

**North Carolina Department of Revenue
Post Office Box 25000
Raleigh, North Carolina 27640-0001**

To Registered Taxpayers:

Part I of this document lists additional changes made by the 2003 General Assembly to the taxes administered by the Sales and Use Tax Division. The Department issued a series of Important Notices in July 2003 setting out legislative changes pertaining to food, computers and computer software, medical-related property, tangible personal property, lease or rental, and direct mail; the notices are available on the Department's website. Specific details of those changes are not included in this document. Legislative changes supersede any information previously set forth in Sales and Use Tax Administrative Rules or Technical Bulletins relating to any subject matter of the legislation. The changes are cited in order of effective date. Part II of this document contains information relating to the sales and use tax forms.

I. Legislative Changes

Effective June 30, 2003

Consumer Use Tax

The line on the individual income tax return for reporting and payment of consumer use tax on out-of-state purchases will continue for the 2003 and 2004 tax years. The use tax line was originally scheduled to be deleted from the income tax return beginning with the return for the 2003 tax year.

Effective July 1, 2003

Maintain State Sales Tax Rate

The additional ½% State sales and use tax was extended, resulting in the continuation of the 4½% general State rate of tax. The tax was originally scheduled to be repealed for sales made on or after July 1, 2003. The ½% State tax is repealed for sales made on and after July 1, 2005.

Effective July 15, 2003

Definitions

A number of definitions were added, amended, or repealed in G.S. 105-164.3. Some of these changes are addressed in the Important Notices issued by the Department in July 2003 and were necessary to bring North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Project. The following definitions, followed by subsection reference, were affected by the 2003 law changes: computer (4a); computer software (4b); custom computer software (5c); delivered electronically (5d); direct mail (7a); drug (8a); durable medical equipment (8b); durable medical supplies (8c); electronic (8d); lease or rental (17); load and leave (17a); manufactured home (21); mobility enhancing equipment (21a); modular home (21a); modular homebuilder (21b); over-the-

counter drug (25a); prepared food (28); prescription (29); prewritten computer software (29a); prosthetic device (30a); and tangible personal property (46). Two definitions were assigned the same subsection reference (21a); one of the definitions will be recodified.

Basis for Exempting Food

G.S. 105-164.13B was rewritten and changes the basis for exempting food from the State sales or use tax. With the exception of candy, the exemption no longer references items for home consumption and items that would be exempt if purchased under the Federal Food Stamp Program. The following items are subject to the combined State and county tax: alcoholic beverages, tobacco products, candy (unless purchased for home consumption and exempt if purchased under the Federal Food Stamp Program), soft drinks, prepared food, dietary supplements, and food sold through vending machines. See January 1, 2004 changes for additional information on candy and soft drinks.

Advance Notice of New Tax or Rate Change

G.S. 105-466(c) sets out the advance notice required to be given by a county to the Secretary for new taxes or rate changes. A provision was added to make the applicability of a new tax or tax rate change to purchases made from printed catalogs effective on the first day of a calendar quarter after a minimum of 120 days from the date the Secretary notifies the seller of the new tax or tax rate change.

Sourcing Principles

G.S. 105-164.4B was amended to add provisions for the sourcing of periodic rental payments and direct mail. A definition of transportation equipment was added in connection with the sourcing of periodic rental payments.

Exemptions

G.S. 105-164.13(43) was rewritten to exempt custom computer software and the portion of prewritten computer software that is modified or enhanced if the modification or enhancement is designed and developed to the specifications of a specific purchaser and the charges for the modification or enhancement are separately stated. Prior to this change, prewritten software that was modified or enhanced based on the specifications of a specific customer was considered custom computer software and was exempt from the tax. Under current law, canned or prewritten software will not be exempt as a result of customized modification or enhancement.

G.S. 105-164.13(51), which exempts water delivered through main lines or pipes, was added. Formerly, water delivered through main lines or pipes was excluded from tax under the definition of tangible personal property. There is no change in the application of tax.

Voluntary Collection of Use Tax

G.S. 105-164.6A(b) was rewritten to provide that the collection period for sellers voluntarily collecting use tax cannot be more often than annually if the seller's State and local tax collections are less than one thousand dollars (\$1,000) in a calendar year.

Effective October 1, 2003

Due Date

G.S. 105-164.16 was amended to change the due date for returns filed on a monthly basis from the 15th to the 20th of the month following the month covered by the return. The return for October 2003 will be due on November 20, 2003.

Administration of County Tax on Food

G.S. 105-469 was amended to provide that the county tax on food is to be administered as if it were a State tax. The 2% tax on food will be reported separately on the sales and use tax return and will be distributed monthly to counties as set out in G.S. 105-469(a). See Section II on Forms Changes for changes in reporting the tax.

Wine Shippers

G.S. 105-164.8(b) sets out the conditions under which a retailer making mail order sales is engaged in business in this State and subject to this State's tax. The subsection was amended to provide that a retailer who is a holder of a wine shipper permit issued by the ABC Commission pursuant to G.S. 18B-1001.1 is considered engaged in business and is liable for collecting this State's tax. This legislation allows for direct shipment of wines to North Carolina residents and requires the retailer to collect this State's tax, notwithstanding that the seller may be located outside this State.

Sales Tax Holiday

G.S. 105-164.13C was amended to delete printers, printer supplies, and educational software from the list of items that qualify for the exemption during the sales tax holiday. Computers with a sales price of three thousand five hundred dollars (\$3,500) or less per item will continue to be exempt during the holiday. Sales involving layaway contracts and similar deferred payment and delivery transactions will no longer be excluded from the exemption. School supplies with a sales price of one hundred dollars (\$100) or less per item will continue to be exempt.

Direct Pay Permit for Direct Mail

G.S. 105-164.27A(a) was amended to allow purchasers of direct mail to apply to the Secretary of Revenue for a direct pay permit. The permit may only be used for purchases of direct mail.

Effective January 1, 2004

Exemption Process for State Agencies

The Department will be adopting procedures regarding the exemption process as set out in the new section G.S. 105-164.29A. A State agency must obtain from the Department a sales tax exemption number beginning January 1, 2004 in order to be eligible for the new exemption that is effective July 1, 2004.

Tax on Modular Homes

G.S. 105-164.4(a)(8) is a new subdivision that levies a 2½% State tax on the sales price of a modular home including accessories attached when delivered to the purchaser. The sale of a modular home to a modular homebuilder is a retail sale. A modular homebuilder

is defined as the person selling the home to the purchaser who will be occupying the home. The effect of this provision is that the manufacturer/builder will be liable for collecting the tax on the sale to the modular home "dealer." The sale of the home by the dealer to the home owner/occupant will not be taxable.

Taxation of Candy and Soft Drinks

Candy will be exempt from the State tax and subject to only the 2% county tax on food regardless of whether it is purchased for home consumption and could be purchased under the Federal Food Stamp Program. G.S. 105-164.13(50) pertaining to sales of items through vending machines was rewritten. Until January 1, 2004, fifty percent (50%) of the sales price of tangible personal property sold through vending machines except for closed container soft drinks and tobacco products are taxable; one hundred percent (100%) of the sales price of tobacco products and closed container soft drinks are taxable. Effective January 1, 2004, the partial exemption will include closed container soft drinks; therefore, only fifty percent (50%) of the sales price of closed container soft drinks sold through vending machines will be taxable.

Effective July 1, 2004

Exemption for State Agencies

G.S. 105-164.13 was amended to add a new subdivision (52) that allows an exemption for State agencies. The items must be purchased by the State agency for its own use; must be purchased pursuant to a valid purchase order issued by the agency and bearing the exemption number and description of property or be paid for with a State-issued check, electronic deposit, credit card, procurement card, or credit account of the State agency; and for purchases other than by a purchase order, the agency must provide to or have on file with the retailer the agency's exemption number. For indirect purchases of building materials, etc., the State agency will continue to request a quarterly refund of the local sales and use taxes paid.

II. Forms Changes

Several changes have been made to the sales and use tax forms as a result of legislative changes. There is now a separate line for reporting food tax. The 2% county tax on qualifying food is to be reported separately on the line identified as 2% Food Rate. The county tax on food does not require a breakdown of tax collected by county, but the total 2% food tax is reported on Form E-536, Schedule of Sales and Use Tax by County. There is also a separate line for the new 2½% State rate of tax on modular homes. The line for the 4% State rate of tax has been deleted. Payment booklets for the period October 1, 2003 through September 30, 2004 will contain the revised forms; all returns filed for periods beginning October 1, 2003 must be submitted using the new forms.

Frequently asked questions with responses can be found on the Department's website at www.dor.state.nc.us. If you have questions about the information in this document or about sales and use tax, you may contact the Taxpayer Assistance Call Center at 1-877-252-3052 (toll-free) or write to the Taxpayer Assistance Division, North Carolina Department of Revenue, Post Office Box 25000, Raleigh, North Carolina 27640-0001.