in the Reserve Fund to an amount in the State's account in the Unemployment Trust Fund: the surtax would be suspended when the amount in the Trust Fund equals or exceeds $1 billion.

Section 2 simplifies the provisions applicable to employers that must be given the option to reimburse the Unemployment Insurance Fund for benefits paid on their behalf as opposed to paying contributions.[14] Under current law, most nonprofit organizations and all Indian tribes and subsidiaries of an Indian tribe that make this election must maintain a reserve account equal to 1% of the taxable wages paid to its employees. The bill imposes this same 1% reserve requirement on governmental entities, as well as all nonprofit organizations.

For governmental entities, the change essentially ensures that the funds are available in the employer's account to pay unemployment benefits when the benefits are paid. The change represents a one-time cash flow expenditure for governmental entities because not only will these entities have to pay the full reimbursement cost of benefits paid to claimants in 2012 in January of 2014, they will also have to make advance payments for the four calendar quarters beginning with the quarter that begins July 1, 2013, to build the 1% reserve. The largest quarterly advance will likely be the one made for the first quarter of the calendar year, payable in April 2014. Thereafter, governmental entities will have an annual reconciliation to maintain the 1% balance in their reserve account. The Division will determine the amount necessary to maintain the appropriate reserve balance on August 1st of each year.

Most nonprofit organizations currently maintain a 1% balance in their reserve accounts. However, some are allowed to post a surety bond or have a line of credit in lieu of the 1% reserve. This change may represent a similar cash flow issue for these nonprofits. Currently, the bonds and lines of credit are allowed for two-year periods. Effective July 1, 2013, the bill prevents a nonprofit organization from submitting a line of credit or a surety bond to secure its reimbursing election. The bill does allow current lines of credit or surety bond contracts to expire in their normal course.

Administratively, Section 2 simplifies the statutes by adopting the relevant provisions of federal law. The bill does not change coverage of employers subject to the UI program.

SECTION 3: ADMINISTRATION AND COLLECTION OF CONTRIBUTIONS

Substantively, Section 3 allows the Secretary of Commerce to compromise an employer's liability under the same limited circumstances that the Secretary of Revenue has to compromise a tax liability. When the Secretary compromises an employer's liability and

[13] The surtax last triggered on in 2005 and has been collected since then.
[14] FUTA requires states to give governmental and nonprofit employers a reimbursement option.

the liability is at least $1,000, the Secretary must make a written statement that sets out the amount of the liability, the amount accepted under the compromise, a summary of the facts concerning the liability, and the findings on which the compromise is based.

Administratively, Section 3 consolidates the provisions concerning the administration and collection of contributions in one Article. It does not change the current law.

SECTION 4: ADMINISTRATION OF EMPLOYER ACCOUNTS

Substantively, Section 4 greatly reduces the number of reasons for which an employer may be relieved from having benefits charged against the employer's account. This change conforms to the benefit changes made in Section 5, and more fully explained in that section of the summary.

Section 4 also amends the penalty enacted last session that prohibits the release of charges when an overpayment is made to a claimant because the employer failed to respond timely to a request for information concerning the claim. To comply with federal law, a state must impose this penalty as part of its UI program, effective on or before October 21, 2013. The penalty applies to employers that have exhibited a pattern of failing to respond. Section 4 defines a "pattern of failing" by providing that a pattern cannot be found unless the employer failures during the year prior to the request is less than 2% of the total requests made to that employer. It also moves the effective date of this provision from October 1, 2013, to October 21, 2013, the date required by federal law.

Administratively, Section 4 consolidates the provisions concerning how and when contributions are credited to an employer's account and how and when benefit charges are credited against an employer's account. It also requires an employer with 25 or more employees to file the Quarterly Tax and Wage Report electronically. Under current law, the electronic filing requirement applies to an employer with 100 or more employees.

SECTION 5: PAYMENT OF BENEFITS

Substantively, Section 5 does the following:

- Requires a waiting week for each claim filed.
- Eliminates and modifies many of the reasons for which a claimant may qualify for benefits and changes the terms of the disqualification.
- Changes the calculation for how an individual's WBA is determined; reduces the maximum WBA to a statutorily set amount of $350; and changes the calculation for an individual's partial WBA.
- Reduces the maximum duration of regular UI benefits and limits the applicability of optional extended benefits.
- Redefines "suitable work".
- Places additional benefit limitations on company officers and spouses of company officers.

Waiting week.

To obtain benefits, an individual must file a valid claim for unemployment benefits and register for work. The bill requires an individual to wait a week for each claim filed before receiving a benefit. Under current law, the waiting week is limited to one per benefit year. A valid claim is one that meets certain employment and wage standards. The bill does not change those standards:

- An individual must have been paid wages in at least two quarters of the base period.
- An individual must have been wages totaling at least six times the average weekly insured wage during the base period, which is the first four of the last five completed calendar quarters. If the individual does not have sufficient base period wages, the alternative base period is the last four completed quarters.

Qualification changes.

For an individual that files a valid claim, the Division must determine whether the individual qualifies for benefits. Qualification for benefits is determined based on the reason for separation from employment. The bill makes the following qualification changes:

- Reduced work hours. – An individual may qualify for benefits if the individual's work hours have been reduced by more than 50% as part of a unilateral and permanent reduction of work hours. Under current law the reduction in work hours need only be 20%.[15]
- Disciplinary suspension. – An individual may qualify for benefits if the individual has been placed on disciplinary suspension for more than 30 consecutive days. Under current law the suspension need only be for 10 consecutive days. The issue becomes whether the reason for suspension is a disqualifying reason for benefits.
- Good cause.[16] – The bill eliminates all but two of the reasons for which an individual could voluntarily quit work and still qualify for UI benefits. Those two reasons are domestic violence and military spousal relocation.[17] The reasons eliminated include: bankruptcy; impending closure; spousal relocation; disability or other health concern, whether or not it is related to work; disability or health concern of minor child, aged or disabled parent, or disabled immediate family member; inability to accept work during a particular shift because of concerns related to child care, elder care, or care of a disabled family member.
- Substantial fault.[18] – The bill eliminates substantial fault. Under substantial fault, an individual may qualify for a reduced number of weeks of UI benefits if the reason for separation included fault on the part of the individual, but the fault did not rise to the level of misconduct. Under the bill, an individual would either qualify for benefits, or not qualify; there would be no qualifying for a reduced number of weeks of benefits.

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[15] The bill does not change the 15% reduction of work pay as a reason for qualifying for benefits if the reduction is part of a unilateral and permanent reduction of work pay.
[16] Benefits not charged to employer's account.
[17] An individual that qualifies for benefits under this section would still need to meet the work search requirements to be eligible for a benefit.
[18] Benefits not charged to employer's account.

In addition to the reasons given above for disqualification of benefits, an individual may be disqualified for leaving work without good cause attributable to the employer, for misconduct, or for failing to secure the necessary licenses, permit, bond, or surety required for the job. The length of the disqualification period may be two years, or it may be less. The current law gives the Division a lot of discretion in defining the length of the disqualification. The bill would remove this discretion. An individual would either qualify for the full duration of benefits, or not qualify for the benefits at all. And if an individual is disqualified for benefits, the disqualification only applies to that claim.

Weekly benefit amount.

The Division must determine the WBA and the duration of benefits a qualifying individual is entitled to receive. The bill makes the following changes in the calculation of the WBA:

- Changes the calculation of the WBA from 50% of the individual's high-quarter wages in the base period, not to exceed the maximum WBA, to 50% of the individual's average weekly wage in the last two quarters of the base period. [19] North Carolina's average weekly benefit (AWB) for 2011 was $291.[20] The Upjohn Institute report noted that wages for the two quarters immediately preceding unemployment were typically 66.4% of the high-quarter wages. Based on that assumption, this change is expected to reduce aggregate UI benefits by 33.6%. The actual number of claimants impacted is indeterminable; it would impact any individual whose quarterly wages are reduced in the two quarters preceding an unemployment claim.
- Sets the maximum WBA in statute at $350.[21] Currently, the Division calculates the maximum WBA annually based on 66 2/3% of the average weekly insured wages on August 1; the maximum WBA in the State today is $535.[22] An estimated 21.7% of weekly claims checks exceed $350; of those, approximately 17% are at the maximum amount. North Carolina's maximum WBA is 70% higher than the average of the following eight states compared in the Upjohn Institute report for 2011: AL ($265), FL ($275), GA ($330), KY ($415), MS ($235), SC ($326), TN ($275), and VA ($378).
- Changes the base for determination of the disregard for partial earnings from 10% of the individual's AWW in the high-quarter to 20% of the individual's WBA.

Duration of regular benefits.

The duration of regular benefits in North Carolina ranges from 13 weeks to 26 weeks[23] depending upon the total benefit amount the individual is entitled to receive. The bill ties

[19] The methods states use to determine WBA vary greatly. At least half of the states use the high-quarter method. Other methods used include: multi-quarter, annual wage, average weekly wage formula.
[20] That amount was slightly higher than the AWB in the surrounding states of AL ($204), FL ($232), GA ($268), KY ($287), MS ($191), SC ($238), TN ($238), and VA.
[21] An individual annual wages would need to be $36,400 to qualify for a maximum benefit of $350.
[22] An individual's annual salary would need to be $55,640 to receive the maximum benefit of $535.
[23] The average duration of regular UI benefits in December 2012 was 16.3 weeks. The exhaustion rate for North Carolina for the 3rd quarter of 2012 was 54.2%. The highest exhaustion rate was 63.9% in the 2nd quarter of 2010 and the lowest was 12.5% in the 1st quarter of 1989.

the duration of regular benefits to the seasonal adjusted statewide unemployment rate, as determined by the US DOL. The duration could change twice a year: January 1 and July 1. The bill also reduces the maximum number of weeks from 26 to 20.[24] Based on these two changes, the duration of benefits would vary as follows:

Seasonal adjusted UI rate	**Minimum number of weeks**	**Maximum number of weeks**
Less than or equal to 5.5%	5	12
Greater than 5.5% up to 6%	6	13
Greater than 6% up to 6.5%	7	14
Greater than 6.5% up to 7%	8	15
Greater than 7% up to 7.5%	9	16
Greater than 7.5% up to 8%	10	17
Greater than 8% up to 8.5%	11	18
Greater than 8.5% up to 9%	12	19
Greater than 9%	13	20

Weekly certification.

Once an individual qualifies for UI benefits, the individual must meet weekly work search eligibility requirements to receive the benefit. The individual must submit a certification each week attesting that the individual meets the work search requirements. If an individual does not meet the eligibility requirements, the individual is ineligible to receive a benefit until the reason for the ineligibility ceases to exist. The work search requirements are that the individual must be able to work, available to work, actively seeking work, and accepting suitable work. The Department of Commerce has made some administrative changes in this area, and the bill makes some statutory changes in it.

Last biennium[25] the General Assembly enacted legislation to place the Employment Security Commission as a division under the Department of Commerce. Through the merger process, the Division of Employment Security and the Division of Workforce Solutions have agreed in a Memorandum of Understanding (MOU) executed in November 2012 as to how each division will support the common goal of serving UI claimants who are in need of financial and job-seeking assistance. As part of that MOU, claimants will be encouraged to file UI claims remotely. The Division of Workforce Solutions will be the lead division that assists UI claimants with job search, retraining, and other support. As part of the re-employment goals, new UI claimants will be required

[24] Upjohn Institute reports that from 2006-2011, 43% of claimants exhausted their maximum eligibility of 26 weeks. During that time period, 43% of claimants would have been affected by a reduction in the number of weeks.

[25] SL 2011-145 and SL 2011-401.

to have an in-individual interview with someone from the Division of Workforce Solutions within the first four weeks of receiving an initial UI benefit. The purpose of the individual visit is to verify the claimant's work search, schedule claimants to participate in an employability assistance process, and identify those claimants that need subsequent on site employability interviews. If an individual fails to come, the individual's UI benefit may be stopped.

The bill makes the following statutory changes in the work search requirements:

- It defines "suitable work" as any job paying 120% of the individual's WBA after the first 10 weeks of benefits.
- It eliminates the part-time suitable work exception. Under current law, if an individual is unemployed from a part-time job, the individual is not required to accept full-time employment.
- Under current law, an individual is considered to meet the work search requirements if the individual is in school. The bill restricts this provision by limiting it to enrollment in a training program approved by the Division, as required under FUTA.

Lastly, the bill places additional benefit restrictions on company officers and spouses of company officers. Under current law, an individual is disqualified from receiving benefits if the individual is self-employed and can reasonably return to work. Also, an individual or the individual's spouse is disqualified from receiving benefits if the individual is unemployed because the individual's ownership share of the employer was voluntarily sold and the individual held 5% or more of the outstanding shares of voting stock, or was a partner, or was the sole proprietor. Under the bill, a corporate officer that qualifies for benefits would be limited in the duration of benefits to six weeks.

Administratively, Section 5 consolidates the provisions concerning benefits in one Article. Except as otherwise noted in the summary, it does not intend to change the other provisions of current law.

SECTION 6: EXTENDED BENEFITS

Under federal law, a state must offer extended benefits during times of high unemployment in the state.[26] Extended benefits are typically funded 50% by the State and 50% by the federal government. Federal law sets one definition of high unemployment that a State must follow. It also provides optional definitions that may trigger extended benefits earlier than the mandatory definition. North Carolina's current law includes both the required trigger and the optional triggers.

The duration of extended benefits is typically equal to 50% of the total amount of regular benefits. By limiting the number of weeks of regular benefits, the bill indirectly reduces the number of extended benefits an individual may receive. Section 7 of the bill would also make one other change to the applicability of extended benefits in North Carolina by providing that the optional triggers would not "trigger on" unless the federal government has agreed to pay 100% of those extended benefits.

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[26] North Carolina "triggered off" extended benefits in May 2012.

SECTION 7: ADMINISTRATION OF BENEFITS

Substantively, Section 7 does two things:

- It changes the administration of UI benefits by limiting the ability of employers to file attached claims on behalf of their employees.
- It authorizes the Division to collect fraudulent overpayments through attachment and garnishment.

Under current law, an employer may file a claim for an employee that it intends to keep on its payroll. That employee must be able to work for the employer and available to return to work for that employer whenever that employer calls the individual back to work. Otherwise, the employee does not have to meet the weekly certification requirements of engaging in work search efforts.

Historically, attached claims account for approximately half of UI claims, although the percentage declined to 40-45% during the recent recession. Although it is difficult to determine what employers file attached claims, it appears that those most likely to do are the employers engaged in manufacturing and construction. It also appears that a large amount of the current indebtedness can be attributed to employers who have reached the maximum contribution rate and that those employers may be largely related to manufacturing and construction. With the current limitations on the computer capabilities at the Division, a more accurate analysis is not available.

Some attached claims are filed for one or more weeks of unemployment. Under the regulations previously issued by the Employment Security Commission[27] an employer that files attached claims for one or more weeks must furnish the Division with a definite date when work will become available for the claimant. This period may not extend for more than six weeks unless the time period is extended by the local office.

Other attached claims are filed for days within a week. For example, an individual employed by a company that builds roads may file attached claims for employees when the weather outside prohibits work for less than three customary scheduled full-time days during the work week. This unemployment is known as partially unemployed. Under current law, an individual who is partially unemployed must serve one waiting week per benefit year. Under the bill, a claimant must serve a waiting week for each claim. That change effectively eliminates partially unemployed claims.

Under the bill, only certain employers will be allowed to file attached claims, and there are restrictions on how those claims are processed:

- Only employers that have a positive account balance would be allowed to file attached claims. If an employer that wished to file an attached claim had a negative account balance, the employer would have to make a voluntary contribution to the Unemployment Insurance Fund in an amount sufficient to bring its account balance to zero or better.

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[27] Regulation 10.15 and 10.16.

- An employer would have to immediately reimburse the Unemployment Insurance Fund for the full cost of UI benefits paid to the employee through the attached claim.
- An employer could only file an attached claim once a year for each employee, and the duration of the attached claim could not extend beyond six weeks.

Section 7 adds attachment and garnishment to the collection tools available to the Division to recover fraudulent overpayments. The Division requested this ability. A fraudulent overpayment is one that is made based on a finding that the claimant, or another individual acting in the claimant's behalf and with the claimant's knowledge, has knowingly made a false statement or representation or failed to disclose a material fact for the purpose of obtaining or increasing an unemployment benefit.

Administratively, Section 7 consolidates the provisions governing the administration of UI benefits in one Article.

SECTION 8: LOCAL OFFICES

The US DOL allocates grant money to the State to administer the UI program. Some of this grant money may be used to operate local offices. The State has historically appropriated money from the Employment Security Administration Reserve Fund to finance additional local offices. The amount appropriated in the past to fund local offices has been $19.5 million. North Carolina currently operates 90 local offices. By comparison, South Carolina operates 56 and Virginia operates 39. Section 1 of the bill restricts the use of the money in the Unemployment Insurance Reserve Fund so that continued appropriations may not be made from that fund to finance local offices. The restriction may result in the consolidation of local offices. Section 8 of the bill sets general parameters the Department of Commerce must consider as it determines the appropriate number and location of local offices.

SECTION 9: CONFORMING CHANGES

Section 9 makes conforming changes to other statutes.

SECTION 10: JOINT LEGISLATIVE OVERSIGHT COMMITTEE ON UNEMPLOYMENT INSURANCE

Section 10 establishes a Joint Legislative Oversight Committee on Unemployment Insurance. The Committee consists of eight members, four appointed by the Speaker of the House of Representatives and four appointed by the President Pro Tempore of the Senate. The Committee expires in 10 years. The Committee is authorized to do the following:

- Study the unemployment insurance laws and the administration of those laws.
- Review the State's unemployment insurance laws to determine which laws need clarification, technical amendment, repeal or other change to make the laws concise, intelligible, and easy to administer.
- Monitor the payment of the debt owed by the Unemployment Insurance Trust Fund to the federal unemployment account.

- Review and determine the adequacy of the balances in the Unemployment Trust Fund and the Unemployment Insurance Reserve Fund.
- Study the workforce development programs and reemployment assistance efforts of the Department of Commerce.

SECTION 12: EFFECTIVE DATE[28]

The bill would become effective July 1, 2013. Changes made by the act to unemployment benefits apply to claims for benefits filed on or after July 1, 2013.[29] Changes made by the act to require an account balance by an employer that is a governmental entity or a nonprofit organization and that elects to finance benefits by making reimbursement payments in lieu of contributions apply to advance payments payable for calendar quarters beginning on or after July 1, 2013. Changes made by the act to the determination and application of the contribution rate apply to contributions payable for calendar quarters beginning on or after January 1, 2014.

IRC Update.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-10	**HB 82**	**Representative Howard**

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE AND TO DECOUPLE FROM CERTAIN PROVISIONS OF THE FEDERAL AMERICAN TAXPAYER RELIEF ACT OF 2012.

SUMMARY: Session Law 2013-10 does the following:

- ***Updates from January 1, 2012, to January 2, 2013, the reference to the Internal Revenue Code used in determining certain State tax provisions, thereby incorporating and conforming to many of the provisions contained in the American Taxpayer Relief Act of 2012 (ATRA) [30] to the extent North Carolina law tracks those provisions, including:***
    - ***15-year depreciation schedule for leasehold, restaurant, and retail property***
    - ***Modified limitations on itemized deductions***

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[28] The bill section numbers inadvertently omitted a Section 11.

[29] Congress extended the Emergency Unemployment Compensation program (EUC) from January 2, 2013, to January 1, 2014, in the *American Taxpayer Relief Act of 2012*. The program provides claimants up to 47 additional weeks of benefits, financed by an appropriation from the federal government. A state's participation in the program is optional. North Carolina is currently a party to the agreement. The State can terminate the agreement with 30 days' notice. To participate in the agreement, a state cannot change the mathematical formula used to determine weekly benefit amounts in a manner that will result in the average WBA being less than the average WBA was in June 2010. The bill would violate this "non-reduction" rule, effective July 1, 2013.

[30] The federal legislation made many other changes that are not discussed in this Analysis because they either had no or minimal impact on North Carolina taxable income.

- ***Student loan interest deduction***
- ***Income exclusion for employer-provided educational assistance programs***

- ***Decouples from ATRA enhancements or extensions to the following provisions for the 2013 tax year:***
  - ***Bonus depreciation***
  - ***Section 179 expensing (for both 2012 and 2013)***
  - ***Qualified tuition and expenses deduction***
  - ***Mortgage insurance premium as interest deduction***
  - ***Income exclusion for discharge of residence indebtedness***
  - ***Income exclusion for IRA distributions to charity by a person who has attained age 70.5.***

- ***Adjusts the following three tax credits that were enhanced by ATRA to achieve revenue neutrality:***
  - ***Work Opportunity credit***
  - ***Earned Income credit***
  - ***Adoption credit***

PRIOR LAW: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.[31] The General Assembly determines each year whether to update its reference to the Code.[32] Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made. Maintaining conformity with federal tax law simplifies tax reporting because a taxpayer will not need to account for differing federal and State treatment of the same asset. Prior to the passage of this legislation, the reference to the Code was January 1, 2012.

BACKGROUND: On January 2, 2013, the American Taxpayer Relief Act of 2012 (ATRA) was signed into law[33] and made substantial changes to the tax code. ATRA was intended to avert the anticipated "fiscal cliff" due to the sunset provisions scheduled to take effect in 2013 that would have ended the Bush-era tax cuts contained in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), which were temporarily

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[31]North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

[32]The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation … shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would … be invalidated as an unconstitutional delegation of legislative power."

[33] P.L. 112-240.

extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Relief Act).

ANALYSIS:

Update IRC Reference Date

Section 1 of the act updates the reference to the Code from January 1, 2012 to January 2, 2013, the date that ATRA became law. In doing so, North Carolina conforms to the following provisions:

- 2-year extension of the 15-year depreciation schedule for leasehold, restaurant, and retail property.[34]
- Permanent repeal of the limitation on itemized deductions for filers with incomes below $300,000 (MFJ) and application of the limitation for filers with incomes over $300,000.[35]
- Permanent increased phaseout ranges and elimination of the 60-month rule for the student loan interest deduction.[36]
- Permanent income exclusion for employer-provided educational assistance programs.[37]

Bonus Depreciation

Section 2 of the act does not conform to the one-year extension of the 50% bonus depreciation provision for property placed in service before January 1, 2014. The act decouples in the same manner that has been done in the past. A taxpayer is required to add back 85% of the accelerated depreciation amount in the year it is claimed for federal purposes with a corresponding 20% deduction over the next five years. The taxpayer will be deducting the same amount of an asset's basis under State law as under federal law, it is just that the timing of the deduction differs. If North Carolina had conformed to this

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[34] If the provision had not been extended, this property would have been subject to a 39-year recovery period.

[35] Generally, taxpayers itemize deductions if their total deductions are more than the standard deduction amount. Since 1991, the amount of itemized deductions a taxpayer may claim has been reduced by 3% of the amount by which the taxpayer's AGI is above a certain amount. This limitation is known as the Pease limitation. EGTRRA repealed the Pease limitation on itemized deductions for 2010. The 2010 Tax Relief Act extended the repeal through 2012. ATRA permanently repeals the Pease limitation on incomes at or below $250,000 for individual filers and $300,000 for MFJ for tax years beginning after December 31, 2012. ATRA reinstates the limitations for individual filers over $250,000 and for MFJ with AGI over $300,000 beginning in 2013. The deduction phaseout will equal 3% of the taxpayer's AGI over that threshold, although the total phaseout is capped at 80% of the total deductions claimed. If ATRA had not been enacted, the applicable threshold for 2013, as adjusted for inflation, would have been $178,150 for MFJ filers.

[36] Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for interest expenses up to $2,500. Prior to 2001, this benefit was only allowed for 60 months and phased-out for taxpayers with income between $40,000 and $55,000 ($60,000 and $75,000 for joint filers). EGTRRA eliminated the 60-month rule and increased the income phase-out range from $40,000-$55,000 to $50,000-$65,000 ($100,000 and $130,000 for joint filers), with adjustments for inflation. ATRA permanently extends these changes for taxable years beginning after December 31, 2012.

[37] An employee may exclude from gross income up to $5,250 for income and employment tax purposes of employer-provided education assistance. Prior to 2001, this incentive was temporary and only applied to undergraduate courses. EGTRRA expanded this provision to graduate education. ATRA makes these changes permanent for taxable years beginning after December 31, 2012.

provision, the cost would have been approximately $140 million in FY 12-13 and $141 in FY 13-14.

Explained. – Businesses may depreciate the cost of a new asset[38] over a period of time, usually five to 15 years. Bonus depreciation allows a business to claim more of a deduction up front and spread the remainder out over the normal depreciation schedule.

Federal Background. – Since 2002, businesses have been authorized to take an additional depreciation deduction on depreciable property ranging from 30% to 100%, known as bonus depreciation. Most recently, the 2010 Tax Relief Act authorized 100% bonus depreciation for investments placed in service after September 8, 2010, and before January 1, 2012. It also provided 50% bonus depreciation for qualified property placed in service after December 31, 2012, and before January 1, 2013. ATRA extends the 50% bonus depreciation provision for one year.

North Carolina Background. – Since 2002 and through 2012, North Carolina has decoupled from the federal bonus depreciation provisions in the same manner as under this act.

Section 179 Expensing

Section 3 of the act does not conform to the enhanced **s**ection 179 expensing provision for 2012 or 2013. For tax year 2012, the deduction and investment limits are $250,000 and $800,000, respectively. For tax year 2013, the deduction and investment limits are $25,000 and $200,000, which is what the limits would have been at the federal level if ATRA had not been enacted.[39]

The act further provides that the property's basis will be the same for federal and State purposes and treats the difference in the same manner as State tax law has historically treated the bonus depreciation: A taxpayer must add back 85% of the additional expensing taken under federal law in 2012 and 2013 and then deduct 20% of this amount

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

[39] Drafting error has resulted in some confusion regarding this provision. Part of the error was not identified until after the conclusion of session and need to be corrected in the 2014 Session. The intended deduction and investment limits were supposed to be $125,000 and $500,000 for tax year 2012 and $25,000 and $200,000 for tax year 2013. These would have been the federal limits for those tax years if ATRA had not been enacted. However, S.L. 2013-10 mistakenly referred to the IRC as it existed on May 1, 2010, for purposes of determining the section 179 deduction and investment limits. As of May 1, 2010, the deduction and investment limits were $250,000 and $800,000. Since the act became law on March 13, 2013, in the middle of the 2012 filing season, the General Assembly could not retroactively change the provision with respect to the 2012 tax year. Therefore, the deduction and investment limits for tax year 2012 are $250,000 and $800,000 to the extent those were the federal limits as of May 1, 2010.

Each year, the General Assembly enacts legislation that makes technical, clarifying, and administrative changes to the tax laws. This year, those changes were enacted in S.L. 2013-414, and it was the logical vehicle to correct the section 179 provision. The Department of Revenue suggested putting the limits in the statute rather than referencing the Code so that the legislative intent would be clearer. Therefore, the act removed the May 1, 2010, date and replaced it with a listing of the limits for the respective tax years. Unfortunately, an additional error was made with regard to the 2013 tax year by stating $125,000 as the phase-out amount rather than the $200,000 figure as intended. The necessary clarification should be made next session.

over the succeeding five years. Full conformity to the section 179 expense deduction would have been $38 million in FY 12-13 and $22 million in FY 13-14.

Explained. – Section 179 of the Code allows the expensing of the purchase price of some business assets[40] in the year of purchase rather than taking depreciation[41] throughout the life of the asset. In other words, expensing trades a smaller yearly deduction over time for a larger deduction in year one. Use of the allowance has two components: a deduction limit and a phaseout threshold. The deduction limit is the maximum amount of the deduction that the taxpayer may elect to take. The phaseout threshold is the maximum amount that can be spent on equipment before the deduction begins to be reduced. The deduction is reduced, dollar for dollar, by the amount that exceeds the threshold. Prior to 2010, section 179 was commonly thought to apply to small businesses because of its maximum deduction and investment limits.[42] However, the enhancements made by the Small Business Jobs Act of 2010 (2010 Jobs Act) were the most expansive ever enacted and those limits have been extended under ATRA.

Federal Background. – The 2010 Jobs Act increased the deduction limit for tax years 2010 and 2011 from $250,000 to $500,000 and increased the phaseout from $800,000 to $2 million. The 2010 Jobs Act also broadened the definition of qualified property to include qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, and computer software. These enhancements were set to expire for the 2012 taxable year with the limits reverting to prior levels of $25,000 and $200,000.

The 2010 Tax Relief Act did not extend the types of property that qualify for the deduction beyond the 2011 taxable year, but it increased the limits for taxable year 2012 to $125,000, adjusted for inflation ($139,000) and $500,000. Under the 2010 Tax Relief Act, the deduction limits were set to revert to their prior levels of $25,000 and $200,000 in 2013.

ATRA increases the section 179 limitations for tax years 2012 and 2013 to the same limitations that applied to 2010 and 2011 and extends the qualified real property allowance through 2013. Qualified property generally consists of qualified leasehold property, restaurant property, and retail improvement property. Taxpayers can deduct up to $500,000 of section 179 property for tax years beginning in 2012 and 2013 with a $2 million phaseout. If ATRA had not been enacted, the federal limits under section 179 would have been $125,000 and $500,000 for 2012 and $25,000 and $200,000 for 2013.

The special rule allowing off-the-shelf computer software to be subject to section 179 expensing was scheduled to expire for software placed in service after 2012. ATRA

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40 The business asset must be newly purchased tangible personal property that is used more than 50% for business purposes and is eligible to be depreciated under the Code. The newly purchased property may be new or used equipment.

41 Generally, taxpayers take the Section 179 expensing deduction first and claim bonus depreciation on any remaining basis.

42 Prior to the Emergency Economic Stabilization Act of 2008 (EESA), deduction limit was $125,000 with a phase-out beginning at $500,000.

extended the expensing of such software for another year. Thus, off-the-shelf software placed in service in 2013 is subject to the section 179 expensing election.

North Carolina Background. – Prior to 2010, North Carolina typically conformed to the enhanced section 179 expense deduction provisions. However, given the expansive nature of the enhancements made by the 2010 Jobs Act, North Carolina decoupled by maintaining the limits of $250,000 and $800,000 for taxable years 2010 and 2011. North Carolina conformed to the expanded definition of qualified property in 2011.

Work Opportunity Tax Credit

Section 4 of the act conforms to the extension of the work opportunity tax credit under ATRA, but it adjusts the North Carolina credit amount from 6% to 3% for the 2013 tax year to achieve revenue neutrality.

Explained. – The federal work opportunity tax credit is available to employers that hire individuals from the targeted groups listed below. The amount of the credit is generally 40% of the qualified worker's first-year wages up to $6,000.[43] The targeted groups are:

- Qualified individuals in families receiving certain government benefits, including Title IV-A social security benefits (aid for dependent children) or food stamps
- Qualified individuals who receive supplemental social security income or long-term family assistance
- Veterans who are members of families receiving food stamps, who have service-connected disabilities, or who are unemployed
- Designated community residents
- Vocational rehabilitation referrals certified to have physical or mental disabilities
- Qualified summer youth employees who live in empowerment zones, enterprise communities, or renewal communities
- Ex-felons hired no more than one year after the later of their conviction or release from prison

Federal Background. – The credit was scheduled to terminate in 2012 for wages paid to all targeted individuals, except for qualified veterans. The credit as it applies to wages paid for qualified veterans was scheduled to terminate in 2013. ATRA extended the credit for all groups for two-years through 2013.

North Carolina Background. – North Carolina provides a State income tax credit to a taxpayer who is allowed a work opportunity tax credit under the Internal Revenue Code. The amount of the credit is equal to 6% of the amount of credit allowed under the Code.[44] The credit is set to expire January 1, 2014.

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[43] $3,000 for summer youths and $12,000, $14,000, or $24,000 for qualified veterans, providing certain requirements are met. For long-term family aid recipients, the credit is equal to 40% of the first $10,000 in qualified first year wages and 50% of the first $10,000 of qualified second-year wages.

[44] The credit may be claimed against the franchise tax or the income tax. The taxpayer must elect the tax against which a credit will be claimed when filing the return; the election is binding. The credit allowed may not exceed

Deduction for Qualified Tuition and Related Expenses

Section 5 of the act conforms to the federal enhancements of the qualified tuition and expenses deduction for tax year 2012, but not for tax year 2013. For tax year 2013, a taxpayer will be required to add back the amount of the deduction taken at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $6 million in FY 13-14.

Explained. – Subject to income limitations, a taxpayer may take an above-the-line deduction for qualified education expenses paid during the year for the taxpayer or the taxpayer's spouse or dependents. Generally, any accredited public, nonprofit, or proprietary post-secondary institution is an eligible educational institution. The maximum deduction is $4,000 for an individual whose adjusted gross income for the tax year does not exceed $65,000 ($130,000 for MFJ filers), or $2,000 for other individuals whose adjusted gross income does not exceed $80,000 ($160,000 for MFJ filers).

Federal Background. – This deduction was established under EGTRRA and was scheduled to expire in 2006. It was subsequently extended through 2011. ATRA extends the deduction for two more years through 2013.

North Carolina Background. – North Carolina has previously conformed to this provision.

Section 5(b) disallows, for tax year 2013, the State deduction for taxpayers who opted to claim the Hope scholarship credit, the Lifetime Learning credit, or the American Opportunity tax credit in lieu of the federal deduction for tuition and fees.

At the federal level, a taxpayer may opt to claim one of the three above-named credits in lieu of the deduction for tuition and fees. A taxpayer who does so is eligible to claim a deduction on the North Carolina tax return for the tuition and fees deduction they forfeited on the federal return that they would have otherwise been entitled to claim had they not chosen to take one of the federal credits. By disallowing the State deduction, taxpayers are treated similarly regardless of whether they elected the federal credit or the federal deduction. Otherwise, a taxpayer who claims the federal deduction would get no State tax benefit (to the extent this act requires an addback for that deduction) while those who claim the federal credit would be entitled to the State tax deduction.

Income Exclusion for Distributions from IRAs to Charity

Section 6 of the act does not conform to the extension of the income exclusion for a qualified charitable distribution from an individual retirement plan by a person who has attained the age of 70½ for tax year 2013. It requires a taxpayer to add back the amount excluded at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $3 million in FY 13-14.

50% of the tax against which it is claimed. Any unused portion of the credit may be carried forward for five years.

Explained. – Generally, a taxpayer must include in gross income distributions made from a traditional or Roth IRA account except to the extent they represent a return of nondeductible contributions or are rolled over into another qualified retirement plan.

Federal Background. – Since 2006,[45] taxpayers age 70½ or older may contribute up to $100,000 from their IRA account to a charity tax-free. This income exclusion was set to expire for distributions made in tax years beginning after December 31, 2011. ATRA extends the availability of this exclusion for two years for distributions made in tax years beginning in 2012 and 2013.

North Carolina Background. – North Carolina has previously conformed to this provision.

Section 6(b) would allow a taxpayer age 70½ or older to take a charitable deduction for the donation of an IRA distribution to charity to the extent the taxpayer was required to add back the amount excluded from gross income at the federal level.

At the federal level, a taxpayer may not get a double benefit for donating an IRA distribution to charity by both excluding it from income and taking the charitable deduction. A taxpayer may elect one but not both. If a taxpayer elects to take the 170 charitable deduction at the federal level, the deduction would flow through for North Carolina purposes.[46] However, if a taxpayer elects the income exclusion, there would be no benefit at the State level because, under this act, a taxpayer is required to add that amount back. Therefore, this section allows the taxpayer to take a charitable deduction for that contribution.

Income Exclusion for Discharge of Qualified Principal Residence Indebtedness

Section 7 of the act does not conform to the extension of the income exclusion for the discharge of qualified principal residence indebtedness. It requires a taxpayer to add back the amount excluded at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $8 million in FY 13-14.

Explained. – Taxpayers are generally required to recognize income from the discharge of indebtedness. An exception from this rule is for the discharge of qualified principal residence indebtedness, which has been excludible from gross income on a temporary basis since 2007.[47] The exclusion is limited to $2 million, and applies to indebtedness incurred in the acquisition, construction, or substantial improvement of a principal residence and secured by the residence.

Federal Background. – This exclusion was scheduled to expire for debt discharged after December 31, 2012, but was extended for one year under ATRA.

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[45] This exclusion was originally authorized by the Pension Protection Act of 2006. The law was extended through 2009 by the Emergency Economic Stabilization Act of 2008, and through 2011, by the 2010 Tax Relief Act.

[46] Nonitemizers may take the credit under G.S. 105-151.26.

[47] This exclusion was originally authorized in the Mortgage Debt Relief Act of 2007.

North Carolina Background. – North Carolina has previously conformed to this provision.

Deduction for Mortgage Insurance Premiums as Interest

Section 8 of the act conforms to the extension of the deduction for mortgage insurance premiums as interest for tax year 2012, but not for tax year 2013. Therefore, taxpayers are required to add back the amount they took as a deduction at the federal level for purposes of determining North Carolina taxable income. If North Carolina had conformed to this provision, the cost would have been approximately $6 million in FY 13-14.

Explained. – Generally, taxpayers may not deduct any interest paid or accrued during the tax year that is considered personal interest. This restriction does not apply to certain types of interest, including qualified residence interest. Qualified residence interest includes interest on home acquisition indebtedness of up to $1 million and interest on home equity indebtedness of up to $100,000. In the case of a home acquisition loan, an individual who cannot pay the entire down payment amount may be required to purchase mortgage insurance.

Federal Background. –Since 2006, premiums paid for qualified mortgage insurance in connection with acquisition indebtedness for a qualified residence are treated as qualified residence interest and are deductible.[48] The treatment of qualified mortgage insurance as qualified residence interest was set to expire for amounts paid or accrued after December 31, 2011. ATRA extends the availability of the deduction for two years through 2013.

North Carolina Background. – North Carolina has previously conformed to this provision.

Earned Income Tax Credit

Section 9 of the act conforms to changes made under ATRA to the earned income tax credit, but it adjusts the North Carolina credit amount from 5% to 4.5% for the 2013 tax year to achieve revenue neutrality.

Explained. – The EITC is a refundable tax credit for working low to moderate income families that varies depending on the number of the taxpayer's qualifying children.

Federal Background. –EGTRRA made a number of changes to simplify the credit and to reduce the marriage penalty experienced by married taxpayers claiming the credit. The American Recovery and Reinvestment Act of 2009 (ARRA) increased the credit amount from 40% to 45% of a family's first $12,570 of earned income for families with three or more children and the beginning point of the phase-out range for married coupled filing a joint return by $1,880. The enhancements were set to expire for the 2011 taxable year. The 2010 Tax Relief Act extended the enhancements

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[48] The deduction is subject to a phaseout. For every $1,000, or fraction thereof, by which the taxpayer's AGI exceeds $100,000, the amount of mortgage insurance premiums treated as interest is reduced by 10%.

through the 2011 and 2012 taxable years. ATRA extends for five additional years, through 2017, the expansions that increased the EITC for families with three or more children and increased the phase-out range for all married couples filing a joint return.

North Carolina Background. – North Carolina provides a State income tax credit to a taxpayer who is eligible for the federal EITC. The amount of the credit is equal to 5% of the amount of credit allowed under the Code. The credit is set to expire January 1, 2014. North Carolina conformed to the EGTRRA enhancements to the federal credit in 2001 and to the extension of those enhancements under the 2010 Tax Relief Act.

Adoption Credit

Section 10 of the act conforms to changes made under ATRA to the adoption credit, but it adjusts the North Carolina credit amount from 50% to 30% for the 2013 tax year to achieve revenue neutrality.

Explained. – Taxpayers who adopt children can receive a tax credit for adoption expenses. Qualified adoption expenses include adoption fees, court costs, attorney fees, and other expenses related directly to the legal adoption of an eligible child. A taxpayer may also exclude from income adoption expenses paid by an employer.

Federal Background. –EGTRRA increased the credit from $5,000[49] to $10,000, and provided a $10,000 income exclusion for employer-assistance programs. The Patient Protection and Affordable Care Act of 2010 extended these benefits to 2011 and made the credit refundable. The 2010 Tax Relief Act extended the enhancements made by EGTRRA for one year. ATRA made permanent the increased adoption credit amount and the exclusion for employer-assistance programs as enacted in EGTRRA. Therefore, the adoption credit and income exclusion maximum amounts are $10,000, adjusted for inflation, with an income phase-out range between $150,000 and $190,000, adjusted for inflation

North Carolina Background. – North Carolina provides a State income tax credit to a taxpayer who is eligible for the federal adoption credit. The amount of the credit is equal to 50% of the amount of credit allowed under the Code. The credit is set to expire January 1, 2014. North Carolina conformed to the EGTRRA enhancements to the federal credit in 2001 and to the extension of those enhancements under the 2010 Tax Relief Act.

[49] $6,000 for a special needs child.

IRC Update

Federal Provision	Decouple/Conform		Cost to Conform		2 FY Total
	For tax year 2012	For tax year 2013	FY12-13	FY13-14	
BUSINESS-RELATED PROVISIONS					
Bonus Depreciation	(No 2012 law change)	Decouple			
Enhanced Section 179 Expensing	Decouple	Decouple			
15-year depreciation schedule for leasehold, restaurant, and retail property	Conform	Conform	-2	-3	
Work Opportunity Tax Credit	Conform	Conform & Adjust	-1		
INDIVIDUAL-RELATED PROVISIONS					
Limitation on Itemized Deductions	(No 2012 law change)	Conform	-1	-3	
Education-Related Expenses					
• Qualified Tuition & Expenses Deduction	Conform	Decouple	-3		
• Student Loan Interest Deduction	Conform	Conform	-3	-6	
• Income Exclusion for Employer-Provided Education Assistance	Conform	Conform	-3	-6	
Residence-related Benefits					
• Mortgage Insurance premium as interest	Conform	Decouple	-5		
• Income exclusion for discharge of residence indebtedness	(No 2012 law change)	Decouple	-2		
Tax-free distribution from IRAs to charity/age 70.5 or older	Conform	Decouple	-4		
Earned Income Tax Credit	(No 2012 law change)	Conform & Adjust			
Adoption Tax Credit	(No 2012 law change)	Conform & Adjust			
			-24	-18	-42

Property Tax/Deannexation.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-19	**SB 97**	**Senator Goolsby**

AN ACT TO REQUIRE RELEASE OF PROPERTY TAXES IN ANY AREA THAT WAS PART OF A MUNICIPALITY FOR SIX MONTHS OR LESS AND THEN DEANNEXED.

SUMMARY: S.L. 2013-19 authorizes the governing body of a municipality to release property tax if the property was within the corporate limits for less than six months and if the municipality has not sent notice of the property tax. S.L. 2013-19 is effective when it becomes law and expires July 1, 2016.

CURRENT LAW: Property taxes are levied on a fiscal year basis with each fiscal year beginning on July 1 and ending the following June 30. Property added through annexation is subject to prorated property taxes as provided in G.S. 160A-58.10.

G.S. 105-380 prohibits the governing body of any taxing unit from releasing, refunding, or compromising any property taxes within its jurisdiction.

BILL ANALYSIS: S.L. 2013-19 authorizes the governing body of a municipality to release property tax if the property was within the corporate limits for less than six months and if the municipality has not sent notice of the tax.

BACKGROUND: In May 2009, the City of Wilmington voted to annex an area commonly known as "Monkey Junction." Originally scheduled to be annexed in June 2010, the effective date of the annexation was delayed due to litigation and did not become effective until January 1, 2012. S.L. 2012-3, effective July 1, 2012, deannexed the Monkey Junction area.

Under current law, the area annexed on January 1, 2012, and deannexed July 1, 2012, would be subject to prorated property tax for the tax year that began on July 1, 2011.

The City of Wilmington indicated that notice of the tax for Monkey Junction has not been sent, and no taxes have been collected from the area.

EFFECTIVE DATE: S.L. 2013-19 is effective when it becomes law and expires July 1, 2016.

Economic Development Jobsites Program.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-130	**HB 439**	**Rep. Howard, Moffitt, Murry, Tine**

AN ACT TO CREATE AN INFRASTRUCTURE PROPERTY TAX DEFERRAL PROGRAM.

SUMMARY: Session Law 2013-130 creates a property tax deferral program to defer a portion of taxes on a parcel of property if the parcel (i) is at least 100 contiguous acres, (ii) is zoned for industrial and/or office use, (iii) does not have a building permit for a primary building or structure issued for it, and (iv) is classified under the present use value (PUV) property tax deferral program or was classified under the PUV program within the previous six months. The portion of taxes to be deferred is the sum of the value of any improvements on the site and the difference between the true value of the site and the value of the site treated as agricultural land in the present-use value program.

PRIOR LAW: North Carolina previously had seven property tax deferral programs: (i) historic district property held as a future site of historic structures, (ii) the circuit breaker tax deferral program, (iii) nonprofit property held as a future site of low or moderate income housing, (iv) PUV property, (v) working waterfront property, (vi) historic property, and (vii) the inventory deferral program. Uniform tax provisions for all deferral programs include the following:

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

BILL ANALYSIS: This act creates an eighth property tax deferral program for sites with potential to be developed for office or industrial applications in order to encourage horizontal improvement so as to make the sites more readily adapted to those uses in a shorter timeframe. In order to qualify, the site must be zoned for office and/or industrial use, must consist of at least 100 acres, may not have a building permit for a primary building or structure issued for it, and must be currently enrolled in or have been enrolled within the previous six months in the PUV program. The amount of property tax liability that can be deferred is the portion of tax that represents the increase in the property value resulting from any existing horizontal improvement plus the difference between the property valued at its true value and the property valued as agricultural land in the present use value system.

The deferred taxes are carried forward in the records of the county and, if applicable, the city in which the property is located until the occurrence of a disqualifying event. A disqualifying event causes the current years' tax liability (without benefit of the program) and some previous years' deferred tax liability to be due and payable as follows:

- If, within five years of classification, an amount equal to the deferred taxes is not invested in improvements to make the land suitable for office and/or industrial use ("minimum investment"), the deferred taxes for the preceding five years are due and payable.
- If the minimum investment is made but the property is classified for 10 years in the program, the deferred taxes for the preceding five years are due and payable.
- If some or all of the land is rezoned for a use other than office and/or industrial use, all deferred taxes are due and payable.
- If land is transferred or a building permit issues for the land, the deferred taxes (for only that portion transferred or to which the permit applies) for the preceding year are due and payable. The remaining parcel continues to receive treatment under this classification, even if it no longer meets the size requirement.

The tax collector must annually notify the owner of the accumulated sum of deferred taxes and interest. The owner must notify the county assessor if the land loses eligibility for the program, or the owner will be subject to a penalty of 10% of the total amount of deferred taxes and interest. The uniform provisions for deferral programs apply to this tax deferral program. Annual applications should be filed within the regular listing period and may be filed later if the board of equalization and review determines there is good cause for the lack of timely filing.

Deferred taxes are not triggered if land enrolled in the program is eligible and is transitioned back into a PUV program. The Secretary must annually report the number and location of lands enrolled in the program to the Department of Commerce, and the Department of Commerce must include that information in an annual publication.

EFFECTIVE DATE: This act became effective for taxes imposed for taxable years beginning on or after July 1, 2013.

Amend Definition of Special Purpose Project.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-135	**HB 629**	**Rep. Martin, R. Brawley, Lewis**

AN ACT TO AMEND THE DEFINITION OF A SPECIAL PURPOSE PROJECT TO INCLUDE AGRICULTURAL AND FORESTRY WASTE DISPOSAL FACILITIES.

SUMMARY: S.L. 2013-135 amends the definition of a special purpose project to include agricultural and forestry waste disposal facilities.

CURRENT LAW: A "special purpose project" is defined as any structure, equipment, or other facility for any one or more of the following purposes: water systems or facilities; sewage disposal systems; public transportation systems; public parking lots; public auditoriums; recreational facilities, including museums; rehabilitation facilities; orphanages; or land, equipment, and facilities for the disposal, treatment, or recycling of certain solid waste, etc.

The Local Government Commission may approve the issuance of bonds for special purpose projects under the Industrial and Pollution Control Facilities Financing Act. The governing body of the county in which the special purpose project is located must notice and conduct a public hearing and approve in principle the issuance of bonds beforehand.

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

BILL ANALYSIS: This act amends the definition of "special purpose project" to include land, equipment, and facilities for the disposal, treatment or recycling of solid waste, forestry waste, agricultural waste, or other waste including any residual material which is the byproduct or excess raw material remaining after the completion of any commercial, consumer, governmental, agricultural, or industrial production process. Included within this purpose are facilities for the handling and transport of products resulting from treatment and recycling.

BACKGROUND: Currently there are two waste wood facilities planned for North Carolina that will export wood pellets to a major English power plant. The first plant will be located in Wilson County with construction to begin this summer. The second plant is slated to be built near Gulf in Chatham County.

EFFECTIVE DATE: This act became effective June 19, 2013.

Taxpayer Debt Information Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-200	**HB 248**	**Rep. Conrad, Fulghum, Cleveland, Blust**

AN ACT TO REQUIRE DISCLOSURE ON THE BALLOT THAT AUTHORIZATION OF INDEBTEDNESS INCLUDES INTEREST AND THAT TAXES MAY BE LEVIED TO REPAY THE INDEBTEDNESS.

SUMMARY: S.L. 2013-200 makes the estimation of interest on a proposed bond issuance of voted debt by a local government part of the LGC review process and requires the ballot question for the authorization of bonds to state that the authorization includes interest and that additional taxes may be levied to repay the debt.

The act became effective September 1, 2013.

CURRENT LAW: Article 4 of Chapter 159 of the General Statutes (Local Government Bond Act) governs the ability of units of local government to borrow money secured by a pledge of the taxing power. When a local government proposes to issue bonds that must be approved by a vote of the people,[50] it must publish a notice of intent to apply to the Local Government Commission (LGC) for approval. After considering an application, the LGC enters an order either approving or denying the application after considering several factors. The LGC must approve the application if it determines the following:

- The proposed bond issue is necessary or expedient.
- The proposed amount is adequate for the proposed purpose.
- The unit's debt management procedures are good, or that reasonable assurances have been given that its debt will be managed in strict compliance with the law.
- The increase in taxes, if necessary to service the proposed debt will not be excessive.
- The proposed bonds can be marketed at reasonable rates of interest.

Upon approval, the local government must hold a public hearing, followed by a bond referendum. Bonds may be issued under a bond order at any time within seven years after the order takes effect and up to 10 years with LGC approval. Any action contesting the

[50] Bonds issued for the following purposes do not require voter approval: (1) to suppress riots, insurrections, or any extraordinary breach of law and order; (2) to supply an unforeseen deficiency in the revenue when taxes actually received or collected during the fiscal year fall below collection estimates made in the annual budget ordinance; (3) to meet emergencies threatening the public health or safety, as conclusively determined in writing by the Governor; (4) to refund outstanding general obligation bonds or general obligation bond anticipation notes; (5) bonds as described in G.S. 159-49(2). There are also certain other purposes for which no vote is required to the extent of two-thirds of the amount by which the outstanding indebtedness of the issuing county, county water and sewer district, metro water district, or city was reduced in the preceding fiscal year.

validity of a bond referendum must begin within 30 days after the publication of the results. After this time period, no right of action may be brought. Chapter 142 governs the issuance of State debt.

BILL ANALYSIS:

Statement of Estimated Interest. – After or at the same time the application is filed, a bond order must be introduced before the governing board of the local government. Once introduced, the board must schedule a public hearing.

Section 1 of the act requires that, after the bond order has been introduced but before the public hearing, the finance officer of the local government unit file a statement with the clerk and the LGC indicating the estimated total amount of interest that will be paid on the bonds over the expected term of the bonds and a summary of the assumptions upon which the estimate is based. It must also include a statement to the effect that the estimate is preliminary, that there is no assurance that the assumptions upon which the estimate is based will occur, and that the actual circumstances at the time the bonds are issued from the assumptions could result in significant differences between the estimated interest and the actual interest. **Section 1** also provides that the validity of the bonds is not subject to challenge on the grounds that the actual interest when issued is different than the amount set forth in the statement.

Publication of Bond Order. – The bond order must be published after it has been introduced and again after it has been approved. Upon publication after introduction, it must include a statement describing the amount of the proposed bonds, indicating that a tax may be levied to pay the principal and interest on the bonds, and announcing when the public hearing will be held. Upon publication after adoption, it must include a statement that any action challenging the validity of the order must commence within 30 days after the date of publication of the notice.

Sections 2 and 3 of the act add similar language to each of the statutes related to the publication of the bond order. They would require inclusion of a statement in the order that the finance officer has filed a statement of estimated interest and indicating what the estimated amount is. The changes would permit a summary of the assumptions to be included in the publication and would include disclaimer language to the effect that the estimated amount of interest is preliminary, is for general informational purposes only, and that the validity of the bonds may not be challenged on the basis of the actual interest being different than the estimated interest once the bonds are issued.

Ballot Question. – Under current law, the form of the question on the ballot for a local bond order is as follows:

"Shall the order authorizing $ **_______** bonds for (briefly stating the purpose) be approved?

[ ] YES

[ ] NO"

Section 4 of the act requires that the ballot question also indicate that the approval includes the application of interest to the principal debt amount authorized, but would not state a specific amount of estimated interest. The ballot would also include a statement that additional taxes may be levied in an amount necessary to pay the principal and interest on the bonds.

EFFECTIVE DATE: This act became effective September 1, 2013, and applies to bonds proposed on or after that date.

Exclude Custom Software from Property Tax.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-259	**SB 490**	**Sen. Gunn, Barefoot, Walters**

AN ACT TO EXCLUDE CUSTOM SOFTWARE FROM PROPERTY TAX.

SUMMARY: S.L. 2013-259 excludes custom computer software from local property tax. Embedded software and the prewritten portion of capitalized, third-party software remain subject to local property tax.

CURRENT LAW: The only forms of intangible personal property subject to local property tax are leasehold interests in exempt real property (G.S. 105-275(31)) and certain computer software (G.S. 105-275(40)).

Under G.S. 105-275(40), computer software and documentation related to the software is excluded from local property tax except the exclusion does not apply to:

- **Embedded software or microcode –** Computer instructions that reside permanently in the internal memory of a computer system and are not intended to be removed without terminating the operation of the computer system and removing a physical part.
- **Capitalized, third-party software** – Computer software that is purchased or licensed from a unrelated person and that is capitalized by the taxpayer under generally accepted accounting principles (GAAP). A person is unrelated to a taxpayer if (1) the taxpayer and the person are not subject to any direct or indirect common ownership and (2) the taxpayer and the person do not have any direct or indirect ownership interest in the other.

BILL ANALYSIS: S.L. 2013-259 narrows the definition of computer software subject to local property tax. The capitalized, third-party software currently subject to local property tax would be limited to software that was not customized through development or modification to meet the customer's specified needs. S.L. 2013-259 excludes customized software from local property tax regardless of who customized the software (i.e., internally by the taxpayer or externally by a third party).

S.L. 2013-259 leaves embedded software subject to local property tax. S.L. 2013-259 only subjects the prewritten portion of capitalized, third-party software to local property tax. S.L. 2013-259 also prohibits State courts from using the law change to interpret any statute in pending litigation.

BACKGROUND: On July 21, 2011, the NC Department of Revenue issued a memorandum to county tax assessors explaining the taxability of modifications to computer software. The Department of Revenue concluded that modifications to taxable software are taxable and modifications to excluded software are excluded. The Department of Revenue's position is based on the interpretation that software, including any modifications, is either taxable or excluded and that property is not subdivided into parts to determine taxability.

The Department of Revenue's memorandum addresses only modifications to software. S.L. 2013-259 addresses both modifications to software and the taxability of customized software that would be taxed as capitalized, third-party software.

EFFECTIVE DATE: S.L. 2013-259 is effective for taxes imposed for taxable years beginning on or after July 1, 2014.

Tax Simplification and Reduction Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-316	**HB 998**	**Rep. Lewis, Setzer, Moffitt, Szoka**

AN ACT TO SIMPLIFY THE NORTH CAROLINA TAX STRUCTURE AND TO REDUCE INDIVIDUAL AND BUSINESS TAX RATES.

SUMMARY: S.L. 2013-316 repeals the estate tax and reduces individual and business tax rates. To help offset the revenue loss from rate reductions applicable to all taxpayers, the act eliminates some tax expenditures and expands the sales tax base. The act makes the following changes to the State's tax structure:

- ***Eliminates the estate tax for decedents dying on or after January 1, 2013.***
- ***Replaces the individual marginal tax brackets with a flat rate. The rate is 5.8% for taxable year 2014 and 5.75% for taxable years thereafter. The act retains the 100% deduction for social security income, enhances the current child credit, increases the standard deduction, and retains the deduction for charitable giving. It eliminates the personal exemption, caps the mortgage interest expense deduction, and repeals many other deductions and credits.***
- ***Reduces the corporate income tax rate to 6% for taxable year 2014, 5% for taxable year 2015, and possibly 3% or 4% in the years thereafter if General Fund revenues equal or exceed an established trigger amount of $20.2 billion in fiscal year 2014-15 or $20.975 billion in fiscal year 2015-16.***
- ***Eliminates several sales tax exemptions and preferential tax rates, effective January 1, 2014, and July 1, 2014.***

- ***Replaces the franchise tax on electricity and the excise tax on piped natural gas with a sales and use tax at the State combined general rate on the gross receipts derived from sales of electricity and piped natural gas, effective July 1, 2014.[51]***
- ***Replaces the gross receipts privilege tax on amusements and taxes amusements with a sales tax on admission charges to an entertainment event at the applicable State and local sales tax rate, effective January 1, 2014.***
- ***Expands the sales tax to include the sales price of service contracts, effective January 1, 2014.***
- ***Establishes an annual gross income tax requirement of $10,000[52] from farming operations to qualify for the sales tax exemptions for farmers, effective July 1, 2014.***
- ***Caps the annual sales tax refund amount a single nonprofit may receive at a State and local combined amount of $45 million, effective July 1, 2014.***
- ***Extends the sunset date applicable to sales tax refunds for passenger air carriers and motorsports for two years, from January 1, 2014, to January 1, 2016.***
- ***Caps the motor fuel excise tax at 37.5 cents per gallon for the period September 1, 2013, through July 1, 2014.***
- ***Directs the Revenue Laws Study Committee to study various tax policy issues.***

CURRENT LAW AND BILL ANALYSIS: S.L. 2013-316 reduces individual and corporate income tax rates, eliminates many tax expenditures, equalizes the tax treatment of utility services, and expands the sales tax base to include amusements and service contracts. The changes reduce revenues by $86.6 million in fiscal year 2013-14 and reduce the growth of revenues by 27% over five years. The projected revenue in fiscal year 2017-18 without these changes is $24,267.2 billion; the projected revenue in fiscal year 2017-18 with the changes made by this act is $23,617.3 billion.

PART I. INDIVIDUAL INCOME TAX CHANGES

This Part simplifies the calculation and administration of the individual income tax laws. It significantly broadens the base and lowers the rate. Currently, there are three tax brackets with rates of 6%, 7%, and 7.75%. Under the act, there is a flat 5.8% tax rate on taxable income for taxable year 2014 and a 5.75% tax rate for taxable years thereafter.[53]

[51]See S.L. 2014-39; it phases-in the sales tax on sales of piped natural gas by the eight gas cities and on sales of electricity by the Cape Hatteras EMC over two years.

[52] See S.L. 2014-3; it allows a three-year income averaging of income and provides a conditional exemption certificate for new farmers.

[53] The highest marginal tax rates in the surrounding states are as follows: GA, 6%; SC, 7%; TN, 0%; VA, 5.75%.

It broadens the base by eliminating most of the credits and deductions allowed under current law. It does not change the taxability of social security income. It increases the standard deduction amounts and eliminates the personal exemptions. It enhances the child credit, retains the itemized deduction for charitable giving, and caps the itemized deduction for mortgage expense and property taxes paid on real estate.

Bill Section	Brief Description
Section 1.1(a)	This Part reorganizes the individual income tax Article. In so doing, this subsection recodifies several of the administrative statutes: short title, purpose, definitions, definition of taxable income, credit for income taxes paid to another state (to prevent double taxation), credit for children, and income tax returns.
Section 1.1(b)	• Repeals obsolete statutes: 105-134.7, transitional adjustments from 1989 tax law changes; 105-134.8, a hold-over re: inventories from the pre-1989 tax law; and 105-151.20, a tax credit for federal retirees for taxes paid on income for years 1985-1988. The repeal is effective for taxable years beginning on or after January 1, 2014. • Repeals statutes whose contents are incorporated into other newly created statutes: 105-134.2, income tax imposed and 105-134.3, year of assessment. • Replaces 105-134.6, adjustments to AGI, with 105-153.5. Many of the adjustments allowed under 105-134.6 are not continued under 105-153.5 and are thus repealed, effective for taxable years beginning on or after January 1, 2014: o Deduction for various itemized deductions allowed under federal law such as the medical expense deduction. o Additional standard deduction amount allowed for the aged or blind. o Deduction of up to $4,000 allowed for income received from one or more state, local, or federal government retirement plans. o Deduction of up to $2,500 allowed for income received from a retirement plan other than a governmental retirement plan. o Deduction of up to $35,000 allowed for severance wages.[54] o Deduction for the amount paid to a taxpayer as compensation for pecuniary loss suffered by reason of erroneous conviction and imprisonment. o Deduction for payments received from Disaster Relief Fund.[55]

[54] Unemployment benefits are subject to income tax, and will continue to be subject to income tax.

[55] Under the Code, most payments received for disaster relief would be deductible as an itemized deduction; payments for lost income are not deductible under the Code. State law provided that in addition to the itemized deductions allowed, a deduction would be allowed for payments for lost income. Under the act, none of the payments would be deductible.

	○ Deduction equal to 5% of the gross purchase price of a qualified sale of a manufactured home community.[56] ○ Deduction not to exceed $50,000 of net business income.[57] ○ Adjustment for federal estate tax that is attributable to an item of income in respect of a decedent.[58] ○ Deductions for amounts contributed to a NC 529 college savings plan.[59] ○ Deduction of $250 for an unpaid member of a volunteer fire department or volunteer recue or emergency medical services squad. ○ Deductions for interest and investment income earned on a trust under the Tobacco Settlement Agreement.[60] This deduction is obsolete. ○ Deduction for payments received from Hurricane Floyd Reserve Fund. This fund no longer exists. This deduction is obsolete. ○ Addition for amounts allowed as a deduction under the Code by a separate tax. This deduction is obsolete. [61] • Repeals the following tax credits that do not have a sunset and that are only applicable to individual income tax: 105-151.11, child care credit; 105-151.18, credit for the disabled; 105-151.21, credit for taxes paid on farm machinery; 105-151.26, credit for charitable contributions made by non-itemizers, and 105-151.33, credit for education expenses.[62] The repeal is effective for taxable years beginning on or after January 1, 2014. • Repeals the following tax credits that do not have a sunset and are applicable to both individual and corporate income tax: 105-151.1, credit for construction of dwelling units for handicapped persons; 105-151.12, credit for real property donations; 105-151.13, credit for conservation tillage equipment;

[56] S.L. 2008-107. The deduction was scheduled to sunset for taxable years beginning on or after January 1, 2015.
[57] S.L. 2011-145.
[58] Removing the adjustment simplifies the tax code. Its purpose is to avoid double taxation by both the decedent's estate and the beneficiary. Its scope is small.
[59] The interest earned on the plan continues to be exempt for federal and state tax purposes. The deduction only applied to amounts contributed to a NC 529 college savings plan, not to amounts contributed to any other college savings plan.
[60] Entity for which this deduction enacted chose to organize as a C-corporation. Therefore the deduction in the individual income tax law is not used or needed. The provision was part of an agreement for the Fund to reside in NC, *see S.L. 1999-333*.
[61] This provision was enacted for lump sum distributions when those distributions were deductible for federal income tax purposes. Today, those amounts are included in federal taxable income. For federal tax purposes, the income may be taxed at different rates.
[62] S.L. 2013-364, House Bill 269, also repealed the tax credit for educational expenses for children with disabilities and provided a scholarship grant for essentially the same group of people. A grant may not exceed $3,000 per semester.

	105-151.14, credit for gleaned crops; and 105-151.25, credit for construction of poultry composting facility. The repeal is effective for taxable years beginning on or after January 1, 2014. • Allows the following tax credits that are only applicable to individual income tax to sunset as scheduled: 105-151.28, credit for premiums paid on long-term care insurance; 105-151.31, earned income tax credit; and 105-151.32, credit for adoption expenses. • Allows the following tax credits that are applicable to both individual and corporate income tax to sunset as scheduled; the credits sunset for the 2014 taxable year unless otherwise noted: NC ports, film production (2016), recycling oyster shells, investing in renewable energy (2016), donating money to a nonprofit or governmental entity to invest in renewable energy (2016), constructing renewal fuel facilities, biodiesel producers, work opportunity, renewable energy property facility, historic rehabilitation (2015), low-income housing (2015), interactive digital media, mill rehabilitation (2015), Article 3J, and railroad intermodal facilities (2038).
Section 1.1(c)	Repeals the definition for retirement benefits. The definition is not needed because the deduction for retirement benefits is eliminated.
Section 1.1(d)	Replaces the graduated marginal tax rates of 6%, 7%, and 7.5% with a flat rate of 5.8% for taxable year 2014 is 5.8%. *New G.S. 105-153.7.* Makes significant changes to the individual income tax law by greatly reducing the number of adjustments that must be made to determine NC taxable income. *New G.S. 105-153.5.* • To determine NC taxable income, the only adjustments a person would make to adjusted gross income, as determined under the Internal Revenue Code, are as follows: o Deduction of any Social security benefits received and included in federal taxable income. o Deduction of those amounts that cannot be included in the tax base by federal law, amounts received under the Railroad Retirement Act, interest on US obligations, and income from an Indian tribe. o Deduction for those amounts that cannot be included in the tax base by a North Carolina court order, namely pension income received to the extent the amount is exempt under the *Bailey* decision.[63] o Deductions for those amounts generally accepted as a long-standing practice of the State – interest on State and local obligations, interest on nonprofit educational obligations, and

[63] Federal, State, and local governmental pension income is not taxable in North Carolina if the recipient of the pension income vested in the governmental retirement system on or before August 1989.

	gain from obligations issued prior to 1995 under bond law that exempted it. o Adjustments designed to prevent double taxation, such as a deduction for refunds of income taxes included in gross income. o Adjustments to conform to legislative decisions to decouple from federal income tax law, such as accelerated depreciation. • The standard deduction amount is increased from $6,000 to $15,000 for married taxpayers filing jointly; from $4,400 to $12,000 for heads of household; from $3,000 to $7,500 for single filers; and from $3,000 to $7,500 for married taxpayers filing separately. • There are only two federal itemized deductions allowed: o Charitable contributions. – The same amount allowed as an itemized deduction under the Code. o Mortgage interest and property taxes paid on real estate. – The same amounts allowed as an itemized deduction under the Code, capped at $20,000 for all taxpayers. Married taxpayers may not claim more than the cap amount, regardless of how the taxpayers choose to file. • The tax brackets eliminate the marriage penalty. • Consolidates and simplifies the adjustments when the State decouples from federal accelerated depreciation and expensing. *New G.S. 105-153.6.*[64]
Section 1.(e)	Increases the child credit from $100 to $125 per child if the taxpayer's AGI is below $40,000 for married filing jointly; $32,000 for head of household; and $20,000 for single/married filing separately. The act retains the current tax credit amount of $100 for a taxpayer's whose AGI is over $40,000 and up to $100,000, married filing jointly. The credit is not allowable to a taxpayer's whose AGI is over $100,000, married filing jointly.
Section 1.2	Reduces the individual flat income tax rate from 5.8% to 5.75% for taxable years beginning on or after January 1, 2015.
Section 1.3	Makes technical and conforming changes. Provides that the percentage amount to be withheld from lottery winnings is the individual income tax rate.

PART II. CORPORATE INCOME TAX CHANGES

This Part reduces the corporate income tax rate over a period of two years, with additional reductions possible in the third and fourth years. It simplifies the calculation and administration of the corporate income tax laws by eliminating most of the credits allowed under current law. It does not change the applicability, calculation, or rate of the franchise tax.

Bill Section	Brief Description
Section 2.1(a)	Reduces the corporate income tax rate from 6.9% to 6% for taxable year

[64] See also House Bill 14, S.L. 2013-414, sections 34 and 58(a).

	2014.[65]
Section 2.1(b)	Repeals the following tax credits that do not have a sunset and are applicable to both individual and corporate income tax: 105-130.22, credit for construction of dwelling units for handicapped persons; 105-130.34, credit for real property donations; 105-130.36, credit for conservation tillage equipment; 105-130.37, credit for gleaned crops; and 105-130.44, credit for construction of poultry composting facility. The repeal is effective for taxable years beginning on or after January 1, 2014. Repeals the following tax credits that do not have a sunset and that are only applicable to corporate income tax: 105-130.39, credit for certain telephone subscriber line charges[66] and 105-130.43, credit for savings and loan supervisory fees.[67] The repeal is effective for taxable years beginning on or after January 1, 2014. Allows the following tax credits that are applicable to both individual and corporate income tax to sunset as scheduled; the credits sunset for the 2014 taxable year unless otherwise noted: NC ports, film production (2016), recycling oyster shells, investing in renewable energy (2016), donating money to a nonprofit or governmental entity to invest in renewable energy (2016), constructing renewal fuel facilities, biodiesel producers, work opportunity, renewable energy property facility, historic rehabilitation (2015), low-income housing (2015), interactive digital media, mill rehabilitation (2015), Article 3J, and railroad intermodal facilities (2038). Allows the tax credit for manufacturing cigarettes for exportation to expire as scheduled (2018).
Section 2.2(a)	Reduces the corporate income tax rate from 6% to 5% for taxable years beginning on or after January 1, 2015.
Section 2.2(b)	Allows an additional 1% rate reduction for 2016 if the amount of net General Fund tax collected in fiscal year[68] 2014-15 exceeds $20.2

[65] The corporate tax rate in the surrounding states is: FL, 5.5%, GA, 6%; SC, 5%; TN, 6.5%; VA, 6%.

[66] This statute allowed a tax credit for telephone companies that provide a discount to low income residents for home telephone service under the federal Lifeline program. The federal subsidy for local telephone service under the Lifeline program is $9.25 per month. The State is not required to provide a further subsidy for low income residents, but G.S. 62-140 allows the Commission to order a similar rate reduction. Under an Order of the State Utilities Commission, the State has required public utilities to give an additional reduction in rates of $3.50 for low-income residential consumers. The tax credit repealed by this act allowed the public utility to recover its cost of the reduction in rates. Section 11.1 of S.L. 2013-363 amended G.S. 62-140 to provide that if the State repealed the funding mechanism that allowed a public utility to recover its reduction in the local telephone rates for low-income residential consumers the Commission would be required to eliminate any subsidy funded by the tax credit. In 2011, there were 109,923 Lifeline subscribers. That number dropped to $67,065 in 2012; the reduction is probably due to a FCC requirement that companies recertify Lifeline subscribers. Many customers did not respond to the recertification request; this number may increase for 2013 as eligible subscribers who were de-enrolled choose to reapply for Lifeline service.

[67] In 1985, the General Assembly allowed a tax credit for savings and loan associations equal to the amount of supervisory fees assessed on the association by the Commissioner of Banks. According to the 2011 Biennial Tax Expenditure report, this credit reduced General Fund revenues by approximately $300,000 annually.

[68] See S.L. 2014-100, Sec. 37.1; it clarifies what the term "net General Fund tax collected for a fiscal year" means for purposes of the corporate income tax rate trigger.

	billion. Allows an additional 1% rate reduction for 2017 if the amount of net General Fund tax collected in fiscal year 2015-16 exceeds $20.975 billion. The rate reduction triggers reflect the anticipated General Fund tax collections for that fiscal year. The act provides that the corporate income tax rate for taxable year 2017 will be the rate for taxable years thereafter. The rate may be 5%, 4%, or 3%, depending upon whether one or more of the rate reduction triggers are met.
Section 2.3	Extends the sunset of the tax credit for research and development until taxable years beginning on or after January 1, 2016. Allows the tax credit for interactive digital media to sunset as scheduled for taxable years beginning on or after January 1, 2014.
Section 2.4	Repeals the corporate income tax earmarked for the Public School Building Capital Fund. This Fund has not received this earmarked amount since 2008 because it has been suspended each year in the appropriations act. The amount of the earmark is equal to 5/69 of the net corporate income tax collections, or roughly between $70 and $80 million annually.

PART III. SALES TAX CHANGES

This Part makes changes to the existing sales tax law. It increases the tax rate on some items that were either exempt or taxed at a lower rate. It also imposes some new thresholds and caps. It does not change the State or local sales tax rates. The State general rate is 4.75%; the combined general rate is 7%; and the local rates vary from 2% to 2.75%.[69]

Bill Section	Brief Description
Modify Tax Rate on Manufactured and Modular Homes	
Section 3.1(a)	Increases the sales tax rate on manufactured and modular homes to the State general rate, effective January 1, 2014.[70] Prior to the increase, the tax rate on manufactured homes was 2% with a $300 per article cap; the tax rate on modular homes was 2.5%.[71] The tax applies to the sales price, including the all accessories attached to the home when it is delivered to the purchaser, even if the charges for those accessories are separately stated on the invoice.

[69] All counties have the authority to impose an additional .25% tax; as of April 1, 2013, 25 counties imposed the additional .25% local rate. Durham, Mecklenburg, and Orange counties have an additional .50% sales tax rate for public transit.

[70] See S.L. 2014-100, Sec. 37.3; it allows a sales tax exemption equal to 50% of the sales price, effective September 1, 2014.

[71] In committee discussions, some legislative members expressed a desire to begin taxing manufactured and modular homes more analogous to stick built homes. Sales tax does not apply to the sales price of a stick built home because it is real property and not tangible personal property; however, the State and local sales tax does apply to the cost of the materials used by the builder to create the home.

Section 3.1(b)	Repeals the distribution of 20% of the taxes collected on modular homes to counties.[72]
Section 3.1(c)	Provides that the local sales tax rate does not apply to sales of manufactured or modular homes. Generally, the local sales tax applies to any item subject to the State general rate. This section exempts manufactured homes and modular homes from the local sales tax base.[73]
Section 3.1(d)	Effective January 1, 2014, and applicable to sales made on or after that date. A sale occurs when title to the property transfers or possession is taken; not when the contract or agreement to purchase is signed.[74]
Repeal Sales Tax Exemption for Nutritional Supplements	
Section 3.2(a)	The exemption, G.S. 105-164.13(13c), applies to nutritional supplements sold by a chiropractic physician at a chiropractic office to a patient as part of the patient's plan of treatment. The General Assembly enacted this exemption in S.L. 1997-369, effective October 1, 1997. The term "nutritional supplement" is not defined. The federal Dietary Supplement Health and Education Act of 1994 defines a dietary supplement. There are no laws that require a dietary supplement to be sold only by health care providers. The dispensing of dietary supplements does not require a prescription. If sold elsewhere, a nutritional supplement would be subject to sales tax. Likewise, if a chiropractor sells other items of tangible personal property to their patients at their office, those items are subject to sales tax. This act repealed this exemption, effective January 1, 2014. All nutritional supplements will be subject to sales tax, regardless of where they are purchased or who sells them.
Repeal Sales Tax Exemption for Meal Plans	
Section 3.2(a)	The exemption, G.S. 105-164.13(27), applies to prepared food and food served to students in dining rooms regularly operated by State or private educational institutions or student organizations thereof. The exemption has existed since at least 1957. The provision of meals to students in higher educational facilities has changed extensively since 1957. Today, students purchase meal plans that may consist of both "meal swipes" and food dollars. In many instances, the schools contract with a third party to provide the meals. The current taxability of meals is a hodge-podge: meals purchased with cash are taxable; meals purchased by non-students are taxable; and items purchased with food dollars at locations not operated by the school's food service are taxable. Meals

[72] S.L. 2003-400 began taxing modular homes at 2.5%, regardless of whether they were "on-frame" of "off-frame". Prior to 2003, on-frame modular homes were taxed as manufactured homes at 2%. Off-frame modular homes were not taxed to the ultimate consumer, but instead the general State and local sales tax rate applied to the cost of the materials used by the seller to create the home. The distribution to counties was made to help offset the local revenue loss to counties. The distribution is around $500,000 annually.

[73] The homes are subject to local property taxes annually.

[74]

	purchased with meal swipes are not taxable as well as meals purchased with food dollars at locations operated by the school's food service.[75] This act repealed the exemption, effective January 1, 2014.
Repeal Sales Tax Exemption for Newspapers	
Section 3.2(a)	The exemption, G.S. 105-164.13(28) applies to the sales of newspapers by newspaper street vendors, by newspaper carriers making door-to-door deliveries, and by means of vending machines. In 1957 all newspaper sells were exempt from tax. In 1961 the blanket exemption was repealed. The repeal that existed prior to this act meant similar products were taxed differently. Newspapers sold over the counter, digitally, and by subscription were taxable. Newspapers sold by independent newspaper carriers, subscriptions sold door-to-door, through vending machines, and by street vendors were exempt. Magazine sales had a similar dichotomy until 2009 when the General Assembly repealed the similar exemption provided for magazine sells. The repeal of the exemption was intended to equalize the tax treatment of newspapers. However, G.S. 105-164.13(50) exempts from sales tax fifty percent (50%) of the sales price of items sold through a coin-operated vending machine, other than tobacco.[76]
Conforming changes	
Section 3.2(b)	The sales tax exemption for food sold in an elementary or secondary school remains exempt from taxation. This subsection clarifies that the exemption applies to all K-12 cafeterias, including public schools, private schools, charter schools, and regional schools.
Section 3.2(c)	Makes conforming changes to recognize that the effective date of a tax change applies the same to all items taxed at the general rate.
Section 3.2(d)	This section becomes effective January 1, 2014, and applies to sales made on or after that date.
Agricultural Sales Tax Exemption	
Section 3.3	Subsection (b) of this section repeals many of the sales tax exemptions for items purchased by farmers for farming operations under G.S. 105-164.13. Subsection (a) of this section creates a new statute that allows a sales tax exemption for the items previously exempted under G.S. 105-164.13 for *qualifying* farmers. To qualify for the exemption, a farmer must have an annual gross income of $10,000 or more from farming operations for the preceding calendar year. Under G.S. 105-164.13, anyone who purchased the listed items for farming received the exemption. The only items previously exempted under G.S. 105-164.13 that were not included in the new statute were obsolete items listed in G.S. 105-164.13(4d): metal flue used in curing tobacco.

[75] See S.L. 2014-3, Part IV; it addresses the sales tax issues related to the repeal of this exemption.
[76] See S.L. 2014-3, Part VIII; it provides that the 50% sales tax exemption for items sold through a vending machine does not apply to newspapers, effective October 1, 2014.

	This section became effective July 1, 2014, and applies to items purchased on or after that date.[77]
Repeal Sales Tax Exemption for Bakery Thrift Stores	
Section 3.4(a)	This exemption, G.S. 105-164.(27a), applies to bread, rolls, and buns sold at a bakery thrift store. The General Assembly enacted the exemption in 2007 to ensure that all bread sold at a bakery thrift store is taxed at the same sales tax rate. A bakery thrift store is defined as a retail outlet of a bakery that sells at wholesale over 90% of the items it makes and sells at the retail outlet day-old bread, rolls, and buns returned to it by retailers that acquired those items from the bakery. If the bread sold at the thrift store is prepared at the thrift store bakery, it is taxed as prepared food and is subject to the State and local tax rate. If the bread sold at the thrift store is baked elsewhere, it is taxed as food and is subject to the local tax rate. This act repeals this exemption, effective July 2014, and applicable to sales made on or after that date.
Repeal Sales Tax Holidays	
Section 3.4(a)	Repeals the two sales tax holidays. In 2001, the General Assembly enacted a sales tax exemption applicable to clothing[78] school supplies[79] computers, printers, and software[80] and recreational equipment[81] The exemption applied to purchases made during the first weekend in August. The exemption was commonly referred to as the "back to school sales tax holiday." In 2008, the General Assembly enacted a similar sales tax exemption applicable during the first weekend in November for the following Energy Star-rated products: clothes washers, freezers and refrigerators, central air conditioners and room air conditioners, air-source heat pumps, ceiling fans, dehumidifiers, and programmable thermostats. This section repeals both of these sales tax holidays, effective July 1, 2014.
Nonprofit Refunds of Sales and Use Tax Paid	
Section 3.4(b) and (c)	Places a cap on the amount of State and local sales and use tax refund a nonprofit entity is allowed, effective for the fiscal year 2014-15. Nonprofit entities may apply for a semi-annual refund of the sales and use taxes paid on purchases on items used to carry on the work of the nonprofit entity. A request for a refund for the first six months of a calendar year is due the following October 15; a request for a refund for the second six months of a calendar year is due the following April 15. A refund application submitted more than three years after the due date is barred. Subsection (b) of this section provides that the aggregated annual refund

[77] See S.L. 2014-3, Part III; it made substantial and clarifying changes to the agricultural sales tax exemption, effective July 1, 2014. It allows a three-year income averaging and it provides a conditional exemption for new farmers.
[78] Applied to clothing with a sales price of $100 or less.
[79] Applied to items with a sales price of $100 or less.
[80] Applied to computers with a sales price of $3,500 or less and to computer supplies with a sales price of $250 or less.
[81] Applied to items with a sales price of $50 or less.

	amount of State sales and use taxes allowed an entity for a fiscal year may not exceed $31,700,000. Subsection (c) of this section provides that the aggregated annual refund amount of local sales and use taxes allowed an entity for a fiscal year may not exceed $13,300,000. This aggregate amount will have little impact on refunds currently received, but it may limit future refund amounts.
Section 3.4(c) and (d)	Makes conforming changes.
Extend Sunsets on Various Tax Refund Provisions	
Section 3.5	Extends the sunset for the following annual refund of sales and use taxes paid for two years, from January 1, 2014, to January 1, 2016: • On fuel in excess of $2,500,000 used by an interstate passenger air carrier. • On aviation fuel purchased by a professional motorsports racing team, a motorsports sanctioning body, or a related member of such a team or body that is used to travel to or from a motorsport event. • On 50% of the cost of any tangible personal property other than tires or accessories that comprises any part of a professional motorsport vehicle purchased by a professional motorsports racing team or a related member of a team.

PART IV. ELECTRICITY AND PIPED NATURAL GAS TAX CHANGES

This Part repeals the franchise tax on electricity and the excise tax on piped natural gas and replaces the taxes with a State sales tax on the sale of these utilities. A portion of both the franchise tax and the excise tax are shared with the cities on sales made within the cities. This Part repeals those tax-sharing provisions and substitutes a distribution of a portion of the sales tax derived from these utilities. The Part also directs the Utilities Commission to adjust the rates set by utilities for electricity and piped natural gas to reflect the changes made by this Part.

Bill Section	Brief Description
Section 4.1(a)	Repeals the 3.22% franchise tax on electric power, water, and sewerage companies. It also repeals the following provisions that were related to the franchise tax: • The distribution of 3.09% of the franchise tax derived from sales within a city to that city. *G.S. 105-116.1* • The sales tax deduction for municipalities that sell electric power. *G.S. 105-164.21A* • The payments in lieu of franchise taxes paid by municipalities to the State and the distribution of those revenues. *G.S. 159B-27(b), (c), (d) , and (e)*
Section 4.1(c) and (e)	Subsection (c) repeals the preferential sales tax rates applicable to electricity: 2.83% for sales of electricity sold to a commercial laundry and 3% on other sales of electricity. Subsection (e) imposes a State sales

	tax on sales of electricity and piped natural gas at the combined general rate. The combined general rate is defined as the State's general rate plus the sum of the rates of the local sales and use taxes authorized for every county. That rate is currently 7%.
Section 4.1(d)	Repeals the excise tax imposed on sales of piped natural gas, Article 5E of Chapter 105, and the sales tax exemption for sales of piped natural gas.
Section 4.1(b) and (f)	Subsection (b) makes a conforming change. Subsection (f) provides that the changes made by this section become effective July 1, 2014.
Section 4.2	Directs the Utilities Commission to adjust the rates set by utilities for electricity and piped natural gas to reflect the changes made by Section 4.1 of this act.
Section 4.3	Provides for a distribution of part of the sales tax on electricity and piped natural gas to the cities. Previously, cities received a portion of the franchise tax imposed on electricity and a portion of the excise tax imposed on piped natural gas. This section creates a new distribution formula based upon the amount received by a city under those former distributions, plus growth.
Section 4.4	Makes conforming changes.
Section 4.5	Removes a sales tax preference for sales of electricity by the Cape Hatteras Electric Membership Corporation so that all sales of electricity are taxed the same.[82]

PART V. ADMISSION CHARGES TO AN ENTERTAINMENT ACTIVITY

This Part replaces the gross receipts privilege tax on live entertainment and motion pictures with a State and local sales tax on admission charges to an entertainment activity.[83] The two taxes differ in that the gross receipts tax was imposed upon the person engaged in providing the event; it was not designed to be passed directly onto the consumer. The sales tax is imposed upon the retailer, but it is intended to be passed onto the purchaser and borne by the purchaser instead of the retailer.[84] The gross receipts tax was payable monthly and the return covered the gross receipts received during the previous month.[85] The sales tax is due quarterly, monthly, or bi-monthly depending upon the tax liability of the retailer.[86]

Bill Section	Brief Description
Section 5.(a)	Repeals the 3% privilege tax imposed on live entertainment and the 1% privilege tax imposed on movies, effective January 1, 2014. This subsection also makes a conforming change by repealing the exemptions from the privilege tax. Some of these exemptions were retained by

[82] See. S.L. 2014-39; it phases-in the sales tax on sales of piped natural gas by the eight gas cities and on sales of electricity by the Cape Hatteras EMC over two years.
[83] See 2014-3; it addresses several issues re: to the expansion of the sales tax base to admission charges for an entertainment activity.
[84] G.S. 105-164.7.
[85] By practice, some taxpayers remitted the gross receipts tax at the time the event occurred.
[86] G.S. 105-164.16.

	providing a similar sales tax exemption; others were not.
Section 5.(b)	Imposes a State and local sales tax on admission charges to an entertainment activity. The sales tax is a trust tax. It is payable by the purchaser to the retailer.[87] A retailer is considered to act as a trustee on behalf of the State when it collects tax from the purchaser. The tax should be stated and charged separately unless the retailer displays a statement indicating the sales price includes the tax. It defines an entertainment activity as the following: • A live performance or other live event. This base is substantially the same as the base for the 3% gross receipts privilege license tax under former G.S. 105-37.1. • A motion picture or film. This base is substantially the same as the base for the 1% gross receipts privilege license tax under former G.S. 105-38.1. • A museum, a cultural site, a garden, an exhibit, a show, or a similar attraction or a guided tour at any of these attractions. The imposition statute provides that an admission charge does not include a charge for amenities. In 2011, the General Assembly excluded amenities from the gross receipts privilege tax.[88] This act does not change the policy decision made in 2011.
Section 5.(c)	Exempts the following entertainment activities from the sales tax on admission charges: • An event held at an elementary or secondary school and is sponsored by the school. • A commercial agricultural fair. • A festival or activity that lasts no more than seven days and is sponsored by a nonprofit entity that is exempt from income tax and that uses the entire proceeds exclusively for the entity's nonprofit purpose. • A youth athletic contest sponsored by a nonprofit entity.
Section 5.(d) and (e)	Repeals obsolete statutes and makes conforming changes.
Section 5.(f)	Makes these changes effective January 1, 2014. Provides that for admissions to a live event, the tax applies to the initial sale or resale of tickets occurring on or after that date so that tickets to an event are taxed under the same tax: either the gross receipts privilege tax or the sales tax.

PART VI. SERVICE CONTRACTS

[87] G.S. 105-164.7.
[88] S.L. 2011-330.

This Part imposes a State and local sales tax on the sales price of a service contract.[89] This Part does not modify or repeal the sales tax exemption for installation charges when the charges are separately stated on the billing document given to the purchaser at the time of the sale.

Bill Section	Brief Explanation
Section 6.(a)	Defines a service contract as a warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property.
Section 6.(b)	Imposes a State and local sales tax on the sales price of a service contract.
Section 6.(c)	Exempts from sales tax a service contract provided for an item that is exempt from sales tax, other than a service contract for a motor vehicle. A motor vehicle is exempt from sales tax under G.S. 105-164.13(32) because it is subject to a highway use tax. The tax applies to service contracts for motor vehicles. Exempts from sales tax a service contract for a transmission, distribution, or other network asset contained on utility-owned land, right-of-way, or easement. Exempts from sales tax an item used to maintain or repair tangible personal property pursuant to a service contract if the purchase of the contract is not charged for the item.
Section 6.(d)	Makes these changes effective January 1, 2014.

PART VII. ELIMINATE ESTATE TAX

This Part repeals the estate tax and the generation-skipping transfer tax for decedents dying on or after January 1, 2013.[90]

In 2001, the federal estate tax was designed as a revenue sharing system where the federal estate tax gave estates a 100% credit for state estate tax. Because estates received a full credit for state estate tax imposed, the estates did not pay any additional estate tax if state estate tax also applied. In 2001, all fifty states and the District of Columbia imposed an estate tax. During 2012, the federal estate tax was scheduled to return to the 2001 law for decedents dying in 2013 – meaning that any state estate tax paid would be fully credited against federal estate tax.

On January 1, 2013, the US Congress passed the American Taxpayer Relief Act of 2012 (also called the "fiscal cliff bill"). The 2012 Act permanently changed the federal estate tax system starting January 1, 2013. It repealed the scheduled return to the 2001 version of the federal estate tax; it provides only a deduction for state estate tax paid. Because the deduction does not relieve estates of the financial loss of paying state estate tax, estates do pay additional estate tax if state estate tax applies.

[89] See S.L. 2014-3; it addresses several issues re: to the expansion of the sales tax base to service contracts.
[90] North Carolina imposed an estate tax on the value of the estate over $5.25 million. The tax rate graduated from 0.8% to a maximum rate of 16% for taxable estates over $10,040,000.

PART VIII. CAP EXCISE TAX ON MOTOR FUEL

This Part caps the motor fuel excise tax rate for the period October 1, 2013, through July 1, 2015, at 37.5¢ per gallon. With a cap, the rate may fall below 37.5¢ per gallon for the given period but it may not exceed it. This provision effectively reduced the motor fuel excise tax rate on October 1, 2013, from 37.6¢ per gallon to 37.5¢. Effective July 1, 2014, the rate fell to 36.5¢ under the variable rate formula. The motor fuel tax rate has two components: a flat rate of 17.5¢ and a variable rate that may change every six months.[91] 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.

A motor fuel excise tax is imposed on all motor fuel sold, distributed, or used in the State. 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).
- 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.

PART IX. STUDY AND EFFECTIVE DATE

This Part provides a savings clause. It also gives the Secretary of Revenue the authority to compromise a taxpayer's liability for sales tax on an admission charge to an entertainment activity or on the sales price of a service contract if the taxpayer made a good faith effort to comply with the sales and use tax laws. This additional compromise authority expires July 1, 2020. The purpose of this additional authority is to recognize the compliance issues and learning curve associated with the expansion of the sales tax base to services.

[91]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).

NC Charter School Advisory Board.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-355	**20**	**Sen. Tillman, Soucek**

AN ACT TO CREATE THE NORTH CAROLINA CHARTER SCHOOLS ADVISORY BOARD AND MAKE OTHER CHANGES TO CHARTER SCHOOL LAWS.

SUMMARY: This act provides limited immunity for certain controlled substance offenses in cases of medical necessity, and also provides immunity to a practitioner who dispenses an agent to treat overdoses, or an individual who administers the agent to another person. This act becomes effective December 1, 2013, and applies to offenses committed on or after that date.

BILL ANALYSIS:

Section 1 of the act provides that a person seeking medical assistance for themselves for a "drug-related overdose" (defined term in the act), or a person who seeks medical assistance for another individual who is experiencing a drug-related overdose, has immunity from prosecution for any of the following offenses:

- Misdemeanor possession of a controlled substance.
- Felony possession of less than one gram of cocaine..
- Felony possession of less than one gram of heroin.
- Misdemeanor possession of drug paraphernalia.

Any evidence obtained in connection with an investigation of other crimes committed by a person who may be entitled to limited immunity under the act remains admissible as to those crimes.

Section 2 provides there is no civil or criminal liability for the following:

- A practitioner who prescribes, dispenses, or distributes naloxone hydrochloride, an opioid antagonist approved by the Food and Drug Administration for the treatment of a drug overdose, to (i) a person at risk of experiencing an opiate-related overdose, or (ii) to another person in a position to assist an at risk person.
- A person who received an opioid antagonist, and administers it to another person if they have a good faith belief the person is experiencing a drug-related overdose, and the person exercises reasonable care in administering the agent.

EFFECTIVE DATE: This act becomes effective December 1, 2013, and applies to offenses committed on or after that date.

NC Charter School Advisory Board.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-355	**SB 337**	**Sen. Tillman, Soucek**

AN ACT TO CREATE THE NORTH CAROLINA CHARTER SCHOOLS ADVISORY BOARD AND MAKE OTHER CHANGES TO CHARTER SCHOOL LAWS.

THIS SUMMARY COVERS ONLY SECTION 3 OF S.L. 2013-355. A SUMMARY OF THE ENTIRE LAW IS AVAILABLE AS S337-SMRQ-51(sl).

SUMMARY: Section 3 of S.L. 2013-355 exempts real property occupied by a charter school and exclusively used for educational purposes from local property tax. Ownership of the property is not required.

CURRENT LAW:

G.S. 105-278.4 exempts certain real and personal property used for educational purposes. Exemption has an ownership requirement.

G.S. 105-278.7 exempts certain real and personal property used for educational, scientific, literary, or charitable purposes. Exemption has an ownership requirement.

G.S. 105-275(43) provides an exemption from local property tax for real (and tangible personal property) that is subject to a capital lease under G.S. 115C-531. The definition of capital lease in G.S. 115C-531 requires a local board of education be a party to the capital lease for use as school buildings or school facilities.

BILL ANALYSIS: Section 3 of S.L. 2013-355 exempts real property occupied by a charter school and exclusively used for educational purposes from local property tax. The use test requires the charter school "wholly and exclusively" use the property. Ownership of the property is not required.

BACKGROUND: Charter schools often operate on property owned by a separate entity because the charter school is not authorized to enter into a mortgage to buy land. For example, a charter school may lease a building that is owned by an affiliated nonprofit entity. The affiliated entity would have the authority to buy land and mortgage the land to finance the purchase.

EFFECTIVE DATE: Section 3 of S.L. 2013-355 is effective for taxes imposed for taxable years beginning on or after July 1, 2013.

Appropriations Act of 2013.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-360	**SB 402**	**Sen. Brunstetter, Brown, Hunt**

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

SUMMARY: This analysis summarizes only the finance-related provisions in S.L. 2013. The finance provisions of that act are as follows:

- ***Increases fees by $60 million, $54.2 million of which would impact the General Fund and $5.8 million of which would impact various special funds.[92]***
- ***Authorizes a sales tax refund for an interstate passenger air carrier for the period January 1, 2011 through June 30, 2011.***
- ***Restores for one year the transitional hold harmless payments to local governments for repealed reimbursements.***
- ***Increases funding for dredging by allocating to the new Shallow Draft Navigation Channel Dredging Fund 1/6 of 1% of the amount allocated to the Highway Fund from the motor fuel excise tax in addition to appropriating funds for that purpose.***
- ***Sets the insurance regulatory charge at 6%, increase the regulatory fee for the Utilities Commission to .13%, and set the electric membership corporation regulatory fee at $200,000.***
- ***Changes the distribution or use of existing tax proceeds as follows:***
    - ***Reallocates the distribution of the .74% gross premiums tax on property coverage contracts and dedicate 20% to the Workers' Compensation Fund for volunteer safety workers.***
    - ***Eliminates the tax return designation of $3 of a taxpayer's tax liability to be remitted to the NC Public Campaign Fund and repeals the Fund.***
    - ***Directs the portion of the special license plate fee and the deed stamp tax that is remitted to the Natural Heritage Trust Fund to the Clean Water Management Trust Fund and repeals the Natural Heritage Trust Fund.***

The act also makes the following changes related to economic development:

- ***Increases the JDIG application fee and reporting fee.***
- ***Repeals the statutorily-created regional economic development commissions.***

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[92] The Senate budget increased fees remitted to the General Fund by $57.4 million and reduced fees remitted to various special funds by $38 million.

- ***Modifies the Industrial Development Fund and Utility Account.***

BILL ANALYSIS:

FEE INCREASES

S.L. 2013-360 increases fees by $60 million, $54.2 of which would impact the General Fund and $5.8 of which would impact various special funds.

FINANCE-RELATED CHANGES

***Sales Tax Refund for Passenger Air Carrier.* –** An interstate passenger air carrier is allowed an annual refund of the sales and use tax paid by it on fuel in excess of $2,500,000. This refund will expire for purchases made on or after January 1, 2014. A request for a refund is due within six months after the end of the State's fiscal year. The refund period covers purchases made during the State's fiscal year. Refunds applied for after the due date are barred. The only taxpayer that currently qualifies for this credit is U.S. Airways.

In 2010, the sales tax refunds transitioned from a calendar year basis to a fiscal year basis. Because of the transition, U.S. Airways failed to timely file for a refund. In 2012, the General Assembly enacted legislation authorizing a sales tax refund for the period January 1, 2011, through June 30, 2011, and the refund was capped at $3,150,000. Without the cap, the taxpayer would have been entitled to a State sales tax refund of $6,340,000 for that same six-month period. In the availability statement of the House version of the 2012 budget, there was an adjustment in the amount of $6.3 million for the sales tax refund application extension for U.S. Airways. In the Senate version, there was no adjustment to the availability statement for this purpose. In the budget as enacted there was a reserve in the amount of $3.15 million. Pursuant to the 2012 legislation, U.S. Airways applied for a refund for the full amount of $6.34 million.

Section 6.16 allows U.S. Airways to obtain a refund for the amount not previously refunded for the January-June 2011 period.

***Temporarily Restore Hold Harmless Payment.* –** A decade ago, the General Assembly repealed the reimbursements it had traditionally provided to local governments as replacement for the revenue they lost due to the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps. In place of the reimbursements, the General Assembly gave local governments the authority to increase their local sales tax by one-half percent and it provided a transitional hold harmless payment to those local governments whose potential gain from the half-cent local sales tax increase would be less than their loss from the repealed State reimbursements. The hold harmless distribution is made on or before August 15th of each year. The transitional hold harmless payments were to be made through August 2012.

Section 6.17 extends those payments for one additional year, through August 2013.

Set Regulatory Fees. – **Section 15.1** increases from .12% to 0.13% the rate for the public utility regulatory fee beginning with fiscal year 13-14. It also sets at $200,000 for fiscal years 13-14 and 14-15 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 proceeds of the fee are credited to the Utilities Commission and Public Staff Fund and used to reimburse the General Fund for appropriations made to the Utilities Commission to pay the expenses incurred in regulating public utilities.

The last time the rate of the public utility regulatory fee was changed was in fiscal year 04-05. The rate for this fee must be set each year by the General Assembly. The utility regulatory fee is a tax that was first imposed in 1989. 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.

The rate of the fee imposed on electric membership corporations has not changed since the General Assembly enacted it in 1999. 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.[93] Thus, the fee imposed on the North Carolina Electric Membership Cooperation will be passed on to its member electric membership corporations.

Section 20.3 sets the insurance regulatory charge at 6% for the 2013 and 2014 calendar years, the same as the rate set 2010, 2011, and 2012. The proceeds of the fee are credited to the Insurance Regulatory Fund and used to reimburse the General Fund for appropriations made to the Department of Insurance and other agencies to pay the expenses incurred in regulating the insurance industry. The insurance regulatory charge was first enacted in 1991 to defray the State's cost of regulating the insurance industry. The charge is a percentage of each insurance company's gross premiums tax liability.[94]

Section 34.29, as amended by S.L. 2013-363, Sec. 8.1, expands the retail value of a motor vehicle upon which the 3% highway use tax is imposed to include documentation fees and other administrative charges. This section becomes effective January 1, 2014.

CHANGES TO THE DISTRIBUTION OR USE OF TAX PROCEEDS

Clean Water Management Trust Fund. – **Section 14.3** directs the portion of the special license plate fee and the portion of the deed stamp tax[95] proceeds that are both currently remitted to the Natural Heritage Trust Fund to the Clean Water Management Trust Fund. The section also repeals the Natural Heritage Trust Fund.

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[93] 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."

[94] Medical service corporations and health maintenance organizations began paying the charge in 2000.

[95] An excise tax is levied on each instrument by which any interest in real property is conveyed to another person. The tax rate is $1.00 on each $500 of the value of the interest conveyed.

***Scrap Tire, White Goods, and Solid Waste Disposal Taxes Credited to General Fund* - Section 14.16** directs 30% of the tax proceeds from the scrap tire disposal tax to the General Fund. This section ends the current earmarking of these proceeds to the Solid Waste Management Trust Fund, the Scrap Tire Disposal Account, the Inactive Hazardous Sites Cleanup Fund, and the Bernard Allen Memorial Emergency Drinking Water Fund. This section became effective July 1, 2013. **Section 14.17** directs 28% of the tax proceeds from the white goods disposal tax to the General Fund. This section ends the current earmarking of these proceeds to the Solid Waste Management Trust Fund and the White Goods Management Account. This section became effective August 1, 2013. **Section 14.18** directs 12.5% of the tax proceeds from the solid waste disposal tax to the General Fund. This section ends the current earmarking of these proceeds to the Solid Waste Management Trust Fund. This section became effective July 1, 2013.

***Increase Funding for Dredging.* – Section 14.22** allocates one-sixth of one percent of the amount that is allocated to the Highway Fund from the excise tax on motor fuel to the Shallow Draft Navigation Channel Dredging Fund created under the bill.

Workers' Compensation Fund for Volunteer Safety Workers.[96] – North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[97] In addition to the general rate, there is an additional rate of .74% applied to the gross premiums on insurance policies for property coverage. Thirty percent (30%) of the net proceeds of this additional tax is credited to the Volunteer Fire Department Fund,[98] 25% of the net proceeds is credited to the Department of Insurance for disbursement to the county fire districts,[99] and the remainder (45%) is credited to the General Fund.

Section 20.2 reallocates the proceeds of the additional tax by dedicating 20% to the Workers' Compensation Fund for volunteer safety workers. Until April 1, 2016, if the amount remitted is insufficient to meet the needs of the Fund as determined by a DOI actuarial study, the shortfall may be made up either through increased premiums or through an assessment on local governments. Beginning on and after April 1, 2016, the shortfall may be made up only through an assessment on local governments.

NC Public Campaign Fund. – The North Carolina Public Campaign Fund was established in 2002 to offer public campaign financing to court candidates who agree to strict fundraising and spending limits and who reject special interest money and to

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[96] The House Finance Committee passed HB 27 on February 13, 2013, which proposed dedicating the 45% of the net proceeds that is currently credited to the General Fund to the Workers' Compensation Fund for the benefit of volunteer safety workers.

[97] Workers' compensation policies are taxed at 2.5%.

[98] Funds in the Volunteer Fire Department Fund provide matching grants to volunteer fire departments to purchase equipment and make capital improvements.

[99] The Insurance Commissioner will allocate to each county the amount of tax proceeds it received in the previous year. From that amount, the Commissioner will distribute to each fire district in the county the amount it received in the previous year. If the amount of proceeds to be allocated varies from the amount allocated the previous year, then the amount allocated to a county will be either reduced or increased by a percentage, the numerator of which is the population of the county and the denominator of which is the population of the State. If the amount to be distributed to the fire districts differs from the amount distributed the previous year, then the amount distributed will be either reduced or increased by a percentage, the numerator of which is the tax value of the property located in the district and the denominator of which is the tax value of all property located in any fire district in that county.

produce a nonpartisan judicial voter guide, mailed to voters across the state in the weeks before Election Day. The Fund is funded through a $50 surcharge imposed on every active member of the North Carolina State Bar and the designation by a taxpayer on the income tax return of $3.00 of the taxpayer's tax liability.

Section 21.1 repeals the $50 surcharge, the $3.00 designation on the tax return, and the Fund. The State Board of Elections must use the existing money in the Fund only to publish judicial voter guides until the funds have been exhausted.

ADMINISTRATIVE CHANGES

Section 6.9 of S.L. 2013-360 authorizes the NC Department of Revenue to disclose a sample of tax information suitable for statistical analyses to the State Budget Director or the Director's designee. The sample does not include taxpayers' names and identification numbers. This section is effective July 1, 2013.

Section 7.17 of S.L. 2013-360 authorizes the NC Department of Revenue to enter into an additional public-private arrangement in order to expand the implementation of the Tax Information Management System (TIMS). TIMS is the replacement to the Department of Revenue's computer system for processing tax returns. The authority allows an additional $16,000,000 of projects related to TIMS that generate increased revenues or cost-savings greater than a revenue baseline. This section is effective July 1, 2013.

CHANGES RELATED TO ECONOMIC DEVELOPMENT

JDIG Changes. – **Section 15.19** requires Commerce to notify each governing body of an area where a submitted application proposes locating a project subject to any confidentiality agreements imposed by the Department. **Section 15.20** increases from $5,000 to $10,000 the application fee for a Job Development Investment Grant. Every business that is awarded a grant must submit an annual payroll report showing withholdings as a condition of its continuation in the program and identifying eligible positions that have been created. The report must be accompanied by a $1,500 fee, which is allocated among Commerce, Revenue, and OSBM. **Section 15.21** increases the reporting fee from $1,500 to the greater of $2,500 or .03% of an amount equal to the grant less the maximum amount to be transferred to the Industrial Development Fund.

Repeal of Economic Development Commissions.[100] Effective June 30, 2014, Section 15.28 abolishes the statutorily-created Regional Economic Development Commissions and would provide for an allocation of funds appropriated to the Department of Commerce related to the commissions. The section also provides for the distribution of assets held by the Eastern Region upon repeal that is consistent with the current statutory distribution of assets upon dissolution.

Currently, there are seven regional economic development organizations in North Carolina – four statutorily-created commissions and three public-private partnerships that are nonprofit entities. The three partnerships, which were established prior to 1993, are the Charlotte Regional Partnership, the Piedmont Triad Partnership, and the Research Triangle Regional Partnership.[101] The four statutorily-created commissions are:

[100] This provision is similar to SB 127, which passed the Senate and is in House Commerce.

[101] These three regions formed as multi-county partnerships to combine growth efforts around the three largest metropolitan areas.

Advantage West Economic Development Group, North Carolina's Eastern Region, Northeast Commission, and Southeast Commission.[102] The General Assembly appropriates recurring funds to the regions. The Department of Commerce distributes funds to the regions based on a formula that incorporates tier county rankings. Tier ranks are based on unemployment, population growth, median household income, and property value per capita.

Modification to IDF and Utility Account. – **Section 15.18** eliminates the Industrial Development Fund and the Utility Account, as an account inside the fund, and establishes the Industrial Development Fund Utility Account. It also:

- Reverses the change enacted July 1, 2012, limiting IDF availability to the 65 economically distressed counties by expanding the program back to all development tier one and two counties.
- Modifies language requiring that funds be reserved only for projects that "will directly result in the creation of jobs" to projects "reasonably anticipated to result in the creation of jobs." Language regarding job retention has been eliminated.
- Modifies language requiring that funds be reserved only for projects in eligible industries (company HQ, air courier services, information technology/services, manufacturing, warehousing, and wholesale trade) by merely giving priority to such industries instead of funds being reserved to such industries.

Require Certain General Reappraisals.

Session Law	***Bill #***	***Sponsor***
S.L. 2013-362	**SB 159**	**Sen. Tarte, Rucho**

AN ACT TO CORRECT GENERAL REAPPRAISALS RESULTING IN PROPERTY VALUES THAT DO NOT COMPLY WITH THE REQUIREMENTS OF NORTH CAROLINA LAW BY SETTING FORTH THE STEPS REQUIRED TO BRING THE GENERAL REAPPRAISAL INTO COMPLIANCE WITH THE APPLICABLE PROPERTY TAX MANDATES.

SUMMARY: Session Law 2013-362 requires counties to retroactively change appraisals valued during the county's last general reappraisal if certain conditions are met.

PRIOR LAW: The value of real property must be appraised as of January 1 by each county at least once every eight years. Unless another standard applies for limited circumstances, the value to be determined is the true value of the property, or the price at which the property would change hands between a willing and financially able buyer and a willing seller, neither being under any compulsion to buy or sell and both having

[102] In 1993, the General Assembly created four additional regions to market the rural areas of the State.

reasonable knowledge of all the uses to which the property is adapted and capable of being used. While there are limited exceptions, generally speaking, this value (i) must be used by the county until the county conducts its next general reappraisal and (ii) may not be changed for tax years other than the current tax year, regardless of whether the changes are sought by the taxpayer from the assessor, the board of equalization and review, or the board of county commissioners.[1] While G.S. 105-381 permits refunds or releases if the tax in question was levied illegally or due to clerical error and while G.S. 105-394 permits retroactive changes to property tax records to correct "immaterial irregularities" in the listing, appraisal, levy, or collection process, neither provision expressly authorizes retroactive changes to appraisals based on the alleged misjudgments of market value by the county.[2]

BILL ANALYSIS: This act adds a time-limited exception to the general rule that the assessed value may not be changed for tax years other than the current tax year by superseding the time limitations disallowing retroactive changes where the following conditions are met:

- The county has evidence that the majority of commercial neighborhoods reviewed by a qualified appraisal company possess significant issues of inequity.
- The county has evidence that instances of inequity or erroneous data had an impact on the valuation of residential neighborhoods in the county.
- The county's last general reappraisal was performed in one of the years when the economic downturn most severely affected home prices (2008-2012).
- The county's evidence (i) resulted from a review performed by an appraisal service retained and selected by the county and registered with the Department of Revenue and (ii) resulted from a sample size of not less than 375 properties that were examined on site.

If all of the conditions are met, the county must undertake one of the two following options:

- The county must conduct a general reappraisal pursuant to G.S. 105-286 within 18 months with at least 1 appraiser certified by the Department for mass valuations per 4,250 parcels.

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[1] (See G.S. 105-287(c) (any change in appraisals made in non-general-revaluation years may take effect <u>in the current tax year only and not retroactively</u>; G.S. 105-296(i) (changes made informally by the assessor prior to the first meeting of the Bd of E&R may affect <u>only current-year appraisals</u>); G.S. 105-322 (authorizes board of E&R to make changes as permitted by G.S. 105-287 and as needed to resolve timely filed appeals of <u>current year's appraisals</u>); G.S. 105-325 (authorizes board of county commissioners to make changes only to <u>current-year appraisals</u>).

[2] Neither provision has been the subject of much litigation. The leading cases are *Ammons v. Wake County*, 127 N.C. App. 426 (1997), which makes clear that a misjudgment of market value under G.S. 105-381 cannot justify a refund under the "clerical error" standard but does not address the "levied illegally" standard, and *In re: Morgan*, 362 N.C. 339 (2008), which deals with immaterial irregularities. An argument that a misjudgment of market value was either an illegal tax or an immaterial irregularity would render the appeal deadline created by G.S. 105-322 unnecessary, and courts strive to avoid interpreting a statute in a manner that eliminates the relevance of another statute.

- The county must have a qualified appraisal service expand the county's evidence of inequity to cover the entire county.

Once one of the two options has been completed, the county must change the abstracts and tax records so that the assessed value reflects the true value for each tax year until the next general reappraisal required by G.S. 105-286. In making these changes, the county must prioritize significantly overvalued parcels first, significantly undervalued parcels second, other overvalued parcels third, and other undervalued parcels last, and, in making refunds, the governing board of the county (and city, where applicable), must direct that a notice of refund and the refund amount be sent to the owner of record as of the date the payment was made. For overvalued parcels, the county must repay the overpayment with interest in the same manner as if there were an order of the Property Tax Commission reducing a valuation on property resulting in an overpayment under G.S. 105-290(b)(4), which is currently 5% per annum. For undervalued parcels, the additional taxes are treated as taxes on discovered properties pursuant to G.S. 105-312, on which interest does not begin to accrue until the next calendar date of delinquency, which would be the next January 6th. Penalties associated with discovered properties are expressly made non-applicable.

EFFECTIVE DATE: This act became effective when it became law by signature of the Governor on July 26, 2013.

BACKGROUND: In 2011, Mecklenburg County conducted a general reappraisal, which has been a source of controversy and debate. In response to a significantly higher rate of appeal and public criticism, the county commissioned a review of the reappraisal data. The resulting report indicated that many of the neighborhoods throughout the county had valuations that had either major or minor issues affecting the calculation.[3]

The report is available online at the following website:

http://charmeck.org/mecklenburg/county/AssessorsOffice/Pages/RevaluationReview.aspx

The act provides a remedy by conforming the previously established valuations to true or market values as of the date for which the reappraisal was to be effective coupled with a retroactive adjustment to tax liabilities. Laws amending property tax statutes must adhere to two North Carolina constitutional provisions:

- Art. II, Sec. 24 of the NC Constitution prohibits local bills that "extend the time for the levy or collection of taxes or otherwise relieving any collector of tax from the due performance of his official duties."
- Art. V, Sec. 2 of the NC Constitution requires that any "classification" of property for tax purposes "be made by general law uniformly applicable in every county, city, and town."

North Carolina courts have not addressed the question of whether an act permitting or ordering the retroactive changing of property tax assessments in some (but not all)

[3] For example, in the neighborhood review, the report indicated major or minor issues in 49 of 150 neighborhoods, and in the land increase neighborhood review, the report indicated major or minor issues in 38 of 52 neighborhoods.

counties would violate either of these constitutional provisions. Although the act addresses primarily a local issue and Mecklenburg County is the only county known to meet all of the conditions set forth in the act, any county that conducted a revaluation between 2008 and 2012 can meet the act's conditions. A taxpayer or a county in the State may have standing to challenge a law that violated a constitutional provision. It is unknown whether a court would find the act to be local in nature or non-uniform.

Modifications/2013 Appropriations Act.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-363	**HB 112**	**Rep. Dollar, Collins, McElraft**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND OTHER MODIFICATIONS TO THE CURRENT OPERATIONS AND CAPITAL IMPROVEMENTS APPROPRIATIONS ACT OF 2013 AND TO RELATED LEGISLATION.

SUMMARY: Section 11.3 of S.L. 2013-363 extends the tax credit for renewable fuel facilities.

BILL ANALYSIS: S.L. 2013-363, Sec. 11.3, extends the sunset of the tax credit for constructing a renewable fuel facility from January 1, 2014, until January 1, 2017, if both of the following requirements are met:

- The taxpayer signs a letter of commitment with the Department of Commerce on or before September 1, 2013, stating the taxpayer's intent to construct and place into service in this State a commercial facility for processing renewable fuel.
- The taxpayer begins construction of the facility on or before December 31, 2013.

EFFECTIVE DATE: This section became effective July 24, 2013.

Children w/Disabilities Scholarship Grants.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-364	**HB 269**	**Rep. Jordan, Brandon, Jones, Stam**

AN ACT TO CREATE SPECIAL EDUCATION SCHOLARSHIP GRANTS FOR CHILDREN WITH DISABILITIES.

SUMMARY: S.L. 2013-364 would create \ special education scholarship grants for children with disabilities.

CURRENT LAW: A taxpayer is entitled to an education expenses tax credit of up to $3,000 per semester for tuition and special education and related services expenses for each "eligible dependent child" who is a resident of North Carolina and who enrolled for one or two semesters during the taxable year in grades kindergarten-12 at either (i) a nonpublic school or (ii) a public school where tuition is charged for the child's enrollment. For home schools, the credit is equal to the amount the taxpayer paid for special education and related services expenses, not to exceed $3,000 per semester.

Qualifications for the Tax Credit. – In order for a child to be an "eligible dependent child," all of the following criteria must be met:

- The child must be a child with a disability who requires an individualized education program (IEP) under Article 9 of Chapter 115C of the General Statutes (Education of Students with Disabilities) and the federal Individuals with Disabilities Education Improvement Act (IDEA), 20 U.S.C. § 1400 et seq. (2004), as amended. The child must be reevaluated every three years by a local educational agency to verify that the child continues to be a child with a disability. Local educational agencies are not responsible for implementing IEPs for children in parentally placed nonpublic schools.
- The child must receive special education or related services on a daily basis.
- The child must be a child for whom the taxpayer is entitled to deduct a personal exemption under section 151(c) of the Internal Code for the taxable year.

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

Disqualifications for the Tax Credit. – A taxpayer does not qualify for the education expenses tax credit for any semester when the taxpayer's otherwise eligible dependent child was:

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

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

Carryforward of the Tax Credit. – Any unused portion of the credit may be carried forward for 3 succeeding years.

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

BILL ANALYSIS:

S.L. 2013-264 repeals the current tax credit for children with disabilities as well as the Fund for Special Education and Related Services. It creates the following new program in Article 9 of Chapter 115C of the General Statutes (Education of Children with Disabilities). All terms defined for that Article will apply in this law, including the definitions for child with a disability, IEPs, and special education and related services.

Special Education Scholarship Grants (grants) – The program will provide grants of not more than $3000 per semester to eligible students for reimbursement of tuition and special education and related services. Priority will be given in awarding grants to students who received a grant in the previous semester. Otherwise, grants will be awarded to eligible students in the order in which applications are received.

Scholarship Grant Eligibility - A child with a disability under the age of 22 who meets all of the following requirements will be eligible for a scholarship grant:

- Requires an individualized education plan.
- Receives special education or related services on a daily basis.
- Has not been placed in a nonpublic school or facility by a public agency at public expense.
- Has not spent any time enrolled in a postsecondary institution as a full-time student taking at least 12 academic credit hours.
- Has not received a high school diploma.
- Meets one of the following requirements:
  - Was enrolled in a NC public school during the previous semester.
  - Received special education or related services through the NC public schools as a preschool child with a disability during the previous semester.
  - Received a scholarship grant for the previous semester, or received a tax credit for students with disabilities as provided in G.S. 105-151.33 for the fall semester of the 2013-2014 school year.
  - Is eligible for initial enrollment in kindergarten or the first grade in a NC public school.

Administration - The State Education Assistance Authority (SEAA) will administer the scholarship grants.

- **Timeline of awards -** Applications will be made available by May 1 to eligible students. Awards of grants for fall semester will be made by July 1, and awards for spring semester will be made by December 1.
- **Reimbursement Documentation -** At the end of each semester, parents will submit receipts or other documentation to the SEAA for reimbursement up to the maximum amount of the grant. Parents must provide documentation that the student was enrolled in

nonpublic school or was homeschooled and receiving related services for no less than 75 days of the semester for which the parent seeks reimbursement.

- **Verification of Eligibility** – The SEAA may seek verification on information on applications and may revoke grants if parents fail to cooperate with verification efforts. Parents must authorize the SEAA to access information held by the local educational agency.
- **Reevaluation** - After an initial award, students must be reevaluated by the local educational agency every three years to verify the student continues to be a child with a disability.

Reporting – The SEAA must report to the Joint Legislative Education Oversight Committee annually no later than October 1 on the following:

- o Total number, age, and grade level of students receiving grants.
- o Total amount of grant funding awarded.
- o Nonpublic schools in which grant recipients are enrolled, and number of grant students at those schools
- o Types of special education or related services for which grants were awarded.

Appropriations: $3,670,500 is appropriated to the SEAA for the 2013-2014 fiscal year, and $4,341,000 in recurring funds is appropriated to the SEAA for the 2014-2015 fiscal year to implement the act. SB 402 reserved funds for implementation of this act. Of those funds, $3,000,000 per year must be used by the SEAA to fund grants to eligible students. Unexpended funds do not revert and remain available to award grants. The remainders of the funds are transferred to DPI to conduct evaluation of eligible students. The SEAA may retain up to $200,000 of the funds for grants for administrative costs in fiscal year 2013-2014. For fiscal year 2014-2015 and subsequent years, the SEAA may retain 2% annually for administrative costs.

EFFECTIVE DATE: The repeal of the current tax credit (Sections 1, 2, and 3) is effective for taxable years beginning on or after January 1, 2014. The scholarship grant program (Section 4), is effective when it becomes law and applies beginning with the spring semester of the 2013-2014 school year. Sections 5 and 6, concerning appropriations and fund transfers, are effective July 1, 2013. Initial applications for the 2014 spring semester must be made available no later than October 1, 2014 and parents notified of awards as soon as practicable.

BACKGROUND: Approximately six states have scholarship grant programs for students with disabilities: Florida, Georgia, Louisiana, Ohio, Oklahoma, and Utah.

Amend Assessments for Infrastructure Needs.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-371	**SB 103**	**Senator Hartsell**

AN ACT TO EXTEND AND AMEND THE AUTHORITY COUNTIES AND CITIES HAVE TO USE SPECIAL ASSESSMENTS TO ADDRESS CRITICAL INFRASTRUCTURE NEEDS.

SUMMARY: S.L. 2013-371 addresses two issues in the special assessment for critical infrastructure needs that have arisen as local governments have considered its use. It also extends the sunset on this program for two years, from July 1, 2013, to July 1, 2015.

CURRENT LAW: In 2008, the General Assembly gave counties and cities the opportunity to use special assessments on benefitted property as a financing tool for long-term capital projects. Although some local government units have considered using assessment-based financing[103] sometimes in conjunction with project development financing, no unit has done so to date. The ability to use this financing tool expired July 1, 2013.

Assessment-based financing may be used for any purpose for which project development financing may be used. Those purposes include water and sewer systems, public transportation facilities, school facilities, gas systems, electric systems, industrial parks, parks and recreation facilities, and streets and sidewalks. Special assessments may be pledged as additional security for project development financing debt instruments as well as revenue bond financing debt instruments. If the assessment is pledged to secure financing, the city or county must covenant to enforce the payment of assessments.[104] Special assessments must be paid in annual installments over a period not to exceed 30 years.

A county or city may only impose special assessments if it receives a petition for the project to be financed through assessments that meets a two-prong test:

- The petition must be signed by a majority of the owners of the property assessed.
- And those owners must represent ownership of at least 66% of the assessed value of the property to be assessed.[105]

[103] Iredell County may be considering the use of this financing tool in the near future.
[104] Unpaid assessments bear interest at a rate fixed in the assessment resolution. A county or city may foreclose assessment liens under procedures provided by law for the foreclosure of property tax liens.
[105] For example, if there are 21 owners involved and 10 hold 67% of the assessed value of the property to be assessed, at least one of the other 11 owners would have to sign the petition for the county or city to be able to impose the special assessments. Likewise, if 21 owners are involved and one owner owns 67% of the assessed value of the property, that one owner would have to be one of the signatures on the petition for the county or city to impose the special assessments.

The county board of commissioners or city must adopt a preliminary assessment resolution that describes the project, the proposed basis for making the assessment, and information concerning the cost of the work and the terms of payment of the assessment. The proposed basis for making the assessment method most accurately assess property according to the benefits conferred upon it by the project for which the assessment is made. The county or city must hold a public hearing on the matter, prepare a preliminary assessment roll, and publish a confirmation of the assessment roll once it is adopted. An owner of property against which an assessment is made may file a notice of appeal to the General Court of Justice if the owner is dissatisfied with the amount of the assessment.

BILL ANALYSIS: This act addresses three issues:

- An extension of the sunset date from July 1, 2013, to July 1, 2015.[106]
- An adjustment of the assessment in cases where the use of the benefitted property changes.
- Clarification as to how to apply the two-prong test to parcels of property owned by more than one person.

The original legislation enacted in S.L. 2008-165 contained a sunset date of July 1, 2013. Section 3 removes the sunset date from the effective date of the session law. Sections 1(a) and 2(a)[107] place the sunset provision in the statutes and extend the sunset date from July 1, 2013, to July 1, 2015.

One assessment method that may be used is one designed to allocate the costs in accordance with the benefits conferred. Sections 1(b) and 2(b) provide that the benefits conferred on an assessed property may be measured by how the property is used and that the assessment on that property may be adjusted over time if the use of the property changes. However, the assessment may not be changed unless the total amount of all the assessments is sufficient to pay the cost of the project after the adjustment is made.

Sections 1(c) and 2(c) address the two-prong ownership tests for properties owned by more than one person:

- A majority of the owners of the properties to be assessed must sign the petition. For purposes of determining a majority, each parcel of property is given one vote. The sole owner of a parcel is given one vote. Multiple owners of a parcel are given a percentage vote equal to one vote multiplied by a fraction, the numerator of which is one and the denominator of which is the total number of owners of the parcel.
- The petition signers must represent at least 66% of the properties to be assessed. For purposes of determining whether the assessed value represented by those signing the petition constitute at least 66% of the assessed value of all real property to be assessed, 100% of the assessed value of property owned by one person is included in the calculation. For property owned by more than

[106] Senate Bill 104, also introduced by Sen. Hartsell, would repeal the sunset provision.
[107] Section 1 makes the change in the statutes pertaining to counties and Section 2 makes the same change in the statutes pertaining to cities.

one person, that person's proportionate share of the assessed value of that property is included in the calculation.

EFFECTIVE DATE: This act is effective June 30, 2013, and applies retroactively to special assessments imposed on or after that date.

UNC/Report/E-Commerce/Improvements.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-375	**SB 485**	**Senator Apodaca**

AN ACT TO ELIMINATE A DUPLICATIVE REPORTING REQUIREMENT REGARDING PERSONAL SERVICE CONTRACTS FOR THE UNIVERSITY OF NORTH CAROLINA, TO ALLOW THE BOARD OF GOVERNORS TO PROVIDE FOR THE IMPLEMENTATION AND EXPANSION OF E-COMMERCE INFRASTRUCTURE, AND TO CLARIFY THE PROPERTY TAX STATUS OF CERTAIN IMPROVEMENTS ON UNIVERSITY LANDS THAT ARE OWNED BY CERTAIN SOCIAL ORGANIZATIONS.

SUMMARY: Session Law 2013-375 enacted the following:

- ***An elimination of a reporting requirement regarding personal service contracts for the University of North Carolina.***
- ***Authority for the Board of Governors to implement and expand the use of electronic commerce infrastructure and capabilities among the constituent institutions.***
- ***A property tax exemption for improvements to real property that are owned by a university organization and located on land owned by one of the constituent institutions.***

ANALYSIS:

Each State agency reports annually to the Office of State Budget and Management on its use of personal services contracts exceeding $25,000; however, the utility of the reports have been questioned by constituent institutions of The University of North Carolina as those institutions try to become more efficient. **Section 1** of the act exempts The University of North Carolina from the reporting requirement.

Section 2 of the act allows the Board of Governors of The University of North Carolina to implement and expand the electronic commerce infrastructure among the constituent institutions in order to, among other things, allow use of common application programs as the institutions move towards electronic payment services.[108]

Section 3 of the act provides a property tax exemption for improvements made by a social fraternity, sorority, or similar organization on property owned by a constituent institution. The provision solves the tension under prior law that resulted in situations where property was exempt from property tax but the improvements built upon the property were not. Historically, the schools have owned the Greek housing. The exemption will encourage the Greek organizations to invest in the property and help the institutions defer investment in the housing.[109]

EFFECTIVE DATE: The property tax exemption in section 3 is effective for taxes imposed for taxable years beginning on or after July 1, 2013. The remainder of the act became effective when it was signed into law by the Governor on July 18, 2013.

Modern State Human Resources Management/RTR.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-382	**HB 834**	**Rep. Collins, Burr**

AN ACT ENHANCING THE EFFECTIVENESS AND EFFICIENCY OF STATE GOVERNMENT BY MODERNIZING THE STATE'S SYSTEM OF HUMAN RESOURCES MANAGEMENT AND BY PROVIDING FLEXIBILITY FOR EXECUTIVE BRANCH REORGANIZATION AND RESTRUCTURING AND TO IMPROVE TRANSPARENCY IN THE COST OF HEALTH CARE PROVIDED BY HOSPITALS AND AMBULATORY SURGICAL FACILITIES; TO TERMINATE SET-OFF DEBT COLLECTION BY CERTAIN STATE AGENCIES PROVIDING HEALTH CARE TO THE PUBLIC; TO MAKE IT UNLAWFUL FOR HEALTH CARE PROVIDERS TO CHARGE FOR PROCEDURES OR COMPONENTS OF PROCEDURES THAT WERE NOT PROVIDED OR SUPPLIED; TO PROVIDE FOR FAIR HEALTH CARE FACILITY BILLING AND COLLECTIONS PRACTICES; AND TO PROVIDE THAT HOSPITALS RECEIVING MEDICAID REIMBURSEMENTS PARTICIPATE IN THE NORTH CAROLINA HEALTH INFORMATION EXCHANGE NETWORK.

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108 This section is especially meaningful to UNC-CH, UNC-W, and UNC-App. Without the legislation these institutions may have to discontinue the common application service they currently utilize and incur expense to build their own systems.

109 This section is especially meaningful to NCSU. It has developed a new on-campus master planned Greek housing area to encourage on-campus fraternity and sorority housing.

BILL ANALYSIS: Part XII of S.L. 2013-382 prohibits The University of North Carolina (UNC) Health Care System and its affiliates, and other schools of medicine, clinical programs, facilities, and medical practices affiliated with one of the constituent institutions of UNC that provides medical care to the general public, from utilizing setoff debt collection procedures to collect outstanding debts from tax refunds and lottery winnings of debtors.

EFFECTIVE DATE: This Part becomes effective January 1, 2014, and applies to tax refunds determined by the Department of Revenue on or after that date.

Rev Laws Technical, Clarifying, & Admin. Chg.

Session Law	*Bill #*	*Sponsor*
S.L. 2013-414	**HB 14**	**Representative Howard**

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES, AS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE.

SUMMARY: Session Law 2013-414 makes several technical, administrative, and clarifying changes to the revenue laws and related statutes.

EFFECTIVE DATE: Except as otherwise provided, the act became effective when it was signed by the Governor on August 23, 2013.

BILL ANALYSIS:

Section	Explanation
REVENUE LAWS RECOMMENDATIONS	
1	Corrects several references to "reports and statements" where there is no longer a requirement to submit a statement and substitutes the more appropriate term "return." Also replaces "make" or "making" a return with "file" or "filing." Makes other grammatical and stylistic changes to conform to drafting conventions.
2	Deletes a statutory reference due to repeal of another subsection.[110]

[110] In S.L. 2010-89, the General Assembly provided an alternative apportionment formula for a corporation that signed a letter of commitment by September 15, 2010, certifying that it planned to invest at least $500 million in private funds to construct a facility in a development tier one area. No company signed such a letter. The General Assembly enacted the provision at the request of Microsoft; Microsoft announced in August of 2010 that it would be locating in Virginia. Since the alternative apportionment formula provided in G.S. 105-130.4(t2) and G.S. 105-122(c1)(3) was no longer needed, the General Assembly repealed those provision in S.L. 2011-330, s. 5. Therefore, the references to the repealed subdivisions in G.S. 105-122(c1)(2) and G.S. 105-130.4(t1) should be deleted.

3	Corrects reference to period of underpayment to reflect the change in the due date of the corporate return from the third month (March 15) to the fourth month (April 15).
4	Corrects reference to the proper carryforward period under Article 3J when a taxpayer fails to qualify for an extended carryforward period due to a large investment.[111]
5	Makes technical corrections related to the shift from taxable income to AGI as the starting point for determining NC taxable income.[112]
6	Ensures that relevant transitional adjustments under G.S. 105-134.7 are retained by adding them to G.S. 105-134.6 with corresponding changes throughout.
7	Makes technical changes to the Credit for the Disabled.
8	Amends definitions related to the Streamlined Agreement and adjusts the definition of "storage" to clarify that the purchaser must know the original purpose and location where items will be used at the time of purchase.
9	Amends the facilitator reporting requirements to recognize various business practices and recordkeeping by facilitators. The Department was advised that some facilitators provide a credit card number for use by the hotelier before, during, or after the rental of accommodations.
10	Clarifies that a credit is allowed for use tax if the tax is shown on the invoice or other documentation issued by the retailer.
11	Makes various changes to certain sales tax exemptions: (26), (26a), (27), (31a), & G.S. 105-164.13A [113] Adds "prepared food" to various sales tax exemptions to modernize the language as a result of the adoption of definitions for Streamlined purposes and reflects the fact that schools sell both food and "prepared food." (33a): Clarifies that the sales and use tax exemption for tangible personal property delivered by the retailer for use outside the State

[111] The Article 3J credits for creating jobs and for investing in business property have a 5-year carryforward period and the credit for investing in real property has a 15-year carryforward period. S.L. 2012-74 temporarily allows for a 20-year carryforward period under Article 3J for a taxpayer who makes an investment of $100 million in business and real property in a tier one county.
[112] Section 31A.1 of S.L. 2001-145 changed the starting point for calculating NC taxable income from federal taxable income to federal adjusted gross income. This change did not change the tax base or increase NC tax in any way.
[113] These changes were requested by the Department after the introduction of the bill and were not included in the original Revenue Laws recommendation.

	applies to certain printed material. This exemption was adjusted during the 2011 Session at the request of the Department to add "by the retailer." However, additional adjustments are needed to retain the exemption for printed material that is not delivered by the retailer to the United States Postal Service or that is not purchased with a direct pay permit.[114] (43a): Amends the exemption for computer software "designed to run on an enterprise server operating system." The inclusion of the term "designed" has been problematic. The Department issued an "Important Notice" in February 2010 in an attempt to further clarify this issue. At issue are products that are designed but may not be run on an enterprise server operating system. It is burdensome for the Department to attempt to determine if the products meet the "designed" requirement. (57)[115] Clarifies that in order for the exemption for fuel and electricity sold to a manufacturer to apply, the facility must be ***primarily*** engaged in manufacturing.
12	Makes three changes to the sales tax refund statute for nonprofit entities. • Provides that sales and use tax liability indirectly incurred by a nonprofit entity through reimbursement to an employee of the entity for the purchase of tangible personal property and services for use in carrying on the work of the nonprofit entity is considered a direct purchase by the entity. • Replaces the term "medicines" with "over-the-counter drugs" in the statute that permits a refund of sales and use taxes to nonprofit entities and hospitals. • Clarifies that a single member LLC that is disregarded for federal income tax purposes qualifies for a refund if the owner of the single member LLC is a 501(c)(3) and the LLC engages in qualifying activities.
13	Ensures that statute is consistent with the Sales and Use Tax Technical Bulletin Section 46-1 E., which provides that the issuance of a direct pay permit to avoid payment of State and local sales taxes levied on hotel accommodations is a prohibited use. Adds a provision requiring a person who purchases direct mail under a direct pay permit to file a return and pay the tax due monthly or quarterly to the Secretary.

[114] The proposed language tracks the language that is in Sales and Use Tax Bulletin 7.

[115] This change was requested by the Department after the introduction of the bill and was not included in the original Revenue Laws recommendation.

14	Repeals G.S. 105-164.35, which authorizes the Secretary to recompute sales and use tax if, after examining a return, he determines the correct amount of tax is greater or less than the amount shown on the return and to credit or refund excessive payments. This statute, which is specific to sales and use tax, is unnecessary because G.S. 105-241.7 gives the Secretary this authority for all tax types.
15	Provides liability relief to retailers for erroneous information provided by the Department regarding the taxability of certain items or insufficient notice regarding a sales tax rate change as required by the Streamlined Agreement.
16	Clarifies that the credit allowed under Article 5F for similar tax paid to another state also applies to sales and use tax paid in this State and not just paid to another state.
17	Corrects references to Department Divisions based on reorganization. Adds various forms of identity theft to the subject matter jurisdiction of revenue law enforcement officers. Generally speaking, revenue law enforcement officers have the authority to serve and execute notices, orders, warrants, and demands, have full powers of arrest, and must be certified as criminal justice officers.
18	Deletes obsolete provision. The Secretary no longer makes a final agency decision in contested tax cases. Substantive final decisions are published on the OAH website.
19	Amends the secrecy statute as follows: (15a): Modifies the circumstances under which the Department may share information with law enforcement agencies. On occasion, the Department has shared information with the IRS or another taxing jurisdiction under G.S. 105-259(b)(3) that is connected to a criminal investigation. However, some of the information shared may be information that is not "discovered" in the course of the investigation (i.e. audits that occurred prior to the criminal investigation that led the Department to initiate the criminal investigation). While those records may be shared with other taxing agencies (i.e. the IRS) under (b)(3), there may not be specific authorization to share the information with prosecutors (i.e. the US Attorney) who later are working on the criminal case. In addition, the change gets rid of awkward language regarding who may receive the information. The Department has agreements with all agencies with whom it is allowed to share information listing the specific individuals allowed to receive the information. A literal reading of the current language would allow the Department to share the info only with the head of the agency. It clarifies that a prosecutorial agency is a law enforcement agency. Finally, it allows the share of information

	with local law enforcement or law enforcement from another state. (25)[116] Permits the Department to include a retailer's registration number in the public database of retailers who are authorized to collect sales and use tax. The Department already maintains a publicly accessible database listing the names of retailers authorized to collect sales and use tax. Many sellers use the online registry to verify sales and use tax numbers provided by customers who present an exemption certificate. (29): Corrects a citation and statutory reference.[117]
20	Conforms payment for TIMS to current practice. The language in the 2012-13 budget bill differed from standard practice used by DOR since the beginning of benefits funding for the project. Technically, OSBM authorizes DOR to make purchases rather than making those purchases itself.
21	Modifies the circumstances under which the Department may share information regarding the unauthorized substances tax. The current restriction on disclosure could prevent Department employees from sharing information in situations that do not present concerns about Constitutional protections for criminal defendants like double jeopardy or self-incrimination such as: • A prosecutor investigates allegations of law enforcement unlawfully seizing property from specific individuals. Law enforcement personnel report the property has been turned over the Department to satisfy a tax debt. • A prosecutor requests information from the Department in order to satisfy his obligation to provide the defendant in a criminal case with potentially exculpatory information. • A Department employee serving a tax warrant witnesses a crime committed by the taxpayer against a third party.
22	Subsection (a) clarifies the procedure and requirements for obtaining a license for the distribution of tobacco products and provides the Department with specific guidance as to when a license may be denied. This subsection also requires the Department to include certain information on the face of each license, and directs the Department to keep a record of license holders that may be provided to other license holders upon request. Subsection (b) clarifies the violations for which the Secretary, after a

[116] This change has been requested by the Department since the introduction of the bill and was not included in the original Revenue Laws recommendation.
[117] Part 2F of Article 10 of Chapter 143B relates to the E-NC Initiative and has been repealed.

	hearing, may cancel a license for the distribution of tobacco products. Subsection (c) clarifies a distributor of cigarettes may provide security to the Secretary in the form of an irrevocable letter of credit as an alternative to a bond. This subsection also deletes a redundant provision for investigation of license applicants. This section became effective September 1, 2013.
23	Makes changes to the sourcing of direct mail to comply with Streamlined requirements. Under current law, direct mail is sourced to the location from which it is shipped unless it was purchased using a direct pay permit or the purchaser provides the seller with information showing the jurisdictions to which the mail is to be delivered. In those instances, the mail is sourced to the delivery location. Under the Streamlined Agreement, direct mail categorized into "advertising and promotional direct mail" and "other direct mail." The current law as stated above is accurate except that "other direct mail" (direct mail other than advertising and promotional direct mail) should be sourced to the purchaser's address available from the seller's business records if the mail is not purchased using a direct pay permit or if the purchaser does not provide the seller with jurisdictional delivery information.
ADDITIONAL CHANGES	
30	Corrects a citation.
31	Clarifies that Department personnel have the right to access a specialty market registration list. This clarification will assist with compliance checks by Department employees and provide clear direction that operators are required to obtain and provide information to assist with administration and collection of sales tax at events.

32	Adds a sunset to 105-129.16H, which is the credit for donating funds to a nonprofit or unit of State or local government to enable that entity to acquire renewable energy property. G.S. 105-129.16A, which is the credit for investing in renewable energy property, currently has a sunset of January 1, 2016. The same sunset is implied for G.S. 105-129.16H to the extent the credit is tied to G.S. 105-129.16A; that is, G.S. 105-129.16H allows the same credit when the purchaser of renewable energy property is a nonprofit that is not subject to income tax.
33	Deletes the word "large" from the statute. This is a technical change because the credit for large recycling facilities was repealed by S.L. 2010-166.[118]
34	Consolidates the bonus depreciation and section 179 expensing provisions related to decoupling from the Code into a new, stand-alone statute. However, G.S. 105-130.5B(c) and G.S. 105-134.6A(c) contain a drafting error that needs to be corrected. Those subsections state that the investment limitation for tax year 2013 is $125,000 when it should be $200,000. It is anticipated that the General Assembly will make this correction in the 2014 Session. Provides that in the event of a transfer of assets, instead of taking any remaining bonus depreciation deductions, the transferee adds the amount of any remaining deductions to the basis of the transferred asset.
35	Effectuates intent of IRC Update (S.L. 2013-10) by clarifying that charitable deduction is not subject to charitable contribution limitation and carryover provisions but is subject to the overall limitation on itemized deductions under section 68 of the Code.
36	Makes conforming changes required by the fact that G.S. 105-130.6, which dealt with forced combinations, was repealed in 2011 and replaced with a new statute. The definitions for "subsidiary" and "affiliate" are the same definitions that were in G.S. 105-130.6.
37	Modifies the individual income tax credit for charitable contributions by non-itemizers for tax year 2013 by including in the taxpayer's excess charitable contributions the amount by which the taxpayer's charitable contributions for the taxable year would have been deductible under Section 170 of the Code had the taxpayer not elected to take the income exclusion under Section 408(d)(8) of the Code that exceed two percent of the taxpayer's adjusted gross income.

118 The repeal of this credit was a recommendation of the Revenue Laws Study Committee because the incentive was never utilized. The credit was intended for Wisconsin Tissue; however, that company never located in North Carolina.

38	Makes a technical change to reflect the fact that the starting point for calculating North Carolina taxable income is adjusted gross income.
39	Gives the Department flexibility in requiring electronic submissions.
40	Makes the sales tax imposition statute for digital property mirror the sales tax imposition statute for tangible personal property to make clear that the imposition of sales tax on digital property includes lease or rental. This is a technical change.
41	Adds the word "product" to the sourcing provisions for mobile telecommunications, which currently covers only services. This change was recommended by Streamlined in light of the fact that under the federal Mobile Telecommunications Sourcing Act, sales of certain digital products, such as a ringtone, is adjunct to mobile telecommunication service and is, therefore, sourced under the mobile sourcing provisions.
42	Clarifies that joint library systems that serve two or more counties, or counties and cities, are allowed the sales and use tax refund as a public library.[119] Currently, the sales and use tax refund for public libraries applies only to public libraries created by act of the General Assembly. While most libraries are part of a city or county government and receive the refund due to the county/city refund provision, some libraries were chartered by an act of the General Assembly.[120] A public library may also be established jointly by two or more counties or cities and counties under general authority granted in G.S. 153A-270. This provision would allow libraries created pursuant to this general authority, in addition to those created by a specific local act of the General Assembly, to be eligible for a sales and use tax refund.
43	Rewrites the provision dealing with a certificate of exemption for sales tax purposes in light of changes adopted by the Streamlined Governing Board. Among the changes is the requirement that a retailer must pay within 90 days sales tax on a transaction unless it obtains a fully completed exemption certificate, or within 120 days upon audit.
44	Allows the Secretary of Revenue to authorize the Streamlined Sales Tax Governing Board to contract, on behalf of the Secretary, with a certified service provider for the collection and remittance of sales and use taxes on behalf of the seller.

[119] **§ 153A-270. Joint libraries; contracts for library services.**
Two or more counties or cities or counties and cities may establish a joint library system or contract for library services, according to the procedures and provisions of Chapter 160A, Article 20, Part 1.

[120] The Public Library of Charlotte and Mecklenburg County was chartered in 1903 by act of the General Assembly.

45	Makes a technical change to the distribution of part of the sales tax on video programming service and telecommunications service to counties and cities. In 2010, the General Assembly repealed the PEG Grant Fund and increased the revenues from the video programming sales tax designated for Supplemental PEG channel support to $4 million per year.[121] However, the distributional section of the statute was not amended accordingly and still refers to $2 million.
46	Modernizes the language and clarifies that the activities at the establishment must fall within the applicable NAICS code.
47	Codifies the Department's administrative practice of allowing protective refund claims. Generally speaking, there is a time limit within which a taxpayer may file a claim for refund. If the claim for refund is not timely filed, it will be barred. Occasionally, a taxpayer's right to a potential refund is based on a contingent event, such as pending litigation or an ongoing income tax audit in another state, for a taxable period for which the statute of limitations is about to expire, and the outcome of that event may affect the North Carolina tax liability. The Department has administratively allowed for a taxpayer in these circumstances to file a timely but incomplete claim for refund, known as a "protective refund claim," and then later perfect the claim when the essential information becomes available. The new provision requires the taxpayer to file the claim within 6 months of the conclusion of the contingent event. Under prior practice, there was no stated timeline for filing a protective claim. The taxpayer is also required to indicate an estimated amount of the overpayment. Previously, an estimate was not required.
48	Clarifies when a person may object to a proposed rule related to the Secretary's authority to require a combined return and request review by the Rules Review Commission (RRC). The rulemaking process allows an agency to change the text of a proposed rule in response to comments and objections raised during the public hearing and comment period, but a person should not be able to subject a rule to RRC review until the agency has adopted the rule. Under this rewrite, a person may only subject the rule to RRC review after the agency has adopted the rule rather than prior to its adoption.

[121] S.L. 2010-158.

49	Clarifies that it is the intent of the General Assembly to harmonize the language of the local statutes to be consistent with the State sales and use tax statues. These changes clarify that the local statutes are intended to be consistent with G.S. 105-164.8(c) relative to imposition of tax and destination sourcing requirements.
50	Allows a regional public transportation authority created under Article 26 of Chapter 160A[122] to create a special district consisting of one or more counties within its territorial jurisdiction to levy an annual license tax upon any motor vehicle in its jurisdiction to raise revenue for capital and operating expenses of the Authority in providing public transportation systems. Under prior law, regional public transportation authorities can only levy the tax if all counties in the region agree to the tax. Regional transportation authorities created under Article 27 of Chapter 160A[123] already have the authority to levy the tax if less than all of the member counties approve the tax.
51	Codifies Departmental policy promulgated in an Important Notice dated June 30, 2011, that lease receipts billed on or after July 1, 2011, are subject to the 4.75% State rate of sales tax instead of the 5.75% State rate of sales tax, regardless of the fact that the lease was entered into for a definite period of time prior to July 1, 2011, at which time the rate was 5.75%.[124]

[122] This Article applies to the Research Triangle Regional Public Transportation Authority, better known as Triangle Transit or TTA, which is a three-county regional public transit agency serving Wake, Durham and Orange Counties.
[123] This Article applies to the Piedmont Authority for Regional Transportation (PART), which provides inter-city and regional public transportation for the Greensboro, Winston-Salem and High Point, NC area.

[124] S.L. 2009-451 provided for a temporary 1% State sales tax increase (to 5.75%) with a July 1, 2011 expiration date. Without further legislation action, the State sales tax rate returned to 4.75% on July 1, 2011.

52	Makes two clarifying changes regarding the retention by the Department of Revenue of the 911 surcharge for the first year of implementation. S.L. 2011-122 authorized collection of the 911 service charge for prepaid wireless service at the point of retail sale. Although the charge is not a tax, it is collected by the Department of Revenue. To offset the cost of collection, the Department is authorized to retain the cost of collection below a cap. This section clarifies the first year cap applies to the surcharge collected by the retailers in the first year. Due to the delay of the remittance, not all of the charges collected by retailers in the first 12 months will be remitted to the Department in those first 12 months. This section also clarifies that the Department may retain costs incurred by the Department prior to the effective date of the surcharge. In order to ensure compliance, the Department has mailed notification of the law change to all entities that remit the 911 surcharge prior to the effective date of the surcharge.
53	Requires the Department of Revenue to allocate and distribute to cities and counties the amount equal to the average of the local sales and use taxes that was allocated and distributed to them in the preceding three fiscal years if the Department cannot accurately identify and calculate correct amounts for distributions payable in fiscal year 2014-15 because of implementation issues with the Tax Information Management System (TIMS).
54	Expands eligibility for a refund of sales and use taxes to include volunteer fire departments and EMS squads that are financially accountable to a city, a county, or a group of cities and counties and not merely those that are exempt from income tax under the Internal Revenue Code. The IRS treats entities that are financially accountable to a city or a county as tax exempt without any formal determination process. This section modifies the refund statute to match the current IRS practice and allow refunds to entities that would be treated by the IRS as tax exempt under the Internal Revenue Code. The NC Department of Revenue (DOR) has administratively ruled that some volunteer fire departments and volunteer EMS qualify for refunds of sales and use tax because the entities are financially accountable to a city or a county. This provision became effective July 1, 2013, and applies to purchases occurring on or after that date.
55	Makes technical citation changes.

56	Provides that a responsible person in a business entity is personally and individually liable only for the principal amount of taxes owed by the business entity. As recommended by the Revenue Laws Study Committee, the original bill included a proposal to clarify that penalties and interest, in addition to the principal amount of taxes, transfers to a responsible officer in a business entity that fails to pay taxes owed. During discussion in House Finance, the bill was amended to delete this provision, the intent being that a responsible officer should not be liable for penalties and interest. This provision more clearly effectuates that intent by specifically stating that the responsible person may only be liable for the principal amount of taxes owed. This provision became effective when the act became law on August 23, 2013, and applies to assessments proposed on or after that date.
57	Authorizes a new special registration plate for the North Carolina Paddle Festival. The plate costs $30, and the proceeds go to the Friends of the Hammocks and Bear Island, Inc.
58	Makes a series of technical and conforming changes to conform to the passage of S.L. 2013-316 (H998). Subsection (a) incorporates the changes made by Section 34(d) of this act. Subsection (b) repeals reporting requirements that are no longer necessary because the tax credits for which the information is needed have been eliminated. Subsection (c) corrects statutory references. Subsection (d) maintains the current authority cities have to impose a local privilege tax on live entertainment. Under current law, a local tax may not exceed $25. Without this clarification, a city's authority to impose a privilege tax on live entertainment could be interpreted to be more expansive than current law. Subsection (e) does two things: (1) it defines the term "State attraction" for purposes of the sales tax exemption as a physical place supported with State funds that offers cultural, educational, historical, or recreational opportunities, and (2) it exempts from sales tax a service contract provided for an item purchased by a professional motorsports racing team for which it is allowed a sales tax refund under current law.
OCCUPANCY TAX CHANGES	
60	Makes technical changes to various local occupancy tax acts so that they conform to changes made to the Uniform Provisions for Room Occupancy Taxes. In 2010[125] the General Assembly amended the uniform provisions governing occupancy tax to provide that room occupancy tax applies to the same gross receipts as the State sales tax on accommodations and is calculated in the same manner as that tax. The legislation further provided that to the extent this provision

[125] Section 31.6 of S.L. 2010-31.

conflicts with any provision of a local act, the general law supersedes the local provision. Therefore, the changes in this section are technical because to the extent they conflict with State law, they have been superseded by the 2010 legislation. Specifically, there is no State sales tax exemption for businesses that rent fewer than five units, and the exemption for summer camps is not needed because they are already exempt under State law. The other deletions also reflect the application of State sales tax on accommodations.

The table below shows the localities impacted because their legislation either imposes an occupancy tax on campgrounds/campsites or exempts from occupancy tax all or some combination of the following:

- A business that offers to rent fewer than five units
- Summer camps
- Religious organizations
- Educational organizations
- Charitable, benevolent, and other nonprofit organizations

Counties		Cities
Alamance	Johnston	Goldsboro
Alleghany	Lenoir	Greensboro
Buncombe	Madison	Kinston
Carteret	Martin	Washington
Craven	Onslow	
Currituck	Richmond	
Dare	Washington	
Forsyth		
Guilford		

TAX & TAG TOGETHER MOTOR VEHICLE PROPERTY TAX SYSTEM 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 was subsequently extended, and the system went 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. Sections 70-72 of this act consist of those changes.

70	Makes two changes to the effective dates of the acts that establish the combined system: • Removes conditional language. – The current effective date for the combined system contained a conditional clause that allowed the system to be effective earlier than July 1, 2013, if the integrated computer system was operational. The system went online as of July 1, 2013. Therefore, the conditional clause is deleted from the effective dates. • Clarifies local government authority. – Although the tax year for registered motor vehicles does not change under the combined system, the collection date for property taxes is earlier under the combined system. For the months of July, August, and September, local governments will send bills for tax years that begin on or before September 1, 2013. During those same months, the Tax and Tag Together system will begin to send bills for tax years that begin after September 1, 2013. The effective date is amended to clarify local government authority to collect property tax for tax years beginning on or before September 1, 2013, under the statutes as in effect June 30, 2013.
71	Repeals certain prior technical and conforming changes that are now inconsistent with the statutes since they became effective July 1, 2013, and recodifies the necessary technical changes. Over eight different session laws have amended the Tag and Tax Together system. The effective date for the system has also been changed at least three times. The combination of the multiple changes has made further technical changes difficult to make.
71(a)	Repeals inconsistent changes.
71(b)	Clarifies the appeals process for motor vehicle property tax. 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.[126] 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.

[126] 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.

71(c)	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.
71(d)	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. With a July 1 effective date, the first bills sent under the combined system will be for September registration renewals. The October 1st date is used because the tax year for September renewals begins October 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.
72	Allows vehicles of victims of domestic violence, sexual offense, stalking, or human trafficking vehicles to be billed as other personal property, keeping the addresses confidential. Chapter 15C of the General Statutes establishes an Address Confidentiality Program to protect the confidentiality of the addresses of victims of domestic violence, sexual offense, stalking, or human trafficking. If these vehicles were taxed under the combined system, the address would not be confidential.

Appendix A

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