North Carolina

2002 Tax Law Changes

North Carolina Department of Revenue
Tax Administration

PREFACE

This document is designed for use by personnel in the North Carolina Department of Revenue. It is available to those outside the Department as a resource document. It gives a brief summary of the following tax law changes:

(1) Changes made by prior General Assemblies that take effect for tax year 2002. Each change enacted by a prior General Assembly is also discussed in the Department's Tax Law Change document for the year the change was enacted.

(2) Changes made by the 2002 General Assembly, regardless of when they take effect.

The changes are listed by type of tax. The order of the tax types is their order in the General Statutes, except for local sales and use tax changes. The local sales and use tax changes follow the State sales and use tax changes, and both changes are grouped under the heading "Sales and Use Tax." Within a tax type, the changes are listed in numerical order. The document does not include law changes that affect the Department of Revenue but do not affect the tax laws.

For further information on a tax law change, refer to the legislation that made the change. Administrative rules, bulletins, directives, and other instructions issued by the Department, as well as opinions issued by the Attorney General's Office, may provide further information on the application of a tax law change.

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I. ESTATE TAX

G.S. 105-32.2(b) – Estate Tax Changes: The federal Economic Growth and Tax Relief Act of 2001 made changes to the federal estate tax laws by increasing the amount excluded from federal estate tax and by phasing out the state death tax credit over four years beginning in 2002. The changes were effective for federal purposes for decedents dying on or after January 1, 2002.

The General Assembly adopted only part of the federal changes. The General Assembly conformed North Carolina's exemption limits to the federal exemption limits but kept North Carolina's state death tax credit at its 2001 level. The General Assembly accomplished these changes by updating the State's reference date to the Internal Revenue Code and by enacting provisions to "decouple" from the federal reduction in the state death tax credit. The purpose of conforming to the federal exemption limits was to ensure that no State estate tax is due if no federal estate tax is due.

The definition of the Internal Revenue Code that applies for State tax purposes is set out in G.S. 105-32.1(1) and G.S. 105-228.90(1a) and is tied to a particular reference date. The General Assembly updated the State's reference date for the Code from January 1, 2001, to May 1, 2002.

The General Assembly did not elect to conform to the phase-out of the state death tax credit. Instead, the General Assembly amended G.S. 105-32.2(b) to provide that the North Carolina estate tax is equal to the state death tax credit for federal purposes before applying the percentage reductions to the federal credit enacted by the 2001 federal act. Under that act, the state death tax credit is phased out for federal purposes by reducing the credit 25% in 2002, 50% in 2003, and 75% in 2004. The credit is repealed entirely in 2005.

The amendment to G.S. 105-32.2(b) expires January 1, 2004. The General Assembly included this sunset to ensure that it would have to revisit the issue of the State estate tax. If no additional changes are enacted, the State estate tax will be 25% of its current amount in 2004 as a result of the 75% reduction in the state death tax credit and will be eliminated in 2005.

(Effective January 1, 2002, and applies to estates of decedents dying on or after that date. G.S. 105-32.2(b) changes are repealed effective for the estates of decedents dying on or after January 1, 2004. SB 1115, s. 30C.3(a), S.L. 02-126.)

G.S. 105-32.2(b) – Modify Formula for Calculating Tax on Estates with Property in More than One State: This subsection was amended to modify the formula for calculating North Carolina estate tax for estates that include property located in North Carolina and property located in one or more other states. The

Estate Tax Section of the North Carolina Bar Association recommended the change.

The State estate tax is the amount of the federal death tax credit. When an estate has property in two or more states, each state's tax is a percentage of the death tax credit. Under prior law, North Carolina determined the percentage allocable to this State based on the ratio of the net value of the property in North Carolina to the net value of the total estate.

The change substitutes gross value for net value in this calculation. Thus, when an estate has property located in more than one state, North Carolina's portion of the federal state death tax credit amount is calculated by using the gross value of property in North Carolina and the gross value of all property in the estate.

(Effective January 1, 2002; and applies to estates of decedents dying on or after that date, SB 1416, s. 9, S.L. 02-87.)

II. PRIVILEGE TAX

G.S. 105- 41(a)(1) – Voluntary Contributions to N.C. Public Campaign Financing Fund: This subdivision was amended to require the Department of Revenue to provide attorneys the opportunity to make a contribution of $50 to the North Carolina Public Campaign Financing Fund at the same time they pay the annual $50 privilege license tax. Payment of the contribution is not required and is not considered part of the tax owed.

The North Carolina Public Campaign Financing Fund was established to provide an alternative means of financing campaigns of candidates for the North Carolina Supreme Court or Court of Appeals who accept fundraising and spending limits. The hope is that attorneys will provide part of the revenue for the Fund by making contributions with their privilege license taxes.

(Effective for applications for new licenses issued on or after July 1, 2003 and for license renewals issued on or after July 1, 2004; SB 1054, s. 3, S.L. 02-158.)

III. ALCOHOLIC BEVERAGE LICENSE AND EXCISE TAXES

G.S. 105-113.80(c) – Rate Reduction Becomes Effective: The 2001 General Assembly reduced the excise tax rate on liquor sold in ABC stores from 28% to 25%, effective February 1, 2002. The General Assembly reduced the excise tax rate because it imposed a 6% State sales tax on spirituous liquor effective December 1, 2001.

(Excise tax reduction effective February 1, 2002, SB 1005, ss. 34.23(c), (d), and (e), S.L. 01-424.)

G.S. 105-113.82(d) – Beer and Wine Excise Tax Distributions Considered Local Revenues: This subsection was amended to declare that the portion of beer and wine excise taxes distributed to counties and cities is local revenue rather than a State expenditure, and that the Governor may not reduce or withhold the distribution. Although this subsection prohibits the Governor from reducing or withholding the distribution, G.S. 143-25 authorizes the Governor to do so if the Governor has exhausted all other sources of revenue of the State, including surplus remaining in the treasury at the beginning of the fiscal period.

Article III, Section 5(3) of the North Carolina Constitution authorizes the Governor to "effect the necessary economies in State expenditures" if the Governor determines that the State will have a deficit in its budget without this action. The amendment to subsection (d) declares that the amount to be distributed to counties and cities is not a State expenditure so that the Governor's authority under the Constitution will not extend to the revenue to be distributed to the local units. Although it is clear from this change that the General Assembly does not consider local distribution amounts to be an expenditure under the Constitution, the meaning of the Constitution is determined by the courts rather than the General Assembly.

The change to this subsection is the result of the Governor's decision in the 01-02 fiscal year to withhold from cities and counties over $200 million in local reimbursements. The Governor took this action under the authority of Article III, Section 5(3) of the North Carolina Constitution.

(Effective September 24, 2002, HB 1490, ss. 1 and 7, S.L. 02-120.)

IV. CORPORATE FRANCHISE TAX

G.S. 105-114(c) – Recodified – This subsection was recodified as G.S. 105-114.1 and then amended. See the explanation of G.S. 105-114.1.

(Effective January 1, 2003, for taxes due on or after that date; SB 1115, s. 30G.2(b), S.L. 02-126.)

G.S. 105-114.1 – Additional Loophole Closing for Corporate Members of LLCs: The 2001 General Assembly enacted G.S. 105-114(c) in an attempt to close an unintended loophole that allowed corporations to reduce the franchise tax by transferring assets to a controlled limited liability company (LLC). The new subsection required a corporation that was a member of a limited liability company (LLC) and was entitled to receive at least 70% of the LLC's assets upon dissolution to include the LLC's assets in the corporation's investment in tangible property franchise tax base. The member corporation's investment in the LLC was excludible from the computation. The new subsection also repeated the criminal penalties for fraud by stating that a taxpayer who underpays the franchise tax due because of fraud with intent to evade tax is guilty of a Class H felony. The General Assembly's stated purpose for the new subsection was to apply the franchise tax equally to assets held by corporations and assets held by corporate-affiliated limited liability companies.

The General Assembly determined that some taxpayers found a way around the 2001 loophole closing provision by manipulating ownership of the assets. One method was to place a controlled partnership between the corporation and the LLC. To close this loophole, G.S. 105-114(c) was recodified as G.S. 105-114.1. New G.S. 105-114.1 was amended to require the LLC's income, assets, liabilities, or equity to be attributed to a corporation if the corporation and its related members together own indirectly seventy percent (70%) or more of the LLC's assets. A person owns indirectly assets of an LLC if the LLC's governing law provides that seventy percent (70%) or more of its assets, after payments to creditors, must be distributed to the person upon dissolution. The LLC's assets are attributed only to the related members that are corporations. None of the LLC's assets are attributed to the related members that are not corporations. Instead, the amount that would be attributed to that member is also attributed to the corporate members.

Example: A parent corporation, its subsidiary corporation, and an individual that is a shareholder of the parent corporation form a partnership to own an LLC. The parent and subsidiary transfer assets to the LLC. The LLC's governing law provides that upon dissolution, the assets of the LLC will be distributed as follows:

• Parent Corporation	20%
• Subsidiary Corporation	45%
• Individual	35%

Because the parent corporation and its related members own indirectly 100% of the LLC's assets, 100% of the LLC's income, assets, liabilities, and equity must be attributed to the related members that are corporations. The attribution percentage is as follows:

• Parent Corporation	31% (its 20% interest / 65% total interest of all corporate members)
• Subsidiary Corporation	69% (its 45% interest / 65% total interest of all corporate members)

(Effective January 1, 2003, for taxes due on or after that date; SB 1115, s. 30G.2(b), S.L. 02-126.)

G.S. 105-116 – Utility Franchise Tax Changes: The 2001 General Assembly amended this section to accelerate payments by electric companies effective January 1, 2002, and the 2002 General Assembly made two changes to this section. One of the 2002 changes is a clarifying change and the other is a technical change.

Payment Acceleration for Electric Power Companies

The 2001 General Assembly amended subsections (b) and (d) of this section to revise the payment schedule for electric power companies, effective January 1, 2002. The purpose of the revised payment schedule was to require more frequent payments, thereby shifting the receipt of some tax revenue from the 2002-03 fiscal year into the end of the 2001-02 fiscal year.

Amended subsection (b) requires electric power companies to pay their gross receipts taxes on electricity in accordance with the same schedule by which they pay sales and use taxes on electricity. G.S. 105-164.16 sets out the payment schedule for sales and use taxes. It requires a taxpayer that consistently remits at least $10,000 a month in sales and use taxes to pay the taxes twice a month. By application of G.S. 105-241(b)(2), these semimonthly payments must be made by electronic funds transfer. The sales tax law requires a taxpayer who remits between $100 and $10,000 a month to pay on a monthly basis, and requires all other taxpayers to pay on a quarterly basis.

Before this change, all electric power companies paid their gross receipts franchise taxes on a monthly basis and filed a quarterly return. With the changes, electric power companies will pay on a semimonthly, monthly, or quarterly basis depending on their payment schedule for sales and use taxes and will continue to file a return on a quarterly basis. Because electric power companies typically remit large amounts of sales tax on electricity, they will likely pay their sales tax on a semimonthly basis. As a result, they will be required to pay their gross receipts franchise tax on a semimonthly basis as well. They will continue to file a franchise return on the same quarterly schedule, however, because the due date of the quarterly return has not changed. The return is due by the last day of the month following the end of the quarter.

The penalty for underpayments was revised to accommodate the new semimonthly payment periods. Before this change, an electric power company was not subject to interest and penalty on an underpayment for a monthly payment period if it paid at least 95% of what was due and paid the remainder when filing the quarterly return. As revised, an electric power company is not subject to interest and penalty on an underpayment for a semimonthly or monthly payment period if it timely pays at least ninety-five percent of the amount due for each period and includes the underpayment with next quarterly return.

Clarification on Local Taxes

The clarifying change made by the 2002 General Assembly adds new subsection (e1). This subsection states that an electric power company is not subject to any additional franchise or privilege tax imposed upon it by any city or county as long as the company remits the State franchise tax to the Secretary.

In the 01-02 fiscal year, the Governor withheld part of the utility franchise tax distribution from the cities. The Governor took this action under the authority of Article III, Section 5(3) of the North Carolina Constitution to keep the State's budget balanced. In response, several cities enacted ordinances imposing a local franchise tax on the electric power companies in the event distributions are not made. The cities base their authority for the ordinance on subsection (e) of the statute, which prohibits a local tax "[s]o long as there is a distribution to cities from the tax imposed by [G.S. 105-116]."

The change is intended to address the recent issue of additional local taxes sought by cities as a result of the Governor's actions in balancing the budget. Presumably, therefore, new subsection (e) does not affect the authority of those cities that have imposed local taxes under subsection (e) for many years.

Repeal of Obsolete Provision

The technical change made by the 2002 General Assembly deletes an obsolete reference in subsection (a) of the statute to Part 5 of Article 4 of Chapter 105 of the General Statutes. That Part sets out the tax credits for qualified business investments. The reference to that Part is obsolete because the tax credits for qualified business investments can be claimed only against individual income tax. An electric power, water, or sewerage company is therefore not eligible to claim tax credits for qualified business investments against the franchise tax imposed by G.S. 105-116.

(Payment acceleration effective January 1, 2002; HB 232, ss. 6(c), (d), and (j), S.L. 01-427; 2002 technical change effective August 12, 2002; SB 1160, s. 10, S.L. 02-72; 2002 clarifying change effective September 24, 2002, HB 1490, s. 8, S.L. 02-120.)

G.S. 105-116.1 – Electric Power Company Franchise Tax Distributions: The 2001 General Assembly amended this section to reflect the repeal of the special franchise tax on telephone companies, effective January 1, 2002, and the 2002 General Assembly amended this section to address the ability of the Governor to withhold distributions of the tax revenue.

Prior Conforming Changes

The 2001 General Assembly amended this section to reflect the repeal of the gross receipts franchise tax on telephone companies, formerly set out in G.S. 105-120. Effective January 1, 2002, the telephone franchise tax is repealed and replaced with an increased sales tax on telecommunications service.

This section was amended to delete references to telephone companies and to G.S. 105-120, so that the distribution under this section applies only to receipts from electric power companies. In addition, the section was amended in various places to insert language clarifying that the computation and allocation of the hold-harmless adjustment for the city distribution includes only receipts from electric power companies and natural gas companies.

As a result, the hold-back amount for a city will be adjusted to delete the portion attributable to telephone receipts and the adjusted amount will be taken only from receipts from electric power companies and piped natural gas companies. New G.S. 105-164.44F addresses the freeze deduction for receipts from the repealed franchise tax on local telecommunications service.

Distributions Are Local Revenues

The 2002 General Assembly amended subsection (b) of this section to declare that the portion of electric power company franchise taxes distributed to cities is local revenue rather than a State expenditure, and that the Governor may not reduce or withhold the distribution. Although this subsection prohibits the Governor from reducing or withholding the distribution, G.S. 143-25 authorizes the Governor to do so if the Governor has exhausted all other sources of revenue of the State, including surplus remaining in the treasury at the beginning of the fiscal period.

Article III, Section 5(3) of the North Carolina Constitution authorizes the Governor to "effect the necessary economies in State expenditures" if the Governor determines that the State will have a deficit in its budget without this action. The amendment to subsection (b) declares that the amount to be distributed to cities is not a State expenditure so that the Governor's authority under the Constitution will not extend to the revenue to be distributed to cities.

It is clear from this change that the General Assembly does not consider local distribution amounts to be an expenditure under the Constitution. The meaning of the Constitution, however, is determined by the courts rather than the General Assembly.

The change to this subsection is the result of the Governor's decision in the 01-02 fiscal year to withhold from cities and counties over $200 million in local reimbursements. The Governor took this action under the authority of Article III, Section 5(3) of the North Carolina Constitution.

(Prior conforming changes effective January 1, 2002, and apply to taxable services reflected on bills on or after that date; HB 571, s. 11, S.L. 01-430; 2002 change effective September 24, 2002, HB 1490, ss. 2 and 7, S.L. 02-120.)

G.S. 105-120- Telephone Tax Amended and then Repealed: The 2001 General Assembly amended this section, effective January 1, 2002, to make the same changes in the payment schedule for telephone companies that it made for electric power companies in G.S. 105-116. It then repealed this section as part of the telecommunications reform legislation that consolidated all the taxes on telecommunications services into a single State sales tax at the rate of 6%. As a result, the amendments never went into effect. New G.S. 105-164.4B sets out the consolidated telecommunications tax.

(Amendments effective January 1, 2002; HB 232, s. 6(e), S.L. 01-427; repeal effective January 1, 2002; HB 571, s. 12, S.L. 01-430, and HB 338, ss. 118 and 126, S.L. 01-487.)

G.S. 105-127(d) and (e) – Obsolete Provisions Repealed: These subsections were repealed because they were obsolete. These subsections exempted certain stock from property tax. All stock is exempt from property tax under G.S. 105-275(31).

(Effective August 12, 2002; SB 1160, s. 11, S.L. 02-72.)

V. TAX INCENTIVES FOR NEW AND EXPANDING BUSINESSES

Article 3A

Uncodified – Letters of Commitment: Under Article 3A, a taxpayer that signs a letter of commitment with the Department of Commerce to create at least twenty new full-time jobs or place specific eligible machinery and equipment in a specific area within two years after the date the letter is signed may calculate the new jobs credit or machinery and equipment credit based on the area's enterprise tier and development zone designation for the year the letter was signed. For example, a letter of commitment signed by December 31, 2001 would entitle a taxpayer to use the 2001 enterprise tier designation for that area.

G.S. 105-129.3(b) requires the Department of Commerce to designate counties' tiers for the next year by December 31 of each year. The Department of Commerce did not make the designations for 2002, however, until March of 2002 because the Employment Security Commission was unable to provide the data necessary for the Department of Commerce to make the designations within the time set by the statute. The Department of Commerce gave taxpayers letters of commitment dated in the early months of 2002. Under the statute, the tier designations for these letters would be those set for 2002 rather than 2001.

For the taxpayers that received these letters, it was uncertain if the letters would benefit them if the 2001 designations did not apply. To resolve this concern, the legislature enacted a one-time extension to the time period in which a taxpayer can sign a letter of commitment so that a taxpayer who signed a letter of commitment by February 28, 2002 is entitled to the 2001 tier designation instead of the 2002 designation.

(Effective August 12, 2002; SB 1160, s. 1, S.L. 02-72.)

G.S. 105-129.2(17a) – Definition of Overdue Tax Debt: This section was amended to add a new subdivision (17a) to define overdue tax debt. The definition is the same as in G.S. 105-243.1. It is a debt that remains unpaid 90 days after a notice of final assessment is mailed to the taxpayer. The definition was added along with new G.S. 105-129.4(b6) to accomplish the goal of not giving tax credits to taxpayers that are not in compliance with the tax laws.

(Effective for taxable years beginning on or after January 1, 2003; HB 1734, s. 1.5, S.L. 02-172.)

G.S. 105-129.2A(a1) – Sunset Extended for FedEx and other Interstate Air Couriers: The 2002 General Assembly made several changes to Article 3A to address concerns of FedEx, which plans to locate in Greensboro. This section was amended to give FedEx a longer time to claim the credits available under Article 3A than is allowed for taxpayers that are not interstate air couriers.

The change is accomplished by the addition of new subsection (a1). That subsection creates an exception to the sunset of the Article 3A credits for an interstate air courier that enters into a real estate lease on or before January 1, 2006 with an airport authority that provides for the lease of at least 100 acres of real property with a lease term in excess of 15 years. In that case, the Article 3A credits expire for business activities that occur on or after January 1, 2010, instead of the general sunset date of January 1, 2006, found in G.S. 105-129.2A(a). Although the subsection was written to describe the circumstances associated with FedEx, it applies to any interstate air courier that meets the description.

(Effective for taxable years beginning on or after January 1, 2002; HB 1665, s. 2, S.L. 02-146.)

G.S. 105-129.3A – Definition of Development Zone Expanded: This section was amended by adding a new subsection (d) to define when a parcel of property that is partially in a development zone is considered to be entirely within the development zone and, therefore, eligible for the Article 3A enhancements for development zones. All of the following conditions must be satisfied for the parcel of property to be considered entirely within the development zone:

(1) At least fifty percent of the parcel is located within the development zone.

(2) The parcel was in existence and under common ownership prior to the most recent federal decennial census.

(3) The parcel is a portion of land made up of one or more tracts or tax parcels of land that is surrounded by a continuous perimeter boundary.

(Effective for taxable years beginning on or after January 1, 2003; HB 1734, s. 1.4, S.L. 02-172.)

G.S. 105-129.4(a1) – Changes Concerning New Job Creation: The 2001 General Assembly amended this subsection effective for the 2002 tax year. The amendments make a clarifying change and a substantive addition.

The clarifying change concerns the period of time during which a central office or aircraft facility may create the required 40 new jobs. The change makes it clear that for a central office or aircraft facility, the 40 new jobs must be created either (i) within twelve months immediately following the date the taxpayer first uses the property as a central office or aircraft facility or (ii) if the taxpayer uses temporary space during completion of the central office or aircraft facility, within a 36-month period that includes the 24 months immediately preceding and the 12 months immediately following the first use of the property as central office or aircraft facility property. Under the prior law, it was not clear if the "year" allowed for job creation was the taxpayer's taxable year, the calendar year, or a twelve-month period.

The substantive addition to this subsection establishes the minimum number of jobs a taxpayer must create to qualify for the new tax credit for substantial investment in other real property in G.S. 105-129.12A and the time period in which these jobs must be created. To qualify for the credit for substantial investment in other real property, a taxpayer must create at least 200 additional full-time employees to fill new positions at the location in a two-year period beginning when the property is first used in an eligible business.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476.)

G.S. 105-129.4(b) – Wage Standard Changes: The 2001 General Assembly made several changes to this subsection effective for the 2002 tax year, and the 2002 General Assembly made additional changes to this subsection. One of the changes made by the 2002 General Assembly is effective for the 2002 tax year and the others are effective for the 2003 tax year.

The changes made by the 2001 General Assembly that take effect for the 2002 tax year consist of a clarifying change, a conforming change, and a substantive change. The changes made by the 2002 General Assembly consist of three substantive changes.

The clarifying change made by the 2001 General Assembly deletes references to the time a taxpayer applies for a credit and substitutes references to the calendar year in which the taxpayer engages in a qualifying activity. Read literally, the law before this change required the taxpayer to meet the wage standard for the year in which the taxpayer applied for the credit, even if the taxpayer first claimed the credit on an amended return filed two years after the original return. The Department did not interpret these provisions literally, however. Instead, the Department construed these provisions to mean the year in which the qualifying activity occurred.

The conforming change made by the 2001 General Assembly inserts a reference to the new credit for a substantial investment in other property, set out in G.S. 105-129.12A. The average wage of all jobs at a location must meet the wage standard for a taxpayer to qualify for the new credit.

The substantive change made by the 2001 General Assembly sets a new wage standard for the credit for creating new jobs and the worker training credit, effective for the 2002 tax year. The new standard is a two-part test. Under the new test, both the average wage of the jobs for which the credit is claimed and the average wage of all jobs at the facility must meet the wage standard.

The first substantive change made by the 2002 General Assembly was enacted to address concerns raised by FedEx about its eligibility for the jobs tax credit for part-time jobs to be located at its planned distribution center in Greensboro. Under prior law, a taxpayer could not qualify for the jobs tax credit unless the average wage of the new jobs and the average wage of all the jobs at the location meet the wage test. If jobs are part-time rather than full-time, the Department of Revenue requires the taxpayer to apply a full-time equivalency factor to the part-time employees.

The change creates an exception to the requirement that part-time jobs meet the wage standard. Under the amendment, all part-time jobs for which the taxpayer provides health insurance, as described in G.S. 105-129.4(b2), are considered to meet the wage standard, regardless of the actual wages for the jobs. In testimony before the House Finance Committee, FedEx explained that it provides health insurance and other benefits to its part-time workers. Under the amendment, the employer has a 100-day grace period from the date the part-time employee begins work before the health insurance must be provided. Although the amendment was enacted for FedEx, it applies to all taxpayers that provide health insurance for part-time jobs. The change concerning part-time jobs is effective for the 2002 tax year.

The other two changes made by the 2002 General Assembly take effect for the 2003 tax year. One of these changes eliminates the wage standard test for tier one and two areas and for the credit for worker training. Elimination of the wage standard test for tier one areas also eliminates the test for development zones, which have the status of a tier one area under G.S. 105-129.3A for purposes of the wage standard. As part of this change, the reference to the credit for substantial investment in other property is deleted. This is because that credit, in G.S. 105-129.12A, applies only in an enterprise tier one or two area.

Under prior law, the wage standard for a tier one area or a development zone unless was the average weekly wage of the county in which the jobs were located, and the wage standard for a tier two area was 110% of the average weekly wage of the county. Elimination of the wage standard test for the lower tier areas provides an incentive for all jobs created and not just the higher paying jobs.

The wage standard for the worker training credit was eliminated because it was considered redundant and counter to the goal of the credit. A taxpayer cannot qualify for the worker training credit unless the taxpayer also qualifies for the jobs credit or the machinery and equipment credit, both of which have wage standard requirements. Workers in lower-paying jobs may need more training than those in higher-paying jobs.

The other change addresses a practical problem of determining the wage standard that applies to a taxpayer whose taxable year is not a calendar year. Under the statute, wage standards are determined on a calendar year basis.

The amendment provides that a taxpayer must use the wage standard for the calendar year in which its taxable year begins.

(Changes made by the 2001 General Assembly effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476; change made by 2002 General Assembly for FedEx effective for taxable years that begin on or after January 1, 2002; HB 1665, s. 3, S.L. 02-146; other changes made by 2002 General Assembly effective for taxable years beginning on or after January 1, 2003; HB 1734, s. 1.3(b), S.L. 02-172.)

G.S. 105-129.4(b1) – Large Investment Conforming Change and Interstate Air Courier Enhancement – The 2001 General Assembly amended this subsection to make a conforming change that takes effect for tax year 2002, and the 2002 General Assembly amended this subsection to create an exception for FedEx and other interstate air couriers. The change made by the 2002 General Assembly also takes effect in tax year 2002.

The change made by the 2001 General Assembly reflects the changes made to G.S. 105-129.6. As rewritten, that statute no longer requires the Department of Commerce to certify a taxpayer's eligibility for the Article 3A credits. To be eligible for the large investment enhancements in Article 3A, however, a taxpayer must continue to obtain a written determination from the Department of Commerce that the taxpayer is expected to meet the large investment thresholds.

The change made by the 2002 General Assembly gives FedEx and other interstate air couriers a longer period of time in which to make a qualifying investment than is allowed for other taxpayers. The change was made at the request of FedEx, which plans to locate in Greensboro.

Under prior law, a taxpayer was eligible for the large investment enhancements of the Article 3A tax credits if the taxpayer made at least $150,000,000 of qualifying investments within a two-year period. The amendment allows an interstate air courier a seven-year period to make the investment.

(Change made by 2001 General Assembly effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476; change made by 2002 General Assembly effective for taxable years beginning on or after January 1, 2002, HB 1665, s. 4, S.L. 02-146.)

G.S. 105-129.4(b2) – Health Insurance Conforming Change: The 2001 General Assembly amended this subsection to conform with the changes to G.S. 105-129.6. As rewritten, that statute eliminates the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the credits in Article 3A. The changes take effect for the 2002 tax year.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476.)

G.S. 105-129.4(b3) – Environmental Impact Conforming Change: The 2001 General Assembly amended this subsection, effective for the 2002 tax year. The 2002 General Assembly made a technical change to the subsection.

The change made by the 2001 General Assembly reflects the changes made to G.S. 105-129.6. As rewritten, that statute eliminates the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. Under prior law, the Department of Commerce reported to the Department of Environment and Natural Resources (DENR) those taxpayers who claimed on their applications for certification to meet the environmental impact eligibility requirements. As amended, DENR must annually report to the Department of Revenue those persons who have pending actions concerning significant violations or have had final determinations of responsibility for significant violations during the last five years. The Department of Revenue can then use the information provided by DENR when reviewing the returns on which tax credits are claimed.

The technical change made by the 2002 General Assembly corrects an incorrect word in the last sentence of the subsection. The phrase “this last five years” was changed to “the last five years.”

(Change made by 2001 General Assembly effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476; technical change made by 2002 General Assembly effective August 12, 2002; SB 1160, s. 12, S.L. 02-72.)

G.S. 105-129.4(b4) – Safety and Health Conforming and Substantive Changes: The 2001 General Assembly amended this subsection to conform to the changes made to G.S. 105-129.6. The change takes effect for the 2002 tax year.

G.S. 105-129.6 was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. Under prior law, the Department of Commerce reported to the Department of Labor (DOL) those taxpayers who claimed on their applications for certification to meet the safety and health eligibility requirements. As amended, DOL must annually report to the Department of Revenue those employers who have had final orders for serious violations within the past three years. The Department of Revenue can then use the information provided by DOL when reviewing the returns on which tax credits are claimed.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476.)

G.S. 105-129.4(b5) – Eligibility for New Credit: The 2001 General Assembly enacted this subsection to establish eligibility requirements for the new credit for a substantial investment in other real property, set out in G.S. 105-129.12A. The credit takes effect for the 2002 tax year.

To be eligible for the new credit, a taxpayer must obtain a written determination from the Department of Commerce that the taxpayer is expected to make the necessary investment and create the necessary new jobs within the required time periods. If the taxpayer fails to make the required level of investment or timely create the required number of new jobs, the taxpayer forfeits the credit.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476.)

G.S. 104-129.4(b6) – Overdue Tax Debts: This subsection was added to make a taxpayer ineligible for an Article 3A tax credit if the taxpayer has an overdue tax debt at the time the taxpayer claims an installment or carryforward of a credit. An overdue tax debt is defined in G.S. 105-243.1(a)(1) as "[a]ny part of a tax debit that remains unpaid 90 days or more after the notice of final assessment was mailed to the taxpayer. The term does not include a tax debt, however, if the taxpayer entered into an installment agreement for the tax debt under G.S. 105-237 within 90 days after the notice of final assessment was mailed and has not failed to make any payments due under the installment agreement."

(Effective for taxable years beginning on or after January 1, 2003; HB 1734, s. 1.2, S.L. 02-172.)

G.S. 105-129.4(d) – Forfeiture Conforming Changes: The 2001 General Assembly made two conforming changes to this subsection that take effect for tax year 2002. The first change reflects the changes made to G.S. 105-129.6. That statute was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. As a result, this subsection was amended to delete references to making an application for a tax credit and certification by the Department of Commerce.

The second conforming change adds a forfeiture provision for the new credit for substantial investment in other property, set out in G.S. 105-129.12A. That credit requires the creation of 200 new jobs within two years and an investment of at least $10 million within three years. The credit is forfeited if the taxpayer does not meet either of these requirements.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476.)

G.S. 105-129.4(e) – Clarifying Change: The 2001 General Assembly enacted a clarifying amendment to this subsection effective for tax year 2002. The amendment clarifies the term "business" for purposes of determining whether the business has changed ownership. A business is either a taxpayer or an establishment. G.S. 105-129.2 sets out the new definition of establishment.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 6, S.L. 01-476.)

G.S. 105-129.5(c) – Carryforward and Conforming Changes: The 2001 General Assembly made two substantive changes and a conforming change to this subsection that take effect for the 2002 tax year. The 2002 General Assembly made an additional substantive change to this subsection effective for the 2002 tax year.

The first substantive change made by the 2001 General Assembly extends the carryforward period for the tax credit for research and development from five years to 15 years. The second substantive change made by the 2001 General Assembly provides a 20-year carryforward for the new credit for a substantial investment in other property, set out in G.S. 105-129.12A.

The conforming change made by the 2001 General Assembly reflects the changes made to G.S. 105-129.6. That statute was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. References in this subsection to certification by the Department of Commerce were therefore deleted.

The 2002 General Assembly amended this subsection to give FedEx and other interstate air couriers a longer time in which to qualify for a 10-year carryforward that is available for large investments. Most of the Article 3A credits have a five-year carryforward. The law allows a carryforward period of 10 years instead of five if the Secretary of Commerce makes a written determination that the taxpayer will make at least $50,000,000 of qualifying investments over a two-year period. The amendment allows an interstate air courier to make the required investment over a seven-year period instead of the regular two-year period.

This amendment is one of several changes enacted at the request of FedEx, which has plans to build a hub in Greensboro. The amendment is targeted at FedEx but applies to any interstate air courier that constructs a hub in this State.

(Changes by the 2001 General Assembly effective for taxable years beginning on or after January 1, 2002, and apply to credits that are first claimed on or after that date; SB 748, s. 7, S.L. 01-476; change made by 2002 General Assembly effective for taxable years beginning on or after January 1, 2002, HB 1665, s. 5, S.L. 02-146.)

G.S. 105-129.6 – No Application Process, Fees Paid to DOR, and Reports and Disclosure by DOR: The 2001 General Assembly rewrote this section, effective for activities occurring in 2002, to eliminate the confusion caused by having two different agencies, the Department of Commerce and the Department of Revenue, involved in the tax credit process. The confusion is eliminated by removing the Department of Commerce from the role of receiving applications for tax credits, issuing certifications of approval, and reporting on various aspects of the tax credits.

No Application for Certification

The step of applying for an Article 3A tax credit is eliminated. Subsection (a), which required a taxpayer to obtain a certification from the Department of Commerce before claiming a tax credit, is repealed. This change is effective for all business activities occurring on or after January 1, 2002, and it is effective for activities occurring before January 1, 2002, if the taxpayer did not file an application with the Department of Commerce by January 1, 2002. The goal is to eliminate applications for certification for tax credits for returns filed for tax year 2002.

The year 2002, however, is a transition year for eliminating the application for certification. As of January 1, 2002, some taxpayers had submitted applications to the Department of Commerce for credits for which they qualified in tax year 2001 or an earlier year and some had not because they were waiting until closer to the due date of the return in 2002 or because they had not yet filed an amended return to claim a credit for a prior year. A taxpayer who had not filed an application as of January 1, 2002, must still file an application with the Department of Commerce if the taxpayer includes the tax credit on a return filed in 2002. The application, however, is simply a method of collecting the required fee. The Department of Commerce will not make any determinations about eligibility based on this application. The Department of Commerce must mark on the application that the fee has been paid. The taxpayer must then attach the marked application to the taxpayer's tax return.

The Department of Commerce's role in the application process ends on January 1, 2003. If a taxpayer that qualified for a tax credit before January 1, 2002, has not submitted an application to the Department of Commerce by January 1, 2003, the taxpayer must provide the information required by the Department of Revenue when filing a return that includes the credit and must pay any required fee to the Department of Revenue. The taxpayer is not required to interact with the Department of Commerce in claiming the credit.

Fee Paid to DOR

Subsection (a1) was rewritten to require the fee that must be paid by taxpayers before they can claim some of the Article 3A credits to be paid to the Department of Revenue instead of the Department of Commerce. As rewritten, the fee must be paid by the taxpayer when filing a tax return for the taxable year in which the taxpayer engaged in the activity that qualifies the taxpayer for an Article 3A credit. Under prior law, the fee was paid when an application for certification was submitted to the Department of Commerce.

The fee is due at the time the return is due and the credit is not allowable until the fee is paid. The Department of Revenue retains 75% of the fee proceeds and credits the remaining fee proceeds to the Department of Commerce. The fee amount and the allocation of the fee between the Departments of Revenue and Commerce remain the same. The Department of Revenue, rather than the Department of Commerce, is the agency that collects the fee.

Reports Made by DOR

Subsection (b), which required the Department of Commerce to issue an annual report on the Article 3A credits, was rewritten to require the Department of Revenue, rather than the Department of Commerce, to prepare and publish the report, to change the reporting date, to expand the information required in the report, and to include the names of taxpayers receiving the credits. With the elimination of the application to the Department of Commerce, the Department of Commerce will not have data to prepare a report.

As rewritten, the report is due by March 1 and covers the twelve-month period ending the preceding December 31. Before the change, the report was due by May 1 and covered the twelve-month period ending the preceding April 1. The reporting change is effective for business activities occurring on or after January 1, 2002. The first report published by the Department of Revenue under the new requirements is therefore due March 1, 2003, and will cover the twelve-month period ending December 31, 2002.

The information required to be included in the report was expanded to include the names of the taxpayers qualifying for and claiming the credits and specific information about the credits. The specific additional information includes information about tier areas for which credits are claimed, the worker training credit, the research and development credit, and the new credit for substantial investment in other property. The secrecy prohibition in G.S. 105-259 is amended to allow the disclosure of taxpayer names to meet the requirements of subsection (b).

(Effective for business activities occurring on or after January 1, 2002, and for certain activities occurring before January 1, 2002, HB 338, s.123, S.L. 01-487 and SB 748, s. 8(a) and (c), S.L. 01-476. Note that Section 123 of Chapter 487 changed the original effective date of Section 8(a) of Chapter 476.)

G.S. 105-129.7(b) – Reporting New Jobs and Conforming Changes: The 2001 General Assembly amended three subdivisions of subsection (b) to make one substantive and two conforming changes. The substantive change, in subdivision (b)(1), eliminates the requirement that taxpayers, when providing substantiating information about new jobs created, identify whether the new employee lived in a development zone when the employee took the job. Instead, if jobs for which a credit is taken are located in a development zone, the taxpayer must identify the number of those jobs that are filled by residents of the development zone.

Subdivisions (b)(3) and (b)(4) were amended to make two conforming changes. The first change reflects the changes made to G.S. 105-129.6. That statute was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. As a result, subdivision (b)(3) was amended to delete a reference to certification of an investment amount.

The second conforming change reflects the enactment of the credit for a substantial investment in other property, set out in G.S. 105-129.12A. Subdivisions (b)(3) and (b)(4) were amended to add references to this new credit.

(Effective for taxable years beginning on or after January 1, 2002, SB 748, s. 9, S.L. 01-476.)

G.S. 105-129.8(d) – Planned Expansion Period Extended for an Interstate Air Courier: This subsection was amended at the request of FedEx to extend the period of time within which an interstate air courier must plan to create 20 new jobs to qualify for the planned expansion enhancement. The planned expansion enhancement allows a taxpayer to lock in a tier or development zone designation of the establishment at which jobs will be created by signing a letter of commitment with the Department of Commerce. Generally, taxpayers must commit to create at least 20 new jobs within a two-year period. This amendment allows FedEx and other interstate air couriers seven years instead of two years to create the new jobs. This change is one of a number of changes made for FedEx, which has plans to build a hub in Greensboro.

(Effective for taxable years beginning on or after January 1, 2002, HB 1665, s. 6, S.L. 02-146.)

G.S. 105-129.9 – Changes to Credit for Investing in Machinery and Equipment: The 2001 General Assembly made a conforming change and a substantive change to this section, effective for the 2002 tax year. The 2002 General Assembly made three substantive changes to this section. One of these substantive changes takes effect for the 2002 tax year and two take effect for the 2003 tax year.

The 2001 General Assembly made a conforming change to subsection (b) of this section to reflect the changes made to G.S. 105-129.6. That statute was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. As a result, subsection (b) was amended to delete the requirement that the taxpayer include with the application information showing how the taxpayer calculated the eligible investment amount.

The 2001 General Assembly made a substantive change to subsection (c). That change applies the investment threshold for purposes of the credit for investing in machinery and equipment to each establishment rather than to each enterprise tier. Before the change, a taxpayer that had two or more locations in an enterprise tier could add the amount invested at each location in the tier in determining whether the taxpayer met the investment threshold. With the change, the threshold applies separately to each establishment and the taxpayer cannot add the amounts invested at each location. As a result, more investment is required to qualify for the credits.

Two of the changes made by the 2002 General Assembly decrease the credit percentage in some tiers and increase the investment thresholds for some tiers. Reports on the tax credits show that most of the tax credit dollars for the credit for machinery and equipment go to companies in tiers 4 and 5. The changes reduce the machinery and equipment credits for the higher tiers. The changes become effective for the 2003 tax year.

Subsection (a) was amended to decrease the credit percentage in tiers 3, 4, and 5. Under prior law, a taxpayer was allowed a credit equal to 7% of the excess of the eligible investment amount over the applicable threshold, regardless of the tier in which the investment was placed in service. As amended, the credit percentage remains 7% for tiers 1 and 2 but is decreased to 6% for tier 3, 5% for tier 4, and 4% for tier 5.

Subsection (c) was amended to increase the investment thresholds for tiers 4 and 5. For tier 4, the threshold is increased from $500,000 to $1,000,000. For tier 5, the threshold is increased from $1,000,000 to $2,000,000.

The third change made by the 2002 General Assembly creates an exception for FedEx and other interstate air couriers. Subsection (e) was amended to extend the period of time within which an interstate air courier must plan to place specific eligible machinery and equipment in service to qualify for the planned expansion enhancement. The planned expansion enhancement allows a taxpayer to lock in a tier or development zone designation of the establishment at which machinery and equipment will be placed in service by signing a letter of commitment with the Department of Commerce. Generally, taxpayers must commit to placing the machinery and equipment in service within a two-year period. This amendment allows an interstate air courier seven years.

The change to subsection (e) is one of several changes made to the Article 3A credits at the request of FedEx. That company plans to build a hub in Greensboro.

(Changes made by 2001 General Assembly effective for taxable years beginning on or after January 1, 2002, and apply to machinery and equipment first placed in service on or after that date; SB 748, s. 10, S.L. 01-476; changes made by

2002 General Assembly to credit percentage and threshold effective for taxable years beginning on or after January 1, 2003, and apply to business activities that occur on or after that date except for business activities subject to a letter of commitment signed before that date; HB 1734, s. 1.1, S.L. 02-172; exception made by 2002 General Assembly for interstate air couriers effective for taxable years beginning on or after January 1, 2002, HB 1665, s. 7, S.L. 02-146.)

G.S. 105-129.9A – Conforming Changes: The 2001 General Assembly amended subsections (c), (d), and (e) of this section, effective for the 2002 tax year, to conform with the changes made to G.S. 105-129.6. That statute was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. As a result, subsection (c) of this section was amended to eliminate the duty of the Secretary of Commerce to obtain an opinion from the Attorney General before certifying an application in certain circumstances and to replace it with a duty of the taxpayer to obtain a ruling from the Department of Revenue. Subsections (d) and (e) were amended to delete references to certification.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 10, S.L. 01-476.)

G.S. 105-129.12A – New Credit for Substantial Investment in Other Property; Technical Change: This section was enacted during the 2001 legislative session effective for taxable years beginning on or after January 1, 2002. A technical change to subsection (a) was enacted during the 2002 session.

The section was enacted to benefit a specific taxpayer but it applies to any taxpayer that meets the requirements set in the statute. It provides a tax credit for substantial investment in other real property.

Subsection (a) provides that a taxpayer is eligible for this credit if the taxpayer begins to use real property located in a tier one or tier two area in an eligible business during the tax year. The Department of Commerce must make a written determination that the taxpayer will invest at least $10 million in real property at the location within a three-year period and that the location will create at least 200 new jobs within two years of the time the property is first used in the eligible business.

The credit is equal to 30% of the eligible investment amount, which is the lesser of (i) the cost of the property and (ii) the amount by which the cost of all of the real property the taxpayer is using in this State in an eligible business on the last day of the tax year exceeds the cost of all real property used by the taxpayer on the last day of the base year. The base year is the year of the last three preceding years in which the taxpayer had the most real property. In the case of leased property, the cost of the property is equal to the taxpayer's lease payments over a seven-year period, plus any expenditures made by the taxpayer to improve the property before the taxpayer uses it if the expenditures are not reimbursed or credited by the lessor.

The credit is taken in seven equal installments beginning in the year following the year in which the property is first used in an eligible business. When part of the property is first used in an eligible business in one year and another part is first used in an eligible business in a subsequent year, separate credits may be claimed. The basis in the real property for which a credit is claimed must be reduced by the amount of credit allowable.

Subsection (b) provides a method of calculating the credit if only a portion of the property is used in an eligible business. In this circumstance, the amount of allowable credit is reduced by multiplying the allowable credit by the percentage of the square footage of the property actually used in an eligible business.

Subsection (c) provides for the expiration or reduction of the credit. If, in one of the seven years in which the installments of the credit accrue, part or all of the property is no longer used in the business or the number of employees at the property is less than 200, the remaining installments expire.

Subsection (d) provides that a taxpayer may not claim this credit if a credit for investing in central office or aircraft facility property is taken for the same property.

The technical change made by the 2002 General Assembly deletes the word “certification” in the second sentence of subsection (a) and substitutes the word “determination.” This amendment reflects a change in procedure enacted in 2001. Pursuant to amendments to Article 3A in S.L. 01-476, the Department of Commerce no longer makes certifications of approval for Article 3A credits. However, a taxpayer wishing to claim the credit for substantial investment in other property is still required to obtain a written determination from the Secretary of Commerce that the taxpayer is expected to purchase or lease at least $10 million of real property and use that property in an eligible business in that location within three years and create at least 200 new jobs within two years of the time the property is first used in an eligible business.

(New credit effective for taxable years beginning on or after January 1, 2002, and applies to real property first used in an eligible business on or after that date; SB 748, s. 13, S.L. 01-476; technical change effective August 12, 2002; SB 1160, s. 13, S.L. 02-72.)

G.S. 105-129.13(e) - Conforming Changes: The 2001 General Assembly amended this section, effective for the 2002 tax year, to conform with the changes made to G.S. 105-129.6. That statute was rewritten to eliminate the requirement that a taxpayer obtain a certification from the Department of Commerce to claim the Article 3A credits. As a result, this subsection was amended to delete the reference to the application that was formerly required under G.S. 105-129.6.

(Effective for taxable years beginning on or after January 1, 2002; SB 748, s. 14, S.L. 01-476.)

VI. BUSINESS AND ENERGY TAX CREDITS

Article 3B

G.S. 105-129.15(4a) – Conforming Change: This subdivision set out the definition of “pass-through entity” in Article 3B. The subdivision was repealed because the only application of the definition was in the low-income housing tax credit contained in G.S. 105-129.16B of that Article. G.S. 105-129.16B was recodified as G.S. 105-129.41 in new Article 3E. The definitions that apply to the credit, including the definition of “pass-through entity” are set out in G.S. 105-129.40.

(Effective August 15, 2002; SB 1416, s. 3, S.L. 02-87.)

G.S. 105-129.15A – Conforming Change: This section was amended to delete the provisions regarding the sunset of the credit for low-income housing. The provisions are now set out in G.S. 105-129.45 in new Article 3E of Chapter 105. G.S. 105-129.16B, which set out the low-income housing tax credit, was recodified as G.S. 105-129.41 in new Article 3E.

(Effective August 15, 2002; SB 1416, s. 4, S.L. 02-87.)

G.S. 105-129.16B – Housing Tax Credit Changed and Recodified: Two changes were made to this statute with respect to the credit for low-income housing. The first change addresses the effective date of previously enacted legislation. The 2000 General Assembly added G.S. 105-129.16B(c)(1a) to classify low-income housing properties located in counties affected by the 1999 hurricanes the same as properties located in a tier one or tier two enterprise area. The change was effective for taxable years beginning on or after January 1, 2001, for buildings to which federal credits were allocated on or after January 1, 2001. Federal low-income housing credits are allocated to projects in December of each year but the credit may not be claimed until the building is placed in service. As a result, taxpayers who made investments in 2000 in low-income housing projects in counties affected by the 1999 hurricanes and were allocated federal credits in December of 2000 were not eligible for the enhanced credit. The effective date of the 2000 legislation was amended to provide the enhanced credit for buildings located in hurricane-affected counties to which federal credits are allocated on or after January 1, 2000, if the credit is first claimed in a tax year beginning on or after January 1, 2001.

The second change recodifies the credit as G.S. 105-129.41 in new Article 3E of Chapter 105 of the General Statutes. See the section on Article 3E for other changes in the credit for low-income housing.

(Change to effective date of hurricane-affected county recognition effective September 30, 2002; SB 1115, s. 30H, S.L. 02-126; recodification effective for credits for buildings that are awarded a federal credit allocation before January 1, 2003, and for which a federal tax credit is first claimed for a taxable year beginning on or after January 1, 2002; SB 1416, s. 2, S.L. 02-87.)

G.S. 105-129.17(a) – Conforming Change: This subsection was amended to delete provisions that identified the taxes against which the credit for low-income housing could be claimed. The existing credit was recodified as G.S. 105-129.41 in new Article 3E and a new credit was enacted in G.S. 105-129.42. The provisions in this subsection concerning the low-income housing credit are incorporated in the recodified credit in G.S. 105-129.41 and are no longer needed in this subsection.

(Effective August 15, 2002; SB 1416, s. 5, S.L. 02-87.)

G.S. 105-129.19(2a) – Conforming Change: This subsection required the Department of Revenue to include information about the location of each qualified North Carolina low-income building with respect to which a low-income housing credit was claimed in its annual report about Article 3B tax credits to the Revenue Laws Study Committee and the Fiscal Research Division of the General Assembly. The existing credit was recodified as G.S. 105-129.41 in new Article 3E and a new credit was enacted in G.S. 105-129.42. The reporting requirement contained in this subdivision is now set out in G.S. 105-129.44.

(Effective August 15, 2002; SB 1416, s. 6, S.L. 02-87.)

VII. HISTORIC REHABILITATION TAX CREDITS

Article 3D

G.S. 105-129.36(b)(4) – Definition: This subsection was amended to change the definition of the State Historic Preservation Officer. The State Historic Preservation Officer administers the historic preservation programs within the State. Previously, this individual was the Director of the Division of Archives and History or the Director's designee. As amended, the State Historic Preservation Officer is the Deputy Secretary of Archives and History or the Deputy Secretary's designee. The Division of Archives and History is now the Office of Archives and History under the supervision of the Deputy Secretary of Archives and History.

(Effective October 11, 2002; SB 1217, s. 35(e), S.L. 02-159.)

VIII. LOW-INCOME HOUSING TAX CREDITS

Article 3E

New Article 3E – Low-Income Housing Tax Credit: This new Article was enacted to combine the existing tax credit for low-income housing that was previously codified as G.S. 105-129.16B and a new tax credit for low-income housing into one common Article. The credit that was in G.S. 105-129.16B is recodified as G.S. 105-129.41 and applies to low-income housing awarded a federal credit allocation before January 1, 2003, for which a federal tax credit is first claimed for a taxable year beginning on or after January 1, 2002. The new credit is codified as G.S. 105-129.42 and applies to low-income housing awarded a federal credit allocation on or after January 1, 2003.

New Article 3E is the result of efforts by the Department of Revenue, the Housing Finance Agency, and the affected taxpayers. The new Article modifies the housing tax credit to make it simpler and more efficient. Under the prior credit, developers sold the credit by a complex process to investors to obtain funds to finance the developments. The credits generally sold for no more than 45 cents on the dollar, and the number of buyers for the credits was dwindling.

The new credit solves the problem of having to obtain buyers for the tax credit by changing the credit into a refundable credit that is taken by the developer of the housing development rather than passed through to investors in the developer. In practice, a developer is often a pass-through entity. The changes ensure that 100% of the credit is used to finance the development. The changes also end the pressure by developers to make an exception for this tax credit and sever the relationship between the amount of credit a taxpayer can take and the amount of the taxpayer's investment in the pass-through entity that qualified for the credit.

The new and prior credits differ in their tax structure as well as in the type of developments that are eligible for the credits. Eligibility under the prior credits was based largely on enterprise tiers. Eligibility for the new credit is based on the type of income area in which the development is located and how affordable the residential units in the development are to those whose incomes are below the median. The eligibility changes were recommended by the Housing Finance Agency and are designed to better achieve the goal of providing affordable housing the citizens of the State.

G.S. 105-129.40 – Definitions: This section sets out the definitions that apply to new Article 3E. It provides that the definitions in section 42 of the Internal Revenue Code apply to the Article and it sets out definitions for "Housing Finance Agency" and "pass-through entity." The definitions in section 42 of the Code and the definition of "pass-through entity" also applied to the former credit in G.S. 105-129.16B. The definition of "Housing Finance Agency" is new.

(Effective August 15, 2002; SB 1416, s. 1, S.L. 02-87.)

G.S. 105-129.41 – Credit for Low-Income Housing Awarded a Federal Credit Allocation Before January 1, 2003: This section was previously codified as G.S. 105-129.16B. The title of the section was amended to reflect its limited scope. The credit in this section applies only to low-income housing awarded a federal credit allocation before January 1, 2003. Low-income housing awarded a federal credit allocation on or after January 1, 2003 qualifies for the new credit in G.S. 105-129.42 in lieu of the credit in this section.

Numerous changes were made to this section. Subsection (a) was amended to delete references to provisions that were to take effect January 1, 2005. This section does not apply to low-income housing awarded a federal credit allocation on or after January 1, 2003. Therefore, the intended 2005 changes are no longer applicable.

Subsection (a1) was added to provide that the credit allowed in this section may be claimed against the franchise tax, the income tax, or the gross premiums tax. The election is made on the return on which the first installment of the credit is claimed and is binding for all future installments and carryforwards of unused installments. This tax election provision is the same as under prior law and was previously codified as part of G.S. 105-129.17(a) in Article 3B.

Subsection (a2) was added to provide that the credit that may be claimed in a taxable year, including carryforwards, may not exceed fifty percent (50%) of the tax against which it is claimed, reduced by the sum of all other credits. Any unused portion of the credit may be carried forward for the succeeding five years. This cap provision is the same as under prior law and is set out for all Article 3B credits in G.S. 105-129.17(b).

Subsection (b1) was amended to permit a pass-through entity to allocate the credit among its owners at its discretion as long as the owner's adjusted basis in the pass-through entity at the end of the taxable year in which the federal credit is first claimed is at least 40% of the amount of credit allocated to that owner. Under prior law, the owner was required to have an adjusted basis equal to or in excess of the allocated credit. This change was made at the request of taxpayers and was made only because it is part of a transition to the new credit in G.S. 105-129.42.

Subsection (c) was amended to make conforming changes. Language regarding definitions in section 42 of the Code was deleted because the applicable definitions are now set out in G.S. 105-129.40. Language regarding changes to take effect in January 2005 was deleted because the changes are no longer applicable. The credit in this section does not apply to allocations made on or after January 1, 2003.

Subsection (e) was amended to make two substantive changes. First, a reporting requirement was imposed on the taxpayer. The change requires a taxpayer that must recapture all or part of a federal low-income housing credit as a result of disposition to report the recapture event to the Secretary of Revenue and to the Housing Finance Agency. Second, a limitation was placed on the forfeiture provisions. Under the change, a taxpayer is required to forfeit all or part of the State credit only if the event resulting in federal recapture occurs during the period of time during which the State credit is taken, which is either five or six years. The federal credit is taken over a period of ten or eleven years.

Subsection (f) was amended to require a taxpayer to report a change in its percentage ownership of a pass-through entity to the Secretary of Revenue and to the Housing Finance Agency if the taxpayer is required to forfeit all or part of the State credit allocated to it by a pass-through entity because the taxpayer disposed of all or part of its interest in the pass-through entity. Prior law required a forfeiture but did not have a reporting requirement.

(Effective for credits for buildings that are awarded a federal credit allocation before January 1, 2003, and for which a federal tax credit is first claimed for a taxable year beginning on or after January 1, 2002; SB 1416, s. 2, S.L. 02-87.)

G.S. 105-129.42 – Credit for Low-Income Housing Awarded a Federal Credit Allocation On Or After January 1, 2003: This section provides a new credit for low-income housing awarded a federal credit allocation on or after January 1, 2003. This credit differs considerably from the credit that is in effect for allocations made before January 1, 2003. Both the prior credit and the new credit serve as a means to support the development of low-income housing in the State.

Subsection (a) sets out definitions that apply in this section. The defined terms are "Qualified Allocation Plan," "qualified North Carolina low-income housing development," and "qualified residential unit." These definitions apply only to the new credit. G.S. 105-129.40 sets out other definitions that apply to this section.

Subsection (b) provides a State low-income housing credit to a taxpayer that is allocated a federal low-income housing credit for constructing or substantially rehabilitating a qualified North Carolina low-income housing development. The credit is equal to a percentage of the development's eligible basis, as determined under Internal Revenue Code section 42(d). The eligible basis is calculated based on the information contained in the carryover allocation and is not recalculated to reflect subsequent increases or decreases to the basis. No tax credit is allowed for a development that uses tax-exempt bond financing.

Subsection (c) sets out the four categories of housing developments that are considered qualified North Carolina low-income housing developments and therefore eligible for the credit. It also sets out the percentage of a development's eligible basis for which a credit is allowed.

The eligible developments under this credit are based on income rather than on either the enterprise tier of the area in which the development is located or whether the county in which the development is located was affected by a hurricane in 1999. The Housing Finance Agency recommended this change.

Under this subsection, eligibility depends on the type of income area, such as high-income, in which the development is located and on the percentage of residential units in the development that are available to households whose income is below the median income for the location of the development. The following table sets out the categories of developments that qualify for the credit and the amount of credit allowed:

Type of Development	*Percentage of Basis for Which Credit is Allowed*
40% of the qualified residential units are affordable to households whose income is 50% or less of area median income and the units are in a Low-Income county or city	30%
50% of the qualified residential units are affordable to households whose income is 50% or less of area median income and the units are in a Moderate-Income county or city	20%
50% of the qualified residential units are affordable to households whose income is 40% or less of area median income and the units are in a High-Income county or city	10%
25% of the qualified residential units are affordable to households whose income is 30% or less of area median income and the units are in a High-Income county or city	10%

The Housing Finance Agency is responsible for designating counties and cities as Low-Income, Moderate-Income, and High-Income and determining affordability in accordance with the Qualified Allocation Plan in effect as of the time the federal credit is allocated. A change in the income designation of a county or city after a federal credit is allocated does not affect the percentage of the development's eligible basis for which a credit is allowed. The development must meet the affordability requirements for the duration of the federal credit compliance period. Otherwise, the credit is forfeited under subsection (h).

Subsection (d) provides that a taxpayer may elect to receive the credit either as a direct tax refund or as a loan generated by transferring the credit to the Housing Finance Agency. The taxpayer must elect the method of receiving the credit at the time the taxpayer submits to the Housing Finance Agency a request to receive a carryover allocation for the federal credit. The credit is taken in one year. The prior credit was taken over five years.

Subsection (e) addresses the unusual circumstance of a taxpayer that does not submit a request to the Housing Finance Agency to receive a carryover allocation. In that case, the taxpayer must elect the method for receiving the credit when the taxpayer submits federal form 8609 to the Housing Finance Agency, and the taxpayer claims the credit for the taxable year in which the federal form is submitted.

Subsection (f) provides that a pass-through entity that qualifies for this credit does not allocate the credit to its owners as is the general rule for credits earned by pass-through entities. Instead, the pass-through entity is considered the taxpayer for purposes of claiming the credit. This is in contrast to the prior credit, which does pass through to the owners. Under the new credit, if the pass-through entity is paying tax on behalf of the owners of the entity, this credit may not be used to offset that liability.

Subsection (g) addresses when the taxpayer claims the credit and when the credit amount is paid to the taxpayer. The credit is claimed on the income tax return filed for the tax year in which the carryover allocation is received.

Under the direct tax refund method, the credit is applied to the taxpayer's income tax liability. If the credit exceeds the taxpayer's income tax liability, reduced by the sum of all other credits, the excess credit is refundable. The refundable amount, which is the amount of credit in excess of tax liability, is transferred by the Department of Revenue to the Housing Finance Agency.

That Agency holds the refund in escrow. The refund is released to the taxpayer upon the occurrence of whichever of the following occurs first:

(1) The Housing Finance Agency determines that the taxpayer has complied with the Qualified allocation Plan and has completed at least 50% of the activities included in the development's eligible basis.
(2) Within thirty days after the development is placed in service.

Under the loan method, the taxpayer transfers the credit to the Housing Finance Agency and then receives a loan from the Housing Finance Agency for the amount of the credit. The Housing Finance Agency specifies the terms of the loan in accordance with the Qualified Allocation Plan. The Housing Finance Agency is not required to make a loan to a qualified low-income housing development until the Department of Revenue transfers the credit amount to the Agency.

The Housing Finance Agency and the Department of Revenue are working on a request to the Internal Revenue Service concerning the federal tax consequences of receiving the credit as a loan. Preliminary indications are that the loan is not taxable income. This is in accord with the intent of the General Assembly. The ruling will be made available to affected taxpayers when received.

Subsection (h) provides for a forfeiture of all or part of the State credit if the taxpayer is required to recapture any of the federal credit. A taxpayer must immediately report any federal recapture event under section 42 of the Code to the Housing Finance Agency. If the taxpayer or any of its owners are required under section 42(j) of the Code to recapture all or part of a federal credit with respect to a qualified North Carolina low-income development, the taxpayer forfeits the corresponding part of the State credit. Forfeiture of the State credit is not required in two circumstances. One of these circumstances is when the recapture of the federal credit is the result of an event that occurs in the sixth or subsequent calendar year after the calendar year in which the development was awarded a federal credit allocation. The other circumstance is when the taxpayer elected to transfer the credit to the Housing Finance Agency.

Subsection (i) addresses a taxpayer's liability when a forfeiture occurs. A taxpayer that forfeits a credit is liable for all past taxes avoided and any refund claimed as a result of the credit plus interest at the rate established under G.S. 105-241.1(i), computed from the date the Department of Revenue transferred the credit amount to the Housing Finance Agency. The past taxes, refund, and interest are due 30 days after the date the credit is forfeited. A taxpayer that fails to pay the taxes and interest by the due date is subject to the penalties provided in G.S. 105-236.

(Effective August 15, 2002; SB 1416, s. 1, S.L. 02-87.)

G.S. 105-129.43 – Substantiation: This section requires a taxpayer claiming a tax credit under Article 3E to maintain and make available for inspection any information or records required by the Secretary of Revenue or the Housing Finance Agency. The burden of proving eligibility for a credit and the amount of the credit rests upon the taxpayer. This provision is similar to those in G.S. 105-129.7, which applies to the Article 3A credits, and in G.S. 105-129.18, which applies to the Article 3B credits.

(Effective August 15, 2002; SB 1416, s. 1, S.L. 02-87.)

G.S. 105-129.44 – Report: This section requires the Department of Revenue to make an annual report to the Revenue Laws Study Committee and the Fiscal Research Division of the General Assembly identifying the number of taxpayers that claimed an Article 3E tax credit; the location of each qualified North Carolina low-income building or housing development for which a credit was claimed; and the total cost to the General Fund of the credits claimed. This parallels the reporting requirements previously set for the credit in G.S. 105-129.19.

(Effective August 15, 2002; SB 1416, s. 1, S.L. 02-87.)

G.S. 105-129.45 – Sunset: This section provides that Article 3E is repealed effective January 1, 2006, for developments to which federal credits are allocated on or after January 1, 2006. This section therefore preserves the sunset of the credit that was previously set out in G.S. 105-129.15A.

(Effective August 15, 2002; SB 1416, s. 1, S.L. 02-87.)

IX. CORPORATE INCOME TAX

G.S. 105-130.4(a)(1) – Definition of "Business Income" Expanded: This subdivision was amended to expand the definition of "business income" for corporate income tax purposes. Under prior law, income had to meet one of two tests to be business income and therefore apportionable. The first test, known as the "transactional test," required income to be apportioned if it arose from transactions and activity in the regular course of the corporation's trade or business. The second test, known as the "functional test," required income from tangible and intangible property to be apportionable if the acquisition, management, and/or disposition of the property constituted an integral part of the corporation's regular trade or business operations.

As amended, all income that is apportionable under the United States Constitution is "business income." In general, all income from transactions and activities that are dependent upon or contribute to the operations of a taxpayer is apportionable. Income from unrelated business activities that make up a discrete business enterprise is "nonbusiness income."

The General Assembly recognized that this change may increase taxable income and made an exception to the underpayment penalty. A taxpayer is not subject to the penalty for underpayment of estimated tax for the tax year 2002 for any additional tax resulting from the amended definition of business income.

(Effective for taxable years beginning on or after January 1, 2002; SB 1115, s. 30G.1(a) and 30I, S.L. 02-126.)

G.S. 105-130.5(a)(13) – Repeal of FSC Add-Back Takes Effect: The 2001 General Assembly repealed this subdivision effective January 1, 2002. The subdivision was repealed because it is obsolete by virtue of the federal repeal of the Foreign Sales Corporation.

(Effective January 1, 2002; HB 232, s. 4(b), S.L. 01-427.)

G.S. 105-130.5(a)(15) – 30% Additional First-Year Depreciation Add-Back: This subdivision was added to require a taxpayer to add to federal taxable income a percentage of the 30% additional first-year depreciation deduction allowed for federal income tax purposes under section 168(k) or section 1400L of the Internal Revenue Code under the Job Creation and Worker Assistance Act of 2002. The applicable percentage is 100% of the bonus depreciation for tax year 2002, 70% for tax year 2003, and 0% for tax year 2004 and subsequent years. A taxpayer who claimed the bonus depreciation for federal purposes for tax year 2001 and whose North Carolina return also reflected that deduction must also add back 100% of the deduction claimed for tax year 2001 on the

2002 tax return. This adjustment does not result in a difference in basis of the affected assets for State and federal income tax purposes.

The General Assembly recognized that this addition will increase taxable income and made an exception to the underpayment penalty. A taxpayer is not subject to the penalty for underpayment of estimated tax for tax year 2002 if the additional tax is the result of this adjustment.

(Effective for taxable years beginning on or after January 1, 2002; SB 1115, s. 30C.2(a) and 30I, S.L. 02-126.)

G.S. 105-130.5(b)(3a) – Conforming Change: This subdivision was amended to ensure that foreign source dividends and domestic source dividends are treated the same with respect to attribution of expenses. New G.S. 105-130.6A sets limits on the amount of expenses that can be attributed. See the discussion of **G.S. 105-130.6A** for additional information about attribution of expenses to dividends.

(Effective for taxable years beginning on or after January 1, 2001; HB 1670, s. 4, S.L. 02-136.)

G.S. 105-130.5(b)(17) – Clarifying Change: This subdivision was amended to clarify that a corporation may deduct the amount of 911 charges collected and remitted to a local government or to the Wireless Fund only if the collections are included in federal taxable income. This clarification ensures that a taxpayer will not receive an unintended double deduction for these charges by deducting them from federal income and then deducting them again in calculating State income.

(Effective August 12, 2002; SB 1160, s. 14, S.L. 02-72.)

G.S. 105-130.5(b)(21) – Future Deduction for 30% Additional First-Year Depreciation Add-Back: This subdivision was added to deduct from future income tax returns the 30% additional first-year depreciation deduction required to be added to federal taxable income under G.S. 105-130.5(a)(15). A taxpayer may deduct 20% of the total amount of bonus depreciation added to federal taxable income in tax years 2002 and 2003 in each of the first five taxable years beginning on or after January 1, 2005.

(Effective for taxable years beginning on or after January 1, 2002; SB 1115, s. 30C.2(c), S.L. 02-126.)

G.S. 105-130.5(c)(3) – Cross-Reference Added: This subdivision was amended to add a cross-reference to new G.S. 105-130.6A. That new section sets limits on the amount of expenses attributable to dividends received that are not taxed for North Carolina corporate income tax purposes as a result of the dividends received deduction allowed in determining federal taxable income.

(Effective for taxable years beginning on or after January 1, 2001; HB 1670, s. 1, S.L. 02-136.)

G.S. 105-130.6A – Attributing Expenses to Dividends: The 2001 General Assembly repealed G.S. 105-130.5(a)(7) and G.S. 105-130.7(b) and amended G.S. 105-130.5(b) to conform to the federal determination of the taxability of dividends received. As a result, taxpayers were required to attribute expenses to nontaxed dividends in arriving at taxable income.

Financial institution holding companies and other taxpayers affected by this change sought and received legislation limiting the amount of expenses that are attributable to nontaxed dividends. The affected taxpayers asked for the repeal of the attribution requirement. The General Assembly enacted this section and did not repeal the requirement.

The legislation enacting this section states that it is the intent of the General Assembly for the section to apply to tax years 2001 and 2002 and for the 2003 General Assembly to address the issues raised by this legislation as well as related issues after the Revenue Laws Study Committee studies the issues and makes its recommendations. This section does not have an expiration date, however, and will remain in effect until changed by the General Assembly.

This section was enacted to clarify how expenses are attributed to dividends received that are not taxed for North Carolina corporate income tax purposes as a result of the dividends received deduction allowed in determining federal taxable income. The new law provides limits on the potential tax liability of certain taxpayers as a result of the attribution of expenses to dividends.

Subsection (a) provides that the provisions of G.S. 105-130.6 govern the determination of whether a corporation is a subsidiary or an affiliate of another corporation. The subsection also includes definitions for “affiliated group,” “bank holding company,” “dividends,” “electric power holding company,” “expense adjustment,” and “holding company.”

Subsection (b) sets a general rule for attributing expenses related to dividends received. This rule applies to corporations other than bank holding companies or electric power holding companies. The general rule limits the amount of expenses attributed to dividends to 15% of the dividends.

Subsection (c) provides the attribution rule for bank holding companies. For bank holding companies, the amount of expenses attributed to dividends may not exceed 20% of the dividends.

Subsection (d) provides the attribution rule for electric power holding companies. For electric power holding companies, the amount of expenses attributed to dividends may not exceed 15% of the company's total interest expenses.

Subsection (e) places an $11 million cap on the additional tax that a bank holding company and its related companies must pay as the result of attributing expenses to dividends received. If the attribution of expenses results in additional tax of more than $11 million to the bank holding company group, the group may reduce the attributed expenses so that the additional tax effect is $11 million.

The members of the group may allocate the reduction among themselves at their discretion. Each member of the group that has dividends for the year and is required to file a North Carolina return must provide a schedule with its return that lists each member of the group that has dividends, the amount of the dividends, whether that member is a bank holding company, and the amount of expenses attributed to that member in order to reach the $11 million cap. If a member's return is later adjusted so that the tax effect of the attribution of expenses for the group falls below $11 million, the Department of Revenue may increase the amount of attributed expenses for any member of the group to bring the additional tax effect back to the maximum. The Department may assess any additional tax due within three years of the date on which the member's return was changed that resulted in the group falling below the maximum tax effect.

Subsection (f) provides a tax credit to members of a bank holding company. The credit is $2 million if the bank holding company group pays the maximum additional tax liability of $11 million under subsection (e). If the bank holding company group does not pay an additional $11 million, the credit is equal to the additional tax the group paid by attributing expenses of up to 20% of dividends instead of 15% of dividends. The credit is taken in four equal annual installments. For the additional tax paid for tax year 2001, the credit is taken beginning with the tax year 2003. For all other tax years, the credit is taken beginning in the following tax year. The members of the group can allocate the credits among the group at their discretion.

Subsection (g) provides a tax credit to an electric power holding company. The credit is equal to one-half of the additional tax paid as a result of attributing expenses to dividends received. The credit is allowed in the following tax year. The electric power holding company may claim the credit against its own tax liability or may elect to allocate the credit among the members of its affiliated group.

If the electric power company elects to allocate the credit among its group, the credit must be taken in four equal installments beginning in the following tax year or the taxable year for which the taxpayer's final return is due in 2004, whichever is later. The affiliated group of an electric power holding company includes a utility that pays the utility franchise tax under G.S. 105-116 on a quarterly basis. The language about the 2004 tax year ensures that the first franchise tax return on which a credit can be taken is the return filed for the first calendar quarter of 2004.

Subsection (h) provides that the tax credits in subsections (f) and (g) may be claimed against either income tax or franchise tax. A credit may not exceed the amount of tax against which it is claimed and any unused portion of the credit may be carried forward to succeeding tax years. A credit may only be claimed against one tax and the election is made when filing the return on which the first installment of the credit is claimed. The election is binding on that installment and all future installments or carryovers of installments of that credit. Each member of an affiliated group that is claiming a credit under this section must include a schedule with its return that shows for every member of the group the amount of credit taken by it, the tax against which the credit is taken, and the amount of the resulting tax.

(Effective for taxable years beginning on or after January 1, 2001; HB 1670, ss. 2 and 5, S.L. 02-136.)

G.S. 105-130.8(a)(5) - Clarifying Change: This subdivision was amended to clarify that expenses attributed to nontaxed income may not be deducted twice; once in the initial year and again in computing a net economic loss.

(Effective for taxable years beginning on or after January 1, 2001; HB 1670, s. 3, S.L. 02-136.)

G.S. 105-130.34(a) – Clarifying Change: This subsection was amended to clarify that a donation of an interest in real property in North Carolina qualifies for the conservation tax credit only if the interest in property is donated in perpetuity. This change adopts the Department's long-standing historical position.

(Effective August 12, 2002; SB 1160, s. 15(a), S.L. 02-72.)

G.S. 105-130.41 – Ports Tax Credit Extended: The sunset on this credit was extended. The credit was scheduled to expire for taxable years beginning on or after January 1, 2003. The credit now sunsets for taxable years beginning on or after January 1, 2004.

(Effective August 29, 2002; HB 1520, ss. 6(a), 6(b), and 6(c), S.L. 02-99.)

X. INDIVIDUAL INCOME TAX

G.S. 105-134.2(a)*:* Temporary Tax Rate Increase in Effect – The 2001 General Assembly amended this subsection to add a new 8.25% temporary marginal income tax rate bracket. The rate applies to tax years 2001, 2002, and 2003.

The 8.25% individual income tax rate bracket applies as follows: Married individuals filing joint returns – 8.25% on taxable income over $200,000; Heads of households – 8.25% on taxable income over $160,000; Unmarried individuals other than surviving spouses and heads of households – 8.25% on taxable income over $120,000; and Married individuals filing separately – 8.25% on taxable income over $100,000.

(Effective for taxable years beginning on or after January 1, 2001, and expires for taxable years beginning on or after January 1, 2004; SB 1005, s. 34.18, S.L. 01-424.)

G.S. 105-134.6(b)(13) – Obsolete Provision Repealed: This subdivision, which allowed a deduction for the amount that is distributed to a beneficiary of the Parental Savings Trust Fund of the State Education Assistance Authority, has been repealed. Under previous federal law, distributions from qualified state tuition programs (section 529 plans) in excess of the amount contributed were taxable for federal income tax purposes. Under the Economic Growth and Tax Relief Reconciliation Act of 2001, distributions from section 529 plans are not taxable to the extent the distributions are used to pay qualified higher education expenses. Because the General Assembly updated our reference to the Internal Revenue Code to include the federal changes as of May 1, 2002, the deduction provided in this subdivision is obsolete.

(Effective for taxable years beginning on or after January 1, 2002; SB 1115, s. 30C.4, S.L. 02-126.)

G.S. 105-134.6(b)(17) – Future Deduction for 30% Additional First-Year Depreciation Add-Back: This subdivision was added to deduct from future income tax returns the 30% additional first-year depreciation deduction required to be added to federal taxable income under G.S. 105-134.6(c)(8). A taxpayer may deduct 20% of the total amount of bonus depreciation added to federal taxable income in tax years 2002 and 2003 in each of the first five taxable years beginning on or after January 1, 2005.

(Effective for taxable years beginning on or after January 1, 2002; SB 1115, s. 30C.2(d), S.L. 02-126.)

G.S. 105-134.6(c)(3) and (4) – Delay in Elimination of Standard Deduction Marriage Penalty: The 2001 General Assembly amended these subdivisions in two phases to eliminate the marriage penalty with respect to the standard deduction. The 2002 General Assembly postponed the 2001 changes.

The term “marriage penalty” refers to the imposition of a higher income tax liability on a married couple than on two single individuals due to two factors. One factor is the difference in the amounts allowed single taxpayers and married taxpayers as a standard deduction. The other factor is the difference in the thresholds for single taxpayers and married taxpayers under the marginal income tax rates. The standard deduction for a married couple is less than the standard deduction for a single taxpayer multiplied by two. Similarly, the thresholds for the marginal tax rates for a married couple occur at lower taxable income amounts than the thresholds for a single taxpayer multiplied by two.

The 2001 legislation eliminated the standard deduction marriage penalty by increasing the standard deduction for married filers from its current level of $5,000 for married filing jointly to twice the amount allowed single filers and from its current level of $2,500 for married filing separately to the amount allowed single filers. The standard deduction for single filers is $3,000. The increase was to be phased in over the 2002 and 2003 tax years and would have allowed the following increased standard deduction amounts:

Status	*Scheduled 2002 Amount*	*Scheduled 2003 Amount*
Married filing jointly	$5,500	$6,000
Married filing separately	$2,750	$3,000

The 2002 General Assembly amended the effective dates of the 2001 legislation to delay the scheduled increase in the standard deduction amounts for tax years 2002 and 2003 to tax years beginning on or after January 1, 2003 and January 1, 2004, respectively. Thus, unless the General Assembly delays these increases again in 2003, the increase that was originally scheduled for 2002 will take effect in 2003 and the increase that was originally scheduled for 2003 will take effect in 2004. The General Assembly delayed the increases because of the State’s budget woes.

The General Assembly recognized that delaying the change to the standard deduction increases the tax liability of individuals who relied on the change becoming effective for tax year 2002. The General Assembly created an exception to the underpayment penalty. A taxpayer is not subject to the penalty for underpayment of estimated tax for tax year 2002 for any additional tax resulting from the delay.

(Increase originally effective for taxable years beginning on or after January 1, 2002; SB 1005, s. 34.19(a) and (b), S.L. 01-424; delay effective September 30, 2002, SB 1115, ss. 30B.1, 30B.2, and 30I, S.L. 02-126.)

G.S. 105-134.6(c)(8) – 30% Additional First-Year Depreciation Add-Back: This subdivision was added to require a taxpayer to add to federal taxable income a percentage of the 30% additional first-year depreciation deduction allowed for federal income tax purposes under section 168(k) or section 1400L of the Internal Revenue Code under the Job Creation and Worker Assistance Act of 2002. The applicable percentage is 100% of the 30% additional first-year depreciation for tax year 2002, 70% for tax year 2003, and 0% for tax year 2004 and subsequent years. A taxpayer who claimed the bonus depreciation for federal purposes for tax year 2001 and whose North Carolina return also reflected the deduction must also add back 100% of the deduction claimed for tax year 2001 on the 2002 tax return. This adjustment does not result in a difference in basis of the affected assets for State and federal income tax purposes.

The General Assembly recognized that this addition will increase taxable income and made an exception to the underpayment penalty. A taxpayer is not subject to the penalty for underpayment of estimated tax for tax year 2002 for any additional tax resulting from this change.

(Effective for taxable years beginning on or after January 1, 2002; SB 1115, s. 30C.2(b) and 30I, S.L. 02-126.)

G.S. 105-151.12(a) – Clarifying Change: This subsection was amended to clarify that a donation of an interest in real property in North Carolina qualifies for the conservation tax credit only if the interest in the property is donated in perpetuity. This clarification adopts the Department’s long-standing position.

(Effective August 12, 2002, SB 1160, s. 15(b), S.L. 02-72.)

G.S. 105-151.12(f) – Credit for Certain Real Property Donations: The 2001 General Assembly enacted this subsection to create a temporary exception to the change made to G.S. 105-269.15(a) in 2001 concerning the calculation of tax credits by partnerships. The temporary exception is effective for the 2002 tax year and applies to that year and to tax years 2003 and 2004.

Under the change made to G.S. 105-269.15(a), a maximum dollar limit on a tax credit applies to a partnership as a whole rather than to each of the individual partners. This subsection preserves the application of the dollar limit on the credit for real property donations at the individual partner level.

G.S. 105-151.12(a) limits the credit for certain real property donations to $250,000. If a partnership with four partners qualifies for a $1,000,000 tax credit, each partner can claim a tax credit of $250,000. Without new subsection (f), each partner could claim a tax credit of only $62,500 (one-fourth of the maximum $250,000).

This exception was enacted at the request of the Department of Environment and Natural Resources. That Department was concerned that the application of the maximum credit at the partnership level rather than the partner level would decrease the amount of property donated for land conservation purposes.

(Effective for taxable years beginning on or after January 1, 2002, and expires for taxable years beginning on or after January 1, 2005; HB 146, ss. 2 and 3, S.L. 01-335.)

G.S. 105-151.22 – Ports Tax Credit Extended: This credit was amended to add new subsection (d) to set out the sunset on the credit and to extend the sunset. The credit was scheduled to expire for taxable years beginning on or after January 1, 2003. The credit now sunsets for taxable years beginning on or after January 1, 2004. The previous sunset was set out in the session laws and not in the text of the statute.

(Effective August 29, 2002; HB 1520, s. 6(d), S.L. 02-99.)

G.S. 105-151.24 – Delay in Two-Step Increase in Credit for Children: The 2001 General Assembly amended this section to make a two-step increase in the tax credit for a dependent child for whom the taxpayer is allowed to claim a personal exemption. Under the 2001 legislation, the first step was scheduled to become effective for taxable years beginning on or after January 1, 2002, and to increase the credit from $60 to $75. The second step was scheduled to become effective for taxable years beginning on or after January 1, 2003, and to increase the credit from $75 to $100.

The 2002 General Assembly amended the effective dates of the 2001 legislation to delay the scheduled increases in the credit amounts for tax years 2002 and 2003 to tax years beginning on or after January 1, 2003 and January 1, 2004, respectively. Thus, unless the General Assembly delays these increases again in 2003, the increase that was originally scheduled for 2002 will take effect in 2003 and the increase that was originally scheduled for 2003 will take effect in 2004. The General Assembly delayed the increases because of the State’s budget woes.

The General Assembly recognized that delaying the scheduled increases affects tax liability and created an exception to the underpayment penalty. A taxpayer is not subject to the penalty for underpayment of estimated tax for tax year 2002 for any additional tax resulting from the delay.

(Originally effective for taxable years beginning on or after January 1, 2002; SB 1005, s. 34.20 (a) and (b), S.L. 01-424; delay effective September 30, 2002, SB 1115, ss. 30B.2(a), 30B.2(b), and 30I, S.L. 02-126.)

G.S. 105-159.1(e) – Conforming Change: This subsection was amended to apply the new definition of "income tax return preparer" set out in new G.S. 105-228.90(b)(4). That definition was added for purposes of the new offenses in G.S. 105-236(9a) for tax fraud committed by an income tax return preparer. The definition is appropriate for application in this subsection as well and does not change the scope of the subsection.

(Effective December 1, 2002, SB 1218, s. 3, S.L. 02-106.)

G.S. 105-159.2 – Designation of Tax to North Carolina Public Campaign Fund: This statute was enacted to permit an individual to agree to allocate $3.00 of the individual's tax liability to the North Carolina Public Campaign Financing Fund, if the individual has an income tax liability of at least that amount. The North Carolina Public Campaign Financing Fund was established under G.S. 163-278.63 to provide campaign money to nonpartisan candidates for the North Carolina Supreme Court and Court of Appeals who voluntarily accept strict campaign spending and fund-raising limits. On a joint return, each individual may agree to allocate $3.00 to the Fund. Agreeing to allocate $3.00 to the Fund neither increases the tax nor reduces a refund.

The statute requires the Department to make it clear to taxpayers that the allocation supports a nonpartisan court system and does not affect their tax liability or the amount of their refund. The Department must include a specified statement in the individual income tax instructions and must consult with the State Board of Elections concerning information given to taxpayers about the allocation.

The statute makes it clear that a decision to make an allocation to the Fund can be made only by the taxpayer. It prohibits a paid preparer from marking the return to make an allocation to the Fund without the consent of the taxpayer. It also prohibits software packages used to produce North Carolina returns from defaulting to an agreement or an objection.

(Effective for taxable years beginning on or after January 1, 2003; SB 1054, s. 4, S.L. 02-158.)

XI. TAX CREDITS FOR QUALIFIED BUSINESS INVESTMENTS

G.S. 105-163.010(9) – Definition of Qualified Grantee Business Revised: The subdivision was rewritten to delete the list of organizations whose grants make an entity a qualified business venture and to substitute a generic description of entities whose grants make an entity a qualified business venture. The change was made to ensure that taxpayers who are similarly situated received equal treatment. The change resolves addresses constitutional concerns.

Under the prior definition, a grant from any of the following businesses qualified its recipient as a qualified business venture:

- The North Carolina Technological Development Authority.
- The North Carolina Technological Development Authority, Inc.
- North Carolina First Flight, Inc.
- The North Carolina Biotechnology Center.
- The Microelectronics Center of North Carolina.
- The Kenan Institute for Engineering, Technology and Science.
- The federal Small Business Innovation Research Program.

The revised definition applies to the last four in this list. The first three in this list are the same entity that has operated under three different names, and the revised definition does not apply to them. Other entities may meet the generic descriptions in the revised definition, but none were identified in the discussions of the legislation.

(Effective January 1, 2003; HB 1520, s. 3, S.L. 02-99.)

G.S. 105-163.013(c) – Conforming Change: This subsection was amended to eliminate duplicating or conflicting with information set out in the definition of “qualified grantee business” in G.S. 105-163.010(9). Before the change, the subsection repeated the list in that definition of entities whose grants qualify the recipients as a “qualified grantee business.” The definition was revised to substitute generic descriptions for the list of named entities. The amendment to this subsection replaces the list with a cross-reference to the definition.

(Effective August 29, 2002; HB1520, s. 4, S.L. 02-99.)

G.S. 105-163.015 – Sunset Extended: This new section sets out the sunset for the tax credit for qualified business investments and extends the sunset. The credit was scheduled to expire for investments made on or after January 1, 2003. The credit now sunsets for investments made on or after January 1, 2004. The previous sunset was set out in the session laws and not in the statutes.

(Effective August 29, 2002; HB1520, s. 5, S.L. 02-99.)

XII. WITHHOLDING OF INCOME TAX

G.S. 105-163.6 (b) and (c) – 2001 Change in Filing Thresholds Takes Effect: The 2001 General Assembly amended subsections (b) and (c) of this section, effective January 1, 2002, to move more taxpayers from quarterly filing to monthly filing of withholding taxes. The changes require more taxpayers to remit taxes more frequently. As a result, some tax revenue that would have been received in the 2002-03 fiscal year was received at the end of the 2001-02 fiscal year. When a taxpayer is changed from a quarterly filing status to a monthly filing status, the State receives two months of withheld taxes one fiscal year sooner.

Subsection (b) was amended to require an employer who withholds an average of less than $250 of State income taxes from wages each month to file a return and pay the taxes on a quarterly basis. Subsection (c) was amended to require an employer who withholds an average of at least $250 but less than $2,000 from wages each month to file a return and pay the taxes on a monthly basis. . Before these changes, the threshold for distinguishing quarterly filers from monthly filers was $500 instead of $250. The change converted about 70,000 quarterly taxpayers into monthly taxpayers.

(Effective January 1, 2002; HB 232, s. 5, S.L. 01-427.)

G.S. 105-163.7(c) – Unnecessary Provision Repealed: This subsection was repealed because it is no longer needed. The subsection required employers to report to the Secretary of Revenue information regarding workers' compensation when filing their annual withholding reconciliation returns. The subsection required the Secretary to compile the information and give the compiled data to the North Carolina Industrial Commission.

The Industrial Commission obtains workers' compensation information from sources other than the reports made with the annual reconciliation returns. The Industrial Commission does not need duplicate information. This subsection was repealed to eliminate the duplication of information and the unnecessary burden placed on taxpayers. The Industrial Commission concurred in this repeal.

(Effective August 12, 2002; SB 1160, s. 16, S.L. 02-72.)

XIII. ESTIMATED INCOME TAX FOR INDIVIDUALS

Article 4A

Uncodified Temporary Exceptions: Four temporary exceptions apply to the penalty set out in G.S. 105-163.15 for underpayment of estimated income tax by individuals. The exceptions are for tax year 2002 only and apply to underpayments that are the result of the following:

(1) An increase in the taxpayer's income tax liability resulting from updating the State's reference to the Internal Revenue Code.

(2) The add-back for tax year 2002 for amounts taken on the federal return as accelerated bonus depreciation under section 168(k) or section 1400L of the Internal Revenue Code.

(3) The delay in the increase in the standard deduction for married taxpayers.

(4) The delay in the increase in the child care credit.

(All exceptions effective for tax year 2002; SB 1115, s. 30I, S.L. 02-126.)

XIV. ESTIMATED INCOME TAX FOR CORPORATIONS

Article 4C

Uncodified Temporary Exceptions: Four temporary exceptions apply to the penalty set out in G.S. 105-163.41 for underpayment of estimated income tax by a corporation. The exceptions are for tax year 2002 only and apply to underpayments that are the result of the following:

(1) An increase in the taxpayer's income tax liability resulting from updating the State's reference to the Internal Revenue Code.

(2) The add-back for tax year 2002 for amounts taken on the federal return as accelerated bonus depreciation under section 168(k) or section 1400L of the Internal Revenue Code.

(3) The expansion of the category of business income to include all income that is apportionable to this State under the federal Constitution.

(4) The changes made by the 2001 General Assembly concerning subsidiary dividends, if the corporation paid by October 18, 2002, all tax due by that date as a result of the changes.

(All exceptions effective for tax year 2002; SB 1115, s. 30I, S.L. 02-126; HB 1670, s. 6, S.L. 02-136.)

XV. SALES AND USE TAX

Article V

State Sales and Use Tax

G.S. 105-164.3 – Definition Changes: The 2001 General Assembly made extensive changes to this section, effective January 1, 2002. It added 17 new definitions, repealed a definition, and revised several of the existing definitions. Because of the extent of the changes, the Codifier of Statutes put all the definitions in a standard format and renumbered the definitions to eliminate letters after numbers. The 2002 General Assembly revised seven definitions.

The following explanation includes the substantive changes made by the 2001 General Assembly, effective January 1, 2002, and the changes made by the 2002 General Assembly. The effective date that applies to each definition is noted after the definition.

Candy – (2). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of candy set out in that Agreement. The definition sets out the ingredients that constitute candy; these ingredients do not include flour.

Prior law did not include a definition of candy. A definition of candy was enacted so candy can be identified and taxed differently from other types of food, if the General Assembly chooses to do so. The General Assembly has not made any changes in the taxation of candy. Candy that is purchased for home consumption and would be exempt if purchased under the federal Food Stamp Program remains exempt from State tax and the Mecklenburg ½% Public Transit Tax.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Clothing – (3). This definition was added by the 2001 General Assembly to implement the sales tax holiday set out in new G.S. 105-164.13C. During the holiday, clothing with a sales price of $100 or less is exempt from State and local sales and use taxes. The definition of clothing matches the definition of clothing set out in the national Streamlined Sales Tax Agreement. The term is defined as all human wearing apparel suitable for general use. The Agreement definition contains an exhaustive list of items that are included in the definition. The Department will administer this definition in accordance with that list of items.

(Effective January 1, 2002; SB 748, s. 18, S.L. 01-476.)

Clothing accessories or equipment – (4). This definition was added by the 2001 General Assembly to implement the sales tax holiday set out in new G.S. 105-164.13C. During the holiday, clothing with a sales price of $100 or less is exempt from State and local sales and use taxes but clothing accessories and equipment are subject to tax. The definition of clothing accessories and equipment matches the definition of the term adopted by the national Streamlined Sales Tax Agreement. The term is defined as incidental items worn on the person or in conjunction with clothing. The Agreement definition contains an exhaustive list of items that are included in the definition. The Department will administer this definition in accordance with that list of items.

(Effective January 1, 2002; SB 748, s. 18, S.L. 01-476.)

Cost Price – Former (4). The 2001 General Assembly repealed this definition because it is replaced by the definition of "purchase price" set out in subdivision (33) of this section. The new term "purchase price" has the same meaning as the prior term "cost price." Even before the addition of the term "purchase price," the statutes used the terms "cost price" and "purchase price" interchangeably. G.S. 105-164.6(a)(1), for example, used the term "cost price" and G.S. 105-164.6(b) used the term "purchase price."

(Effective January 1, 2002; SB 165, ss. 14 and 53, S.L. 01-414.)

Delivery charges – (6). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of delivery charges set out in that Agreement. As defined, the term means all charges imposed by a retailer for preparation and delivery of personal property or services to a location designated by the consumer.

As a result of the repeal of G.S. 105-164.12, all transportation charges will be taxable without regard to where shipment originates, where title passes, or how the property is shipped. Under prior law, delivery charges were not taxable if title passed to the purchaser at the point of origin.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Dietary supplement – (7). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition is a simpler version of the definition set out in that Agreement but has the same meaning as the definition set out in the Agreement. A dietary supplement is a product that is intended to supplement the diet of humans and is required to be labeled as a dietary supplement under federal law.

A definition of dietary supplement was enacted so these items can be identified and taxed differently from other types of food, if the General Assembly chooses to do so. The General Assembly has not changed the taxation of dietary supplements. These items are subject to State and local sales and use taxes.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Direct-to-home satellite service – (8). This definition was added as a result of the levy of a 5% State sales and use tax under G.S. 105-164.4(a)(7) on direct-to-home satellite services. The term is defined as "programming transmitted or broadcast by satellite directly to the subscribers' premises without the use of ground equipment or distribution equipment, except equipment at the subscribers' premises or the uplink process to the satellite."

(Effective January 1, 2002; SB 1005, s. 34.17, S.L. 01-424; SB 748, s. 18(c), S.L. 01-476.)

Food – (10). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of food set out in that Agreement, with one technical difference. The Agreement definition of food states that the term does not include alcoholic beverages. The Agreement definition of food excludes alcoholic beverages so that the exemption many states have for food will not automatically apply to alcoholic beverages as well.

The definition of food set out in this subdivision includes alcoholic beverages so that the scope of the local prepared food taxes in North Carolina is not inadvertently decreased. The local prepared food taxes in this State use the definition of food set out in the State sales tax statutes as the starting point for the levy of the tax. If alcoholic beverages are not included in the definition of food, the local taxes must impose a tax on alcoholic beverages as well as on prepared food to be able to tax alcoholic beverages. The relevant local acts could be amended to do this, but the same result is achieved with fewer changes to the local acts by including alcoholic beverages in the definition of food.

The definition of food is broad and is not tied to the federal Food Stamp Program. Various categories of food, such as candy and dietary supplements, are also defined to enable the General Assembly to make choices about what to tax and what to exempt from tax.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; HB 748, s. 3, S.L. 01-489; SB 748, s. 18(c), S.L. 01-476.)

Food sold through a vending machine – (11). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of food sold through a vending machine set out in that Agreement. This definition was enacted so that food sold through a vending machine can be identified and taxed differently from other types of food, if the General Assembly chooses to do so. The General Assembly has not changed the taxation of food sold through a vending machine. These items are subject to State and local sales and use taxes based on 50% of their sales price.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Hub – (13): The 2002 General Assembly amended this definition to delete the requirement that more than 60% of the air courier's aircraft value be apportioned to North Carolina and to add the condition that the air courier has or expects to have no less than 150 departures per month from a North Carolina airport. This change was made at the request of FedEx, which plans to build a hub in Greensboro. The company was concerned that it may not meet the description in the existing definition.

(Effective October 1, 2002; HB 1665, s. 1, S.L. 02-146.)

Interstate air courier – (15): The 2002 General Assembly amended this definition to replace a cross-reference to the definition of "air courier services" in G.S. 105-129.2 with the substance of that section. The amendment does not change the meaning of the definition. The definition of "air courier services" in G.S. 105-129.2, which applies to corporate income tax credits, has not changed.

(Effective October 1, 2002; HB 1665, s. 1, S.L. 02-146.)

Mobile telecommunications service – (21). This definition was added by the 2001 legislation that consolidated the taxes on telecommunications into a 6% State sales tax. The definition mirrors the definition of this term in the federal Mobile Telecommunications Sourcing Act. As defined, mobile telecommunications service is a radio communication service carried on between mobile stations or receivers and land stations and by mobile stations communicating among themselves.

(Effective January 1, 2002; HB 571, s. 13, S.L. 01-430; SB 748, s. 18(c), S.L. 01-476.)

Moped – (22): The 2002 General Assembly amended this definition to increase from 20 miles per hour to 30 miles per hour the maximum propulsion speed of the vehicle's motor.

(Effective October 23, 2002; HB 1516, s. 6, S.L. 02-170.)

Place of primary use – (26a): The 2002 General Assembly added this definition as part of the legislation that conformed the sourcing of mobile telecommunications services to federal law. It provides, in part, that the place of primary use is the customer's street address, whether residential or business.

(Effective August 1, 2002; HB 1521, s. 1, S.L. 02-16.)

Prepaid telephone calling service – (27). The 2001 General Assembly added a definition of "prepaid telephone calling arrangement" as part of the legislation that simplified the taxes on telecommunications. It identifies these arrangements so they can be taxed as tangible personal property. The term is defined as a right that is paid for in advance, enables the origination of phone calls by means of an access number, authorization code, or similar means, and is sold in units or dollars whose number or dollar value declines with use and is known on a continuous basis. A prepaid calling card is an example of a prepaid telephone calling arrangement.

The 2002 General Assembly amended this definition by changing the defined term from "prepaid telephone calling arrangement" to prepaid telephone calling service." The change was made to conform to the terminology used in the federal Mobile Telecommunications Sourcing Act. The 2002 amendment does not change the content of the definition.

(Original definition effective January 1, 2002; HB 571, s. 1, S.L. 01-430; SB 748, s. 18(c), S.L. 01-476; 2002 change effective August 1, 2002; HB 1521, s. 2, S.L. 02-16.)

Prepared food – (28). This definition was rewritten by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The rewritten definition matches the definition of prepared food set out in that Agreement. The rewritten definition deletes the phrase "and drink" from the defined term but has the same meaning as the prior definition.

(Effective January 1, 2002; SB 144, s. 2.3, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Protective equipment – (31). The 2001 General Assembly added this definition to implement the sales tax holiday set out in G.S. 105-164.13C. During the holiday, certain clothing is exempt from State and local sales and use taxes but protective equipment is subject to tax. The definition of protective equipment matches the definition of the term set out in the national Streamlined Sales Tax Agreement. The Agreement definition contains an exhaustive list of items that are included in the definition. The Department will administer this definition in accordance with that list of items.

(Effective January 1, 2002; SB 748, s. 18, S.L. 01-476.)

Purchase price – (33). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of purchase price set out in that Agreement. The term has the same meaning as "sales price" when applied to an item subject to use tax.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Retail sale or sale at retail – (34). This definition was rewritten by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The rewritten definition matches the definition of retail sale or sale at retail set out in that Agreement. The revised definition expands the defined term from "retail" to "retail sale or sale at retail," but makes no substantive change in the law.

(Effective January 1, 2002; SB 144, ss. 2.4 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Sales price – (37). This definition was rewritten by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of sales price set out in that Agreement. The revised definition lists items that are included in subpart a. and lists items that are not included in subpart b. Four of the exclusions from tax that were contained in this definition are now set out in G.S. 105-164.13 as exemptions. Subdivision (47) of G.S. 105-164.13 exempts bottle deposits from tax, subdivision (48) of that section exempts deposits on certain replacement parts from tax, subdivision (49) exempts separately stated installation charges from tax, and subdivision (50) exempts from tax 50% of the sales price of most items sold through a vending machine.

The only substantive change made as a result of rewriting the definition affects cash discounts. Under the prior definition, cash discounts were included in the sales price and tax was due on the sales price without regard to the discount.

Under the revised definition, cash discounts are not considered to be part of the sales price.

(Effective January 1, 2002; SB 144, ss. 2.5 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Service address – (39)(Repealed). The 2001 General Assembly added this definition and the 2002 General Assembly repealed it. It was added as part of the legislation that consolidated the taxes on telecommunications into a 6% State sales tax. It was repealed as part of the legislation setting out the sourcing principles for all telecommunications services. With the addition of the sourcing principles and the definition of place of primary use, this definition was no longer needed.

(Original definition effective January 1, 2002; HB 571, s. 1, S.L. 01-430; SB 748, s. 18(c), S.L. 01-476; repeal effective August 1, 2002; HB 1521, s. 3, S.L. 02-16.)

Soft drink – (40). This definition was added by the 2001 legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The definition matches the definition of soft drink set out in that Agreement. The definition differs from the definition of soft drink that applied in the repealed soft drink excise tax previously imposed under Article 2B of Chapter 105.

This definition was enacted so that soft drinks can be identified and taxed differently from other types of food, if the General Assembly chooses to do so. The General Assembly has not changed the taxation of soft drinks.

(Effective January 1, 2002; SB 144, ss. 2.2 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

Sport or recreational equipment – (42). This definition was added to implement the sales tax holiday set out in new G.S. 105-164.13C. During the holiday, certain clothing is exempt from State and local sales and use taxes but sport or recreational equipment is subject to tax. The definition of sport or recreational equipment matches the definition of the term set out in the national Streamlined Sales Tax Agreement. The Agreement definition contains an exhaustive list of items that are included in the definition. The Department will administer this definition in accordance with that list of items.

(Effective January 1, 2002; SB 748, s. 18, S.L. 01-476.)

Telecommunications service – (48). This definition was added by the 2001 legislation that consolidated the taxes on telecommunications into a 6% State sales tax. The definition mirrors the federal definition of this term. As defined, telecommunications service is the transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points, by or through any electronic, radio, satellite, optical, microwave, or other medium regardless of the protocol used for the transmission, conveyance, or routing.

(Effective January 1, 2002; HB 571, s. 1, S.L. 01-430; SB 748, s. 18(c), S.L. 01-476.)

Use – (49). The 2001 General Assembly amended this definition to add "distribution" to the list of activities that constitute "use" for sales and use tax purposes. This addition is a change from prior law. The change brings North Carolina law in line with the United States Supreme Court decision in the case of *D.H. Holmes.* Under the rewritten definition, use tax is due when an in-state retailer contracts with an out-of-state printer to print catalogues or other material and mail the material directly from the printer's place of business to customers of the retailer in North Carolina.

(Effective January 1, 2002; SB 144, ss. 2.6 and 3.2, S.L. 01-347; SB 748, s. 18(c), S.L. 01-476.)

G.S. 105-164.4 – Increases in State Tax Rate and Base: The 2001 General Assembly made numerous amendments to this section, effective January 1, 2002, that either changed the sales tax rate on an item or expanded the State sales tax base to include items that were not previously subject to tax. The 2002 General Assembly amended one subdivision in this section. These changes and their effective dates are as follows.

G.S. 105-164.4(a) - Temporary Increase in State Rate in Effect. The temporary State sales tax increase enacted by the 2001 General Assembly is in effect for calendar year 2002. The State sales tax rate for 2002 is 41/2%. This rate expires June 30, 2003.

(SB 1005, s. 34.13, S.L. 01-424)

G.S. 105-164.4(a)(1f)b. and (1g) - Electricity Sold to Manufacturers. The 2001 General Assembly repealed subpart (a)(1f)b. and replaced it with subdivision (a)(1g), which sets out a new method of taxing electricity sold to manufacturers. Under the new method, the tax rate that applies is set for each fiscal year beginning July 1, and the rate varies among manufacturers based on the megawatt hours of electricity used by each manufacturer in the preceding calendar year.

One rate table applies to the period January 1, 2002, through June 30, 2005, and another rate table applies to periods beginning July 1, 2005. The rate table in effect in 2002 is as follows:

January 1, 2002, through June 30, 2005

Previous Year's Megawatt Hours	*Rate*
900,000 or less	2.83%
Over 900,000	0.17%

A retailer of electricity must determine the amount of electricity used by each manufacturer during each calendar year and notify the manufacturer of the rate that will be in effect for the fiscal year. If a manufacturer has not been in business long enough to have a year's data to use to set the rate, the retailer must estimate the manufacturer's volume of electricity purchases for the coming fiscal year and set a rate based on the estimate.

At the end of a fiscal year, if a manufacturer's volume of electricity purchased for that year is not in the proper category based on the tax rate paid, the manufacturer makes a "true-up" adjustment. If the manufacturer's actual volume entitles the manufacturer to a lower rate than the rate paid, the manufacturer can apply to the Department for a refund. If the reverse is the case and the manufacturer's actual volume subjects the manufacturer to a higher rate than the rate paid, the manufacturer must remit to the Department the difference between the amount paid and the amount due at the higher rate.

(Effective January 1, 2002, SB 748, s. 17, S.L. 01-476 and HB 338, s. 122, S.L. 01-487)

G.S. 105-164.4(a)(4a) – Local Telecommunications Service Removed. The 2001 General Assembly amended this subdivision to delete local telecommunications service from the imposition of the State 3% rate of tax, to delete the reference to the term "utility," and to delete the sales tax exemption for receipts from service provided by means of public coin-operated pay telephone instruments. These provisions were removed as part of the comprehensive revision and simplification of the taxes on telecommunications. Telecommunications are now taxed under G.S. 105-164.4(a)(4c) and G.S. 105-164.4B. As amended, this subdivision applies only to sales of electricity.

(Effective January 1, 2002; HB 571, s. 3, S.L. 01-430.)

G.S. 105-164.4(a)(4c) – 6% Rate on Telecommunications Service. The 2001 General Assembly amended this subdivision to apply to all telecommunications service and to impose a 6% State sales tax on the gross receipts derived from providing telecommunications service. The amendments were made as part of the comprehensive revision and simplification of telecommunications taxes.

Before the amendments, the subdivision applied only to intrastate long distance telephone calls and imposed a 6½% rate on these calls.

The Department of Revenue recommended to the General Assembly that all telecommunications service be taxed at the same rate. The Department made this recommendation due to the difficulties in administering the various taxes on telecommunications and the inequity of taxing some calls, such as intrastate long distance, at 6½% and exempting other calls, such as interstate long distance. Under prior law, local calls were taxed under a 3.22% franchise tax in G.S. 105-120 and a 3% sales tax in G.S. 105-164.4(a)(4a), and intrastate long distance was taxed under this subdivision at 6½%.

The legislation recommended by the Department set the rate at 4½%. The 4½% rate was enacted and was then increased to 6% by a subsequent act of the General Assembly. The 6% rate was a recommendation of the North Carolina Efficiency and Loophole-Closing Commission. That Commission, co-chaired by former Governors Jim Holshouser and Bob Scott and former State Treasurer Harlan Boyles, joined the Department in recommending that all telecommunications services be taxed at a uniform rate. The Commission recommended a rate of 6% and the General Assembly followed that recommendation.

(Effective January 1, 2002; HB 571, s. 4, S.L. 01-430; SB 1005, ss. 34.25(a) and (c), S.L. 01-424; HB 338, ss. 67(b) and (f), S.L. 01-487.)

G.S. 105-164.4(a)(4d) – Prepaid Telephone Calling Service. The 2001 General Assembly added this subdivision to impose sales and use tax at the general State rate on the sale of prepaid telephone calling arrangements. The 2002 General Assembly amended this subdivision to replace the term “prepaid telephone calling arrangement” with “prepared telephone calling service” and to remove the sourcing rules for this service from this subdivision and substitute a cross-reference to the new section that sets out the sourcing rules for this service. The 2002 changes do not change the scope of this service or how it is sourced and taxed.

Under this subdivision, prepaid telephone calling service is taxed at the point of sale as tangible personal property rather than as a telecommunications service as calls are made. The tax applies regardless of whether any tangible personal property, such as a card or a telephone, is transferred at the time of sale. Point of sale taxation of prepaid telephone cards is much simpler for retailers to administer. These cards are often sold at drug stores, grocery stores, and discount department stores, for example, along with many other items of tangible personal property.

(Subdivision effective January 1, 2002; HB 571, s. 5, S.L. 01-430; 2002 amendment effective August 1, 2002; HB 1521, s. 4, S.L. 02-16.)

G.S. 105-164.4(a)(7) – Direct-to-Home Satellite Service. The 2001 General Assembly amended this subdivision, effective January 1, 2002, to impose a 5% State sales tax on the gross receipts derived from providing direct-to-home satellite service to subscribers in this State. A person engaged in the business of providing this service is considered to be a retailer.

The enactment of this tax is one of the recommendations of the North Carolina Efficiency and Loophole-Closing Commission. That Commission, co-chaired by former Governors Jim Holshouser and Bob Scott and former State Treasurer Harlan Boyles, recommended that amusements that compete with each other be taxed equally. The Commission's report notes that cable television is subject to a 5% local franchise tax and that direct-to-home TV services are not subject to a similar local or State tax. The 5% State tax rate is intended to equalize the tax treatment between cable and direct-to-home TV services. The tax is a State tax and is not made part of the local sales tax base because all of the current tax on cable TV service is a local tax and is retained by the units of local government.

(Effective January 1, 2002; SB 1005, s. 34.17, S.L. 01-424.)

G.S. 105-164.4B – General Sourcing Principles: The 2001 General Assembly added this section, effective January 1, 2002, as part of the legislation bringing North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. The 2002 General Assembly amended this section for the same reason. The Agreement establishes uniform sourcing rules that all member states must follow. "Sourcing" refers to the procedure by which a determination is made of the jurisdiction in which a transaction is subject to tax. The sourcing principles in the Agreement are destination based as opposed to origin based.

The section describes various circumstances under which a transaction can be made and specifies where that transaction is subject to tax. An over-the-counter sale is sourced to the seller's business location. When a product is received at a location specified by the purchaser and the location is not the business location of the seller, the sale is sourced to the location where the purchaser receives the product.

The 2002 amendment establishes a default rule for prepaid telephone calling service that authorizes the purchase of mobile telecommunications service. If the authorization for the purchase was not obtained through delivery of a tangible product and the seller does not know the home or business address of the buyer, a call made using that authorization is sourced based on the location associated with the mobile telecommunications number.

Prepaid telephone calling service is taxed as tangible personal property rather than as a telecommunications service. This section therefore governs the sourcing of prepaid telephone calling service. G.S. 105-164.4C sets out the sourcing rules for all telecommunications services, except prepaid telephone calling service.

(Section effective January 1, 2002; SB 144, ss. 2.9 and 3.2, S.L. 01-347; 2002 amendment effective August 1, 2002; HB 1521, s. 5, S.L. 02-16.)

G.S. 105-164.4C – Scope of Tax on Telecommunications Service: The 2001 General Assembly added this section, effective January 1, 2002, as part of the legislation reforming the taxes on telecommunications. The section sets out the scope of the 6% tax imposed by G.S. 105-164.4(a)(4c) on telecommunications service, specifies how bundled telecommunications services and interstate private lines are to be taxed, and sets a cap on the tax payable by certain call centers. The 2002 General Assembly amended this section to establish the sourcing principles for all types of telecommunications services. The sourcing principles conform to the requirements for mobile telecommunications set out in the federal Mobile Telecommunications Sourcing Act and to the standards for other types of telecommunications services set out in the national Streamlined Sales Tax Agreement.

Scope. Subsection (a) specifies that the tax applies to the gross receipts derived from providing telecommunications service in this State and refers to the sourcing principles to determine when service is provided in this State. As enacted in the 2001 legislation, the subsection contained a sourcing rule for mobile telecommunications service but no other telecommunications service. The 2002 General Assembly changed the sourcing rule for mobile telecommunications service and moved it to new subsection (a2).

Sourcing. Subsection (a1), added by the 2002 General Assembly, sets out the general sourcing rules for telecommunications services. Exceptions to these general rules are set out in new subsection (a2). The general rules apply to flat rate, general call-by-call, and postpaid services. Flat rate service is sourced to North Carolina if the place of primary use -- the address of the residence or business-- is in this State. Traditional local service is an example of a flat rate service.

General call-by-call service is sourced to North Carolina if the call both originates and terminates in North Carolina or either originates or terminates in the State and the equipment to which the call is charged is located in the State. For call-by-call service the price of the service depends on the length of each call. Traditional long-distance service over land lines is an example of a general call-by-call service.

Postpaid service is sourced to North Carolina in accordance with one of two methods, at the election of the seller of the service, until January 1, 2004. One method is to use the call-by-call principles. The other method is to use the origination point of the service, as first identified by seller. Effective January 1, 2004, all postpaid telecommunications service must be sourced in accordance with the second method – the origination point of the service. The first method is allowed as an option for two years to give the industry time to conform to the standard. Postpaid calling service is a type of call-by-call service. A credit card call made from a phone booth to a hotel is an example of a postpaid service.

Sourcing Exceptions. Subsection (a2), added by the 2002 General Assembly, lists the types of telecommunications services that are exceptions to the general sourcing principles in subsection (a1). Three types of service do not follow the general sourcing rules. They are mobile telecommunications service, prepaid telephone calling service, and private telecommunications service. The subsection sets out the sourcing rule for mobile telecommunications and makes a cross-reference to the sourcing principles that apply to the other two services.

Under the subsection, mobile telecommunications service is sourced to the place of primary use – the address of the residence or business where the service is primarily used. This differs from the prior sourcing rule for mobile telecommunications service, which required a mobile call to either originate or terminate in the State to be sourced to the State. Under the new rule, a mobile call made in Texas to a person in New York by an individual who lives in North Carolina and takes a trip to Texas would be sourced to North Carolina because the individual's residential address in this State is the place of primary use. Under the prior law, the call would not be sourced to this State because it did not originate or terminate in this State.

There are two exceptions to the sourcing of mobile telecommunications. One is for mobile telecommunications service that is authorized by a prepaid calling service. These mobile calls are sourced as a prepaid calling service. The other is for mobile telecommunications service that is authorized by air-to-ground radiotelephone service. These calls, such as calls made while on an airplane, are sourced as a postpaid service.

Items Included in Gross Receipts. Subsection (b) lists items that are included in gross receipts. As enacted by the 2001 General Assembly, the list of items in subdivision (b)(1) considered to be gross receipts included receipts from local, intrastate, interstate, toll, and private telecommunications. This expanded the telecommunications tax to include interstate calls and to make the tax apply uniformly to the various types of telecommunications services.

The 2002 General Assembly amended this subdivision to delete the references to local, intrastate, interstate, and toll telecommunications and to substitute references to flat rate service and call-by call service. These changes were made to apply the new definitions of those terms. The changes are conforming and not substantive. The categorization of calls as local, intrastate, interstate, and toll and the definitions of these terms were outdated and were replaced by modern terminology.

Receipts from some of the services listed in subdivision (b)(2) were taxable under prior law and some were not. Receipts from charges for directory assistance were not taxable. Receipts from charges for directory listings and the other services listed in that subdivision were taxable when they were associated with local telecommunications service but not when they were associated with toll telecommunications service. The receipts from access charges listed in subdivision (b)(3) and pay telephone providers listed in subdivision (b)(4) were not taxable under prior law. Receipts from charges to pay telephone providers are now included because their receipts are excluded under subsection (c).

Items Excluded from Gross Receipts. Subsection (c) lists items that are excluded from gross receipts. As enacted by the 2001 General Assembly, the list included receipts from a prepaid calling arrangement. The 2002 General Assembly amended subdivision (c)(2) of this subsection to delete the reference to prepaid calling arrangement and substitute a reference to prepaid calling service. This is a conforming change that applies the revised definition set out in G.S. 105-164.3(27) and does not change the substance of the law.

All of the items listed in this subsection were excluded from tax under prior law, except the items listed in subdivisions (c)(2) and (c)(7). Subdivision (c)(2) excludes from tax the receipts from services derived from the use of a prepaid calling card or another prepaid calling service because these services are taxed at the point of sale under G.S. 105-164.4(a)(4d) and G.S. 105-164.4B as tangible personal property. Subdivision (c)(7) excludes receipts from paging services only if the service is a one-way communication. Under prior law, all receipts from paging services were exempt because the transmission was not considered to be “telephonic quality” under the definitions in former G.S. 105-120. Under subdivision (c)(7), receipts from two-paging services are now taxable.

Bundled Services. Subsection (d) specifies how bundled telecommunications services are to be taxed. The 2002 General Assembly did not change this subsection. Prior law contained no provisions on how to tax bundled telecommunications service. A “bundled telecommunications service” is one that includes both taxable and nontaxable services. The subsection sets out two methods for taxation. If the provider of the bundled services offers all the services on an unbundled basis, tax applies to the proportionate price of the taxable services in the bundle. If the provider of the bundled services does not offer the services on an unbundled basis, tax applies to the taxable services included in the bundle based on a reasonable allocation of revenue to that service.

Private Line. Subsection (e) specifies how private telecommunications service is to be taxed. As enacted by the 2001 General Assembly, this subsection referred to interstate private lines and telecommunications service and set out the sourcing principles for receipts from private telecommunications service. The 2002 General Assembly deleted the word "interstate" before private line or private telecommunications service and modified the existing sourcing principles to make them easier to understand and to conform to the sourcing standards in the national Streamlined Sales Tax Agreement. Deletion of the word "interstate" is a conforming change and is not a substantive change.

Under the sourcing principles in the subsection, private telecommunications service that is billed on the basis of channel termination points are sourced on that basis and service that is billed on the basis of channel mileage is sourced on that basis. Charges based on termination points located in this State are sourced to this State. Charges based on channel mileage are sourced to this State if all the mileage is in this State. If the mileage crosses the State border, then 50% of the charges for mileage between a location in this State and a location in the other state are sourced to this State.

The 2002 revisions to the sourcing provisions restate the provisions enacted by the 2001 General Assembly and make one substantive change. The change is to add a sourcing rule in new subdivision (4) for receipts from services that are not billed on the basis of either channel termination points or channel mileage. This new subdivision becomes effective January 1, 2004. It sets out a percentage method for sourcing receipts that cannot be sourced under the other provisions.

Call Center Cap. Subsection (f) sets an annual cap on the tax on certain interstate telecommunications by a call center. The cap is $50,000. The cap applies only to a person that has a direct pay permit from the Department. G.S. 105-164.27A(b) describes the direct pay permit and who is eligible for the permit. The 2002 General Assembly did not change this subsection.

Credit. Subsection (g) states that a taxpayer who pays a tax legally imposed by another state on a taxable telecommunications service is allowed a credit against the North Carolina tax owed. The 2002 General Assembly did not change this subsection.

Definitions. Subsection (h) sets out definitions that apply to the section. As enacted by the 2001 General Assembly, the subsection contained definitions of interstate telecommunications service, intrastate telecommunications service, local telecommunications service, service address, and toll telecommunications service. The definitions of local telecommunications service, private telecommunications service, and toll telecommunications were derived from the definitions of these terms formerly contained in G.S. 105-120.

The 2002 General Assembly rewrote this section to delete outdated definitions and to replace those definitions with modern defined terms. The definitions of interstate telecommunications service, intrastate telecommunications service, local telecommunications service, service address, and toll telecommunications were deleted. Definitions of call-by-call basis and postpaid calling service were added.

As its name implies, "call-by-call basis" is a method of charging for a telecommunications service whereby the price is measured by each call. A "postpaid calling service" is a type of telecommunications service that is charged on a call-by-call basis and is paid for at the time of the call by a credit card or a similar payment mechanism or by billing the call to a telephone number that is not associated with the call.

Cross-references were added to definitions of place of primary use and prepaid telephone calling service. The term "place of primary use" replaces the term "service address." The definitions of call center, mobile telecommunications service, and telecommunications service were renumbered but their substance.

(Section effective January 1, 2002; HB 571, s. 6, S.L. 01-430; HB 338. ss. 67(a), (c), and (f) and s. 69, S.L. 01-487; all 2002 changes except future postpaid and private service sourcing changes effective August 1, 2002; HB 1521, ss. 5 through 14, S.L. 02-16; future sourcing changes effective January 1, 2004, HB 1521, ss. 10 and 14, S.L. 02-16.)

G.S. 105-164.6(a)(1) – Conforming Change: The 2001 General Assembly amended this subdivision, effective January 1, 2002, to delete the term "cost price" and substitute the term "purchase price." Other legislation in the 2001 Session enacted a new definition of "purchase price" in G.S. 105-164.3, and the new definition of "purchase price" replaces the prior definition of "cost price." The two terms have the same meaning. This change also makes the language of G.S. 105-164.6(a)(1) consistent with the language in G.S. 105-164.6(b). Even before the addition of the term "purchase price," G.S. 105-164.6(a)(1) used the term "cost price" and G.S. 105-164.6(b) used the term "purchase price."

(Effective January 1, 2002; SB 165, ss. 15 and 53, S.L. 01-414.)

G.S. 105-164.8 – Retailers Must Collect Tax for Destination County: The 2001 General Assembly made several changes to this section, effective January 1, 2002, to impose a requirement on retailers to collect local use taxes. The change prevents any erosion in collections as a result of the switch from origin-based sourcing to destination-based sourcing in accordance with the sourcing principles set out in G.S. 105-164.4B and applied to local sales and use taxes in G.S. 105-467(c).

The catchline of this section was rewritten to eliminate the reference to the place where a sale is consummated, headings were added to subsections (a) and (b), and subsection (c) was added to set out the new requirement. Under new subsection (c), a retailer that is required to collect the State tax is required to collect a local use tax if a local sales tax does not apply to a transaction. For example, if a sale is sourced to a county where a purchaser receives a product and that county is different from the county where the retailer is located, the retailer must collect the use tax due for the destination county if the retailer is liable for collecting State sales or use tax on the transaction.

(Effective January 1, 2002; SB 144, ss. 2.10 and 3.2, S.L. 01-347.)

G.S. 105-164.12 – Repealed: The 2001 General Assembly repealed this statute, effective January 1, 2002. It provided an exclusion from sales tax for transportation charges when the title to the property passed to the purchaser at the point of origin. Under the statute, delivery charges by a retailer who delivered merchandise in the retailer's trucks were subject to tax, and delivery charges by a retailer who used a common carrier to deliver the merchandise were not subject to tax. The statute was repealed so that the State could adopt and apply the definition of delivery charges set out in the national Streamlined Sales Tax Agreement. As a result of the repeal, all freight, delivery, or transportation charges made in connection with a taxable sale are subject to sales or use tax no matter where title to the property is transferred.

(Effective January 1, 2002; SB 144, s. 2.11 and 3.2, S.L. 01-347.)

G.S. 105-164.12B – Conforming Change: The 2001 General Assembly amended subpart (a)(3)b. and subsection (f) of this section, effective January 1, 2002, to delete the term "cost price" and substitute the term "purchase price." Other legislation in the 2001 Session enacted a new definition of "purchase price" in G.S. 105-164.3, and the new definition of "purchase price" replaces the prior definition of "cost price." The two terms have the same meaning. This change also makes the language of the statutes consistent. Even before the addition of the term "purchase price," some statutes, such as this section, used the term "cost price" and others, such as G.S. 105-164.6(b), used the term "purchase price."

(Effective January 1, 2002; SB 165, ss. 16, 17, and 53, S.L. 01-414.)

G.S. 105-164.13 – Changes to Exemptions: The 2001 General Assembly added several new subdivisions to this section and expanded one of the existing exemptions, effective in 2002. The 2002 General Assembly modified the exemption in subdivision (2a). These changes and their effective dates are as follows:

Commercial Fertilizer, Lime, Land Plaster, and Seeds – (1). The 2001 General Assembly amended this subdivision to limit the exemption for sales of commercial fertilizer to sales of these items to a farmer for agricultural purposes, to incorporate the exemption in repealed G.S. 105-164.13(2) for seeds, and to limit the exemption for seeds to seeds sold to a farmer for agricultural purposes. The changes do not affect the scope of the exemption for lime or land plaster; sales of these items were already exempt only when made for agricultural purposes.

The revisions delete the description of commercial fertilizer as commercial fertilizer "on which the inspection tax is paid." This deletion has no effect on the number of fertilizers that are exempt, however, because G.S. 106-671 imposes an inspection tax on all commercial fertilizer sold in a quantity (more than 5 lbs.) that would be purchased by a farmer for agricultural purposes. The Department of Revenue applies the definition of "commercial fertilizer" in G.S. 106-657 in administering this exemption.

Under prior law, the exemption for commercial fertilizer and seeds applied to whomever the product was sold. The narrowing of the exemption for commercial fertilizer and seeds was one of the recommendations of the North Carolina Efficiency and Loophole-Closing Commission. That Commission, co-chaired by former Governors Jim Holshouser and Bob Scott and former State Treasurer Harlan Boyles, recommended the elimination of the tax preference of not charging the combined State and local sales and use tax rate (then 6%) on fertilizers and seeds purchased by non-farmers. The Commission's report notes that an increasing volume of fertilizers and seeds are purchased for residential use or other non-agricultural uses such as for golf courses or landscaping.

(Effective February 1, 2002, HB 688, ss. 1 and 4, S.L. 01-514.)

Seeds - (2). The 2001 General Assembly repealed this subdivision. An exemption for seeds sold to farmers is preserved in rewritten G.S. 105-164.13(1). See the discussion of the exemption for commercial fertilizer, lime, land plaster, and seeds above for an explanation of why this exemption was revised.

(Effective February 1, 2002, HB 688, ss. 1 and 4, S.L. 01-514.)

Agricultural Substances – (2a). The 2002 General Assembly amended this subdivision to clarify that the exemption set out in the subdivision for certain substances purchased for use on animals or plants held or produced for commercial purposes does not apply to equipment or devices used to administer, release, apply, or otherwise dispense those substances.

The Department of Revenue recommended this change in the wake of the 2001 North Carolina Court of Appeals decision in *American Ripener Company v. Secretary of Revenue*. In that case, the Court upheld the application of the exemption to a generator used to apply a substance. The exemption was not intended to apply to equipment, however, and the Department has never extended it to include equipment. Numerous other exemptions and preferential rates in the sales tax laws apply specifically to agricultural equipment.

(Effective October 31, 2002; SB 1161, s. 9, S.L. 02-184.)

Newspapers Sold in Vending Machines – (28). The 2001 General Assembly expanded this exemption to include all sales of newspapers made by means of a vending machine. Under prior law, some sales of newspapers made by means of a vending machine were exempt and some were not. The prior exemption for vending machine sales depended on whether the vending machine could be characterized as a “street vendor.”

The prior exemption did not specifically address sales of newspapers in vending machines. The exemption applied to newspapers sold by “street vendors” and to newspapers delivered door-to-door. The Department construed the term “street vendor” to include a vending machine located in a public area that was comparable to a street and to exclude a vending machine located on the premises of a private business. The term “vending machine” includes a newspaper rack in which the buyer drops coins to get a newspaper.

(Effective January 1, 2002, SB 400, S.L. 01-509.)

Deposits on Containers – (47). This subdivision sets out an exemption for an item that was formerly excluded from tax in the language of the definition of sales price. The item is amounts charged as deposits on returnable containers. Although this exemption subdivision is new, the law on this subject has not changed. See the discussion of the definition of sales price in G.S. 105-164.3 for an explanation of why this change was made.

(Effective January 1, 2002; SB 144, ss. 2.12 and 3.2, S.L. 01-347.)

Deposits on Replacement Parts – (48). This subdivision sets out an exemption for an item that was formerly excluded from tax in the language of the definition of sales price. The item is amounts charged as deposits on certain replacement parts. Although this exemption subdivision is new, the law on this subject has not changed. See the discussion of the definition of sales price in G.S. 105-164.3 for an explanation of why this change was made.

(Effective January 1, 2002; SB 144, ss. 2.12 and 3.2, S.L. 01-347.)

Installation Charges – (49). This subdivision sets out an exemption for an item that was formerly excluded from tax in the language of the definition of sales price. The item is amounts that are charged for installation and are separately stated. Although this exemption subdivision is new, the law on this subject has not changed. See the discussion of the definition of sales price in G.S. 105-164.3 for an explanation of why this change was made.

(Effective January 1, 2002; SB 144, ss. 2.12 and 3.2, S.L. 01-347.)

Vending Receipts – (50). This subdivision sets out a partial exemption for certain vending receipts that were formerly excluded from tax in the language of the definition of sales price. Under prior law, the definition of sales price excluded from tax 50% of the sales price of tangible personal property sold through vending machines, except for closed container soft drinks and tobacco products. Although this exemption subdivision is new, the law on this subject has not changed. See the discussion of the definition of sales price in G.S. 105-164.3 for an explanation of why this change was made.

(Effective January 1, 2002; SB 144, ss. 2.12 and 3.2, S.L. 01-347.)

G.S. 105-164.13B – Exemption for Certain Food: The 2001 General Assembly rewrote this section, effective January 1, 2002, to reflect the changes made in G.S. 105-164.13 to the definitions of “food” and “prepared food” and to apply the new definitions in that statute of “candy,” “dietary supplement,” “food sold through a vending machine,” and “soft drink.” See the discussion of those definitions for an explanation of why they were changed. Food is exempt from State tax unless it is set out in either subdivisions (1) or (2) of this statute. Food remains subject to the 2% local sales and use taxes, but is not subject to the ½% Mecklenburg Public Transit Tax or the additional ½% local sales and use taxes authorized to take effect on or after December 1, 2002.

Subdivision (1) lists three types of food that are subject to State tax regardless of where they are sold or the purpose for which they are sold. These three types are alcoholic beverages, dietary supplements, and food sold through a vending machine. These types were all subject to tax under prior law, so subdivision (1) makes no changes with respect to the application of State sales tax to these three types of food.

Subdivision (2) lists three types of food that are subject to State tax unless they are purchased for home consumption and would be exempt if purchased under the federal Food Stamp program. The three types are “candy,” “prepared food,” and “soft drinks.” These types were all subject to tax under the same circumstances under prior law, so subdivision (2) makes no changes with respect to the application of State sales tax to these three types of food.

Subdivision (2), however, does not list every type of food that was subject to tax under prior law when it was not sold for home consumption and eligible to be purchased with food stamps. As a result, a few items that were taxable under prior law are exempt under the revised law. The items that moved from taxable to non-taxable are miscellaneous food items such as crackers and peanuts sold at a gas station or by another seller who is not eligible to accept food stamps.

(Effective January 1, 2002; SB 144, s. 2.13, S.L. 01-347; HB 748, s. 3., S.L. 01-489.)

G.S. 105-164.13C – Sales Tax Holiday: The 2001 General Assembly enacted this section to provide an exemption for certain items of tangible personal property sold between 12:01 A.M. on the first Friday in August and 11:59 P.M. the following Sunday. When the exemption was discussed at the General Assembly, the holiday was described as a back-to-school sales tax holiday. The State had its first "sales tax holiday" in August of 2002.

The holiday applies to the following:

- Clothing with a sales price of $100 or less per item.
- School supplies with a sales price of $100 or less per item.
- Computers, printers and printer supplies, and educational software with a sales price of $3,500 or less per item.
- Sport or recreational equipment with a sales price of $50 or less per item.

The exemption does not apply to clothing accessories or equipment, protective equipment, furniture, layaway transactions, items used in a trade or business, or rentals.

(Effective January 1, 2002; SB 1005, s. 34.16, S.L. 01-424 and SB 748, ss. 18(b) and (c), S.L. 01-476.)

G.S. 105-164.16 – Filing Changes for Semimonthly and Quarterly Taxpayers: The 2001 General Assembly amended this section in four separate acts, all of which were effective January 1, 2002. The 2002 General Assembly amended subsections (b) and (b2) of this section, effective October 1, 2002, to change the due date for quarterly returns and to modify the penalty provisions for underpayments by semimonthly taxpayers.

This explanation includes the substantive changes made by the 2001 acts, effective January 1, 2002. It does not include the conforming and technical changes made by those acts. The 2001 Tax Law Changes document includes an explanation of those changes.

Quarterly Returns Due the Last Day of the Month. The 2002 General Assembly changed the due date for quarterly returns from the 15th day of the month following the end of the quarter to the last day of the month. The change is effective October 1, 2002, and applies to taxes collected for the last quarter in 2002. The quarterly return that covers the period October 1, 2002, through December 31, 2002, is therefore due by January 31, 2003 instead of January 15, 2003.

The General Assembly made this change at the recommendation of the Department of Revenue. The Department recommended this change to reduce the volume of all tax returns received on the 15th of each month and to make the due date for quarterly sales tax filers the same as for quarterly withholding tax filers. The change in the due date spreads the processing work of the Department more evenly throughout the month. About 91,000 taxpayers file sales tax returns on a quarterly basis.

On*e Monthly Return for Semimonthly Taxpayers.* The 2001 General Assembly changed the requirements concerning returns filed by semimonthly taxpayers to bring North Carolina law closer to the standards that must be met to comply with the national Streamlined Sales Tax Agreement. Under that Agreement, a state cannot require a taxpayer to file a return more than once a month. Accordingly, this statute was rewritten to delete the requirement that a semimonthly taxpayer file a return twice a month and to substitute a requirement that a semimonthly taxpayer make an electronic funds transfer (EFT) payment twice a month and file a return once a month. This change separates the requirement to make payments from the requirement to file a return and reduces the compliance burden for retailers. A return includes the city and county breakdowns used to distribute local sales and use tax revenue and other information concerning the tax collected for a filing period.

Prior law required semimonthly taxpayers to file a return and make an EFT payment on the 10th and 25th of each month and allowed them to make estimates for these two returns and payments and then file a reconciling return and payment on the 20th of a month. If a taxpayer chose to file a reconciling return, no penalties were assessed for an underpayment if the underpayment did not exceed 10% of the tax due for the two filing periods covered by the reconciling return.

The revised law requires two EFT payments each month and one return. The EFT payments are due on the same dates as under the prior law – on the 10th and 25th of a month – and a return is due on the 20th of a month. The option of the reconciling return is eliminated because it is not needed.

Penalty for Underpayments by Semimonthly Taxpayers. The 2001 General Assembly changed the threshold for penalties for underpayments by semimonthly taxpayers. It increased the threshold from 90% to 95%. It did this to match the underpayment penalty provisions for franchise tax payments made under G.S. 105-116 and piped natural gas excise tax payments made under 105-187.43. To avoid a penalty, a taxpayer must pay at least 95%, rather than 90%, of the amount due on an EFT payment date and pay the remainder with the return filed on the 20th.

The 2002 General Assembly refined the penalty provisions for semimonthly taxpayers in subsection (b2) to conform to the requirements of the national Streamlined Sales Tax Agreement. Under that Agreement, a state that requires a taxpayer to remit tax more than once a month must allow the taxpayer to base the remittance on a calculation method rather than actual collections.

The 2002 changes fulfill this requirement by allowing a taxpayer to base the remittance on its average semimonthly payment for the prior calendar year. The 2002 changes modify the penalty provisions so that a taxpayer is not subject to a penalty or interest on an underpayment if the amount paid is at least 95% of the amount due or the taxpayer's average semimonthly payment for the prior calendar year, whichever is less, and the taxpayer includes the underpayment with the monthly return.

$10,000 Semimonthly Payment Threshold. The 2001 General Assembly decreased the threshold for semimonthly taxpayers from $20,000 to $10,000. As a result, a taxpayer who is consistently liable for at least $10,000 a month in State and local sales and use taxes must pay the tax twice a month. Semimonthly payments must be made by electronic funds transfer and are due on the 10th and the 25th of each month. The purpose of lowering the threshold was to enable the State to receive more frequent payments from more taxpayers, thereby shifting the receipt of some tax revenue from the 2002-03 fiscal year into the end of the 2001-02 fiscal year.

Utilities Same as Other Retailers. The 2001 General Assembly deleted subsection (c) of this section, thereby eliminating the special reporting provisions that applied only to electric power companies and telecommunications companies. Under prior law, the semimonthly payment and reporting requirements did not apply to electric power companies and telecommunications companies. These companies filed returns and made payments on either a monthly or quarterly basis, regardless of the amount of tax remitted with the returns and payments. Under the revised law, these companies must follow the same reporting requirements as other retailers. As a result, most of these companies will pay sales tax on a semimonthly basis because they remit at least $10,000 a month in tax.

The payment and reporting requirements under prior law were designed to match the franchise tax payment and reporting requirements under G.S. 105-116 and G.S. 105-120. The 2001 General Assembly changed the reporting and payment requirements for electric power companies and telecommunications companies under both the franchise tax and the sales tax. These companies now pay sales tax and file sales tax returns on the same basis as other retailers and they pay their franchise tax on the same basis as their sales tax. The purpose of the revised payment schedule is to require more frequent payments, thereby shifting the receipt of some tax revenue from the 2002-03 fiscal year into the end of the 2001-02 fiscal year.

(Monthly return for semimonthly taxpayers effective January 1, 2002; SB 144, s. 2.14, S.L. 01-347; change in semimonthly threshold for all retailers and in payment schedule for utilities effective for filing periods beginning January 1, 2002; HB 232, s. 6(a), S.L. 01-427 and HB 571, s. 7, S.L. 01-430. The changes made by HB 571 were superseded by those made in House Bill 232. Penalty change for semimonthly taxpayers effective October 1, 2002, and applies to payments due on or after that date; SB 1161, s. 11, S.L. 02-184; quarterly filing date change effective October 1, 2002, and applies to taxes levied on or after that date; SB 1161, s. 10, S.L. 02-184.)

G.S. 105-164.20 – Conforming Change: The 2001 General Assembly amended this section to delete the reference to "utility" and replace it with a reference to a retailer of electricity or telecommunications service. This amendment was made because the definition of "utility" in G.S. 105-164.3(25) was repealed. The term "utility" applied only to a business entity that sold electricity or telecommunications service. Therefore, the elimination of the term "utility" does not change the meaning of this section.

(Effective January 1, 2002; HB 571, s. 8, S.L. 01-430.)

G.S. 105-164.23 – Conforming and Technical Changes: The 2001 General Assembly amended this section to delete the term "cost price" and substitute the term "purchase price." That legislation, however, inadvertently left a reference to "cost price" in the section. The 2002 General Assembly amended this section to remove this reference to "cost price" and substitute a reference to "purchase price." It also made technical changes to the wording of the section to make the language of the section gender neutral.

Other legislation in the 2001 Session enacted a new definition of "purchase price" in G.S. 105-164.3 to replace the definition of "cost price." The two terms have the same meaning.

The 2001 change was made to make the language of the statutes consistent. Before the change, some statutes, such as G.S. 105-164.6(b), used the term "purchase price" and others, such as this section, used the term "cost price" to mean the same thing.

(2001 changes effective January 1, 2002; SB 165, ss. 18 and 53, S.L. 01-414; 2002 changes effective August 12, 2002, SB 1160, ss. 17 and 22, S.L. 02-72.)

G.S. 105-164.27A –Direct Pay Permit for Call Centers: The 2001 General Assembly rewrote this section, effective January 1, 2002, to add a direct pay permit for call centers to use for their purchases of telecommunications service and to make a technical change. The 2002 General Assembly amended subsection (b) of this section to correct a drafting error made in the 2001 legislation that left part of a sentence that should have been deleted at the end of the subsection.

The 2001 legislation that added the new permit for call centers made several changes. It changed the designation of the permit from a direct pay certificate to a direct pay permit throughout the section, limited the scope of subsection (a) to a direct pay permit for tangible personal property, added the provisions on the direct pay permit for call centers in subsection (b), and rearranged the other subsections.

Rewritten subsection (a) applies to the direct pay permit that existed prior to the changes made to this section. That permit applies only to tangible personal property. The text of former subsection (c), which set out the effect of a direct pay permit for tangible personal property, was moved to subsection (a) and the heading to subsection (a) was changed to “Tangible Personal Property.” The provisions on the direct pay permit for tangible personal property were rearranged, but their meaning did not change.

Subsection (b) sets out the new direct pay permit for call centers that purchase interstate telecommunications service that originates outside this State and terminates inside this State. A call center is a business that is primarily engaged in providing support services to customers by telephone to support products or services of the business. At least 60% of the calls must be incoming for a business to be primarily engaged in providing support services by telephone.

A permit issued to a call center authorizes the call center to self accrue the sales tax due on its interstate telecommunications service. G.S. 105-164.4C sets an annual cap of $50,000 on the amount of tax payable by a call center on telecommunications service that originates outside this State and terminates inside this State. The permit applies to all telecommunications service provided to the call center, but the $50,000 annual cap applies only to in-coming interstate calls.

Subsection (c) contains the text of former subsection (b). The application provisions were moved so they would follow the two kinds of permits.

Subsection (d) was amended to make conforming changes concerning the new call center permit. The amendments deleted references to “certificate” and inserted references to “permit” and made stylistic changes.

(2001 legislation effective January 1, 2002, HB 571, s. 9, S.L. 01-430; 2002 legislation effective August 12, 2002, SB 1160, ss. 18 and 22, S.L. 02-72.)

G.S. 105-164.28A – Exemption Certificates: This new section authorizes the Secretary to require a person who purchases property that is exempt from tax or subject to a preferential rate of tax to obtain an exemption certificate from the Department to receive the exemption or preferential rate. This section does not apply to a direct pay permit or a certificate of resale because those certificates are addressed in other sections of the law.

The Department of Revenue recommended this addition to recognize in the statutes the practice of administering exemptions through certificates and to make it clear that the Department can establish an approval process for certificates. Before this addition, the statutes did not address exemption certificates except in G.S. 105-236(5a), which establishes a $250 penalty for misuse of an exemption certificate.

The following certificates fall within the category of exemption certificates under this section:

Form E-526	Logging or Pulpwood Certificate
Form E-558	Commercial Fisherman's Certificate
Form E-567	Veterinarian's Certificate
Form E-575	Manufacturer's Certificate
Form E-580	Contractor's and Subcontractor's Certificate
Form E-590	Certificate of Resale
Form E-599	Agricultural Certificate
Form E-599Y	Ice Certificate

(Effective October 31, 2002; SB 1161, s. 12, S.L. 02-184.)

G.S. 105-164.32 – Conforming Change: The 2002 General Assembly amended this section to delete the term "cost price" and substitute the term "purchase price." Other legislation in the 2001 Session enacted a new definition of "purchase price" in G.S. 105-164.3, and the new definition of "purchase price" replaces the prior definition of "cost price." The two terms have the same meaning. This change also makes the language of the statutes consistent. Even before the addition of the term "purchase price," some statutes, such as this section, used the term "cost price" and others, such as G.S. 105-164.6(b), used the term "purchase price" to mean the same thing.

(Effective January 1, 2002; SB 165, ss. 21 and 53, S.L. 01-414.)

G.S. 105-164.44F – Distribution of Telecommunications Taxes: The 2001 General Assembly enacted this section, effective January 1, 2002, to replace the quarterly distribution to cities of the franchise tax on local telecommunications service formerly made under repealed G.S. 105-120. The 2002 General Assembly added subsection (f) to specify the character of the revenue to be distributed under this section.

Method of Distribution. Under this section, the Secretary distributes to the cities 18.26% of the net proceeds of the taxes collected in a quarter, minus $2,620,948. This deduction is one-fourth of the annual “hold-back” from taxes imposed under former G.S. 105-120 and distributed under G.S. 105-116.1. The distribution is made quarterly. The first distribution under this section was made in June of 2002 for the quarter ending March 31, 2002.

The distribution is based on a combination of a per capita distribution and a distribution based on a fixed percentage share of the prior telephone franchise tax distribution, in contrast the source-based distribution under the prior franchise tax. As a result, this section simplifies the reporting requirements for providers of telecommunications service. These providers are no longer required to file city breakdowns with the Department of Revenue listing the receipts derived from service provided within the boundaries of each city.

Under this section, cities are divided into two categories. The first category, set out in subsections (b) and (d), consists of cities incorporated on or after January 1, 2001. This category includes cities served by telephone membership corporations, regardless of their actual date of incorporation. Cities served by telephone membership corporations are included in this category because the corporations were not subject to the franchise tax imposed by former G.S. 105-120 on providers of local telecommunications service. These cities therefore never received a distribution of franchise tax based on telecommunications service provided by a telephone membership corporation. Telephone membership corporations are subject to the tax imposed by G.S. 105-164.4(a)(4c), however.

Cities that are incorporated on or after January 1, 2001 receive a per capita share of part of the “pool” to be distributed. Their part of the “pool” is based on their percentage of the total population of all cities. If for example, their percentage of the total population of all cities is 8%, then they will receive a per capita share of 8% of the “pool.”

The second category, set out in subsection (c), consists of cities that were incorporated before January 1, 2001. These cities receive a proportionate share of part of the “pool” to be distributed. The amount of the “pool” to be distributed to these cities is the amount that is not distributed to the cities in the first category. For example, if 8% of the “pool” is to be distributed to the cities in the first category, then 92% of the “pool” is to be distributed to the cities in the second category.

The amount each individual city in the second category receives is based on the amount it last received under former G.S. 105-120 for the same quarter. All the cities incorporated before January 1, 2001 will have received a distribution under former G.S. 105-120 for every quarter of 2001.

A few cities are not entitled to a share. Subsection (e) describes the cities that are not eligible for a distribution.

Character of Revenue Distributed. New subsection (f) declares that the revenue distributed to cities under this section is local revenue rather than a State expenditure, and that the Governor may not reduce or withhold the distribution. Although this subsection prohibits the Governor from reducing or withholding the distribution, G.S. 143-25 authorizes the Governor to do so if the Governor has exhausted all other sources of revenue of the State, including surplus remaining in the treasury at the beginning of the fiscal period.
Article III, Section 5(3) of the North Carolina Constitution authorizes the Governor to "effect the necessary economies in State expenditures" if the Governor determines that the State will have a deficit in its budget without this action. New subsection (f) declares that the amount to be distributed to cities is not a State expenditure so that the Governor's authority under the Constitution will not extend to the revenue to be distributed to the cities. Although it is clear from this change that the General Assembly does not consider local distribution amounts to be an expenditure under the Constitution, the meaning of the Constitution is determined by the courts rather than the General Assembly.

The addition of this subsection is the result of the Governor's decision in the 01-02 fiscal year to withhold from cities and counties over $200 million in local reimbursements. The Governor took this action under the authority of Article III, Section 5(3) of the North Carolina Constitution. The Governor did not withhold any of the distribution under this section. The General Assembly amended every local distribution statute, however, to add this restriction on the Governor's authority.

(Section added effective January 1, 2002, HB 571, s. 10, S.L. 01-430; SB 1005. s. 34.25, S.L. 01-424; HB 388, ss. 67(d) and (f), S.L. 01-487; subsection (f) added effective September 24, 2002; HB 1490, s. 4, S.L. 02-120.)

Part 7A of Article 5 – Uniform Sales and Use Tax Administration Act: The 2001 General Assembly added this Part, entitled "Uniform Sales and Use Tax Administration Act," to Article 5 of Chapter 105 of the General Statutes, effective January 1, 2002. The Part consists of G.S. 105-164.42A through G.S. 105-164.42I. This Part was added by the legislation enacted to enable North Carolina to become a member of the national Streamlined Sales Tax Project. This Part enacts the Uniform Act proposed by that Project.

(Effective January 1, 2002; SB 144, s. 1.1, S.L. 01-347.)

G.S. 105-164.42A – Short Title: This section names new Part 7A of Article 5 the "Uniform Sales and Use Tax Administration Act."

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42B – Definitions of Uniform Act: This statute defines terms that are used throughout the Uniform Sales and Use Tax Administration Act. The defined terms are "Agreement," "certified automated system," "certified service provider," "member state," "person," "sales tax," "seller," "state," and "use tax." The term "Agreement" means the National Streamlined Sales and Use Tax Agreement. The other terms reflect existing definitions in the sales and use tax statutes.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42C – Authority for Entry: This statute authorizes the Secretary of Revenue to enter into the national Streamlined Sales and Use Tax Agreement with one or more other states. The purpose of the Agreement is to simplify and modernize sales and use tax administration in order to reduce substantially the burden of tax compliance for all sellers and all types of commerce. The statute designates the Secretary of Revenue as the person who is authorized to represent North Carolina in the Agreement.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42D – Relationship to State Law: This statute provides that nothing in the national Streamlined Sales and Use Tax Agreement amends or modifies any law of this State and that implementation of a condition of the Agreement must be approved by the General Assembly.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42E – Requirements of Agreement: This statute sets out the requirements the national Streamlined Sales and Use Tax Agreement must contain in order for North Carolina to become a member of the Agreement. These requirements include:

- Restrictions on the number of State sales and use tax rates.
- Restrictions on maximum amounts of tax due.
- Restrictions on price thresholds for application of tax.
- Uniform standards for sourcing, the administration of exempt sales, bad debt allowances, and returns and payments.
- Uniform definitions.
- A central, electronic registration system for participating sellers.

- A prohibition on attributing nexus to sellers based on their registration under the central system or their voluntary collection of sales and use tax.
- Restrictions on variances in state and local tax bases.
- State administration of local sales and use taxes.
- Restrictions on the frequency of changes in local sales and use tax rates.
- Standard effective dates for tax purposes for boundary changes in local jurisdictions.
- Uniform notice requirements for changes in local tax rates or boundaries.
- Uniform privacy policy for certified service providers.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42F – Cooperating Sovereigns: This statute explains the nature of the national Streamlined Sales and Use Tax Agreement. It states that the Agreement is an accord between member states that provides a mechanism for the member states to establish and maintain a simplified sales and use tax system under the laws of the member states. The Agreement is not a Compact.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42G – Effect of Agreement: This statute provides that North Carolina's entry into the national Streamlined Sales and Use Tax Agreement does not create a cause of action or a defense to an action.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.42H – Certified Automated System: This statute addresses one of the business models envisioned by the national Streamlined Sales and Use Tax Agreement. The model involves the use of a certified automated system in the collection of sales and use taxes.

G.S. 105-164.43A(a) was recodified as subsection (a) of this section with two conforming amendments and new subsection (b) was added. One of the conforming amendments to subsection (a) deletes the reference to a "certified sales tax collection program" and substitutes a reference to a "certified automated system" so that the statute applies the new defined term "certified automated system." The second conforming change inserts a reference to the statute, G.S. 105-164.4B, that sets out the sourcing principles in place of a reference to sourcing based on "ship-to" address. New subsection (b) sets out the liability of a seller that uses a certified automated system and of the provider of the certified automated system.

(Effective January 1, 2002; SB 144, ss. 1.1 and 1.3, S.L. 01-347.)

G.S. 105-164.42I – Contract with Certified Service Provider: This statute addresses one of the business models envisioned by the national Streamlined Sales and Use Tax Agreement. The model involves the use of a certified service provider in the collection of sales and use taxes.

G.S. 105-164.43A(b) was recodified as subsection (a) of this section with several conforming amendments, G.S. 105-164.43B was recodified as subsection (b) of this section with several conforming amendments, and the provisions of repealed G.S. 105-164.43C were incorporated into new subsections (c) and (d) of this statute. The conforming changes to subsections (a) and (b) apply the new defined terms of “certified automated system,” “certified service provider,” and “seller” set out in new G.S. 105-164.42B.

Subsections (c) and (d) repeat the provisions of former G.S. 105-164.43C. Subsection (c) sets out the liability of a certified service provider and of a seller that uses the certified service provider. Subsection (d) establishes the scope of an audit of a certified service provider and of a seller that uses a certified service provider and gives a state the authority to review a certified service provider’s system to determine its accuracy.

(Effective January 1, 2002; SB 144, ss. 1.1 and 1.3, S.L. 01-347.)

G.S. 105-164.42J – Performance Standards: This statute addresses one of the business models envisioned by the national Streamlined Sales and Use Tax Agreement. The model involves the use of a proprietary software system in the collection of sales and use taxes.

The model addressed in this statute affects sellers that use their own proprietary software to administer their sales and use tax functions, instead of using a certified service provider or a certified automated system, and are engaged in business in at least 10 states. The statute allows the Secretary to establish a performance standard for the seller’s proprietary system and to use the performance standard as the measure of the seller’s liability for sales and use taxes.

(Effective January 1, 2002; SB 144, s. 1.3, S.L. 01-347.)

G.S. 105-164.43A – Recodified: This statute was recodified in new Part 7A of Article 5. G.S. 105-164.43A(a) was recodified as G.S. 105-164.42H(a). . G.S. 105-164.43A(b) was recodified as G.S. 105-164.42I(a).

(Effective January 1, 2002; SB 144, s. 1.1, S.L. 01-347.)

G.S. 105-164.43B – Recodified: This statute was recodified in new Part 7A of Article 5. It was recodified as G.S. 105-164.42I(b).

(Effective January 1, 2002; SB 144, s. 1.1, S.L. 01-347.)

G.S. 105-164.43C – Repealed: This statute was repealed because its provisions are incorporated in new G.S. 105-164.42H and G.S. 105-164.42I in new Part 7A of Article 5.

(Effective January 1, 2002; SB 144, s. 1.2, S.L. 01-347.)

G.S. 105-164.44C – Repeal of Food Stamp Reimbursement Occurs Sooner: The 2001 General Assembly repealed the food stamp reimbursement, effective July 1, 2003. The 2002 General Assembly advanced the date of the scheduled repeal and made the repeal of the reimbursement effective July 1, 2002. The repeal of this reimbursement is part of the repeal of all local reimbursements and the replacement of these reimbursements with the authority given the counties in Article 44 of Subchapter VIII of Chapter 105 to levy additional ½% local sales and use taxes. The General Assembly advanced the date of the repeal of all the reimbursements to generate a revenue gain for the State of $333.4 million in fiscal year 2002-2003.

Before its repeal, the statute required the Department of Revenue to distribute annually to counties and cities the amount of tax revenue they "lost" as a result of the repeal of the sales tax on food purchased with food stamps. The amount distributed was based on the amount of revenue they did not receive in fiscal year 1989-90 due to the removal of food stamp food from the sales tax base. The 1989-90 amount was not indexed.

(Original repeal scheduled to become effective July 1, 2003; SB 1005, s. 34.15, S.L. 01-424; 2002 legislation advancing the date of the repeal to July 1, 2002 effective September 30, 2002, SB 1115, ss. 30A.1 and 30I, S.L. 02-126.)

G.S. 105-164.44F – Telecommunications Tax Distribution to Cities: This section was enacted to replace the quarterly distribution to cities of the franchise tax on local telecommunications service formerly made under repealed G.S. 105-120. This section directs the Secretary to distribute to the cities 18.26% of the net proceeds of the taxes collected in a quarter, minus $2,620,948. This deduction is one-fourth of the annual "hold-back" from taxes imposed under former G.S. 105-120 and distributed under G.S. 105-116.1. The distribution is to be made quarterly, so the first distribution under this section will be made in June of 2002 for the quarter ending March 31, 2002.

This section changes the method of distribution from a source-based distribution to a combination of a per capita distribution and a distribution based on a fixed percentage share of the prior telephone franchise tax distributions. As a result, this section simplifies the reporting requirements for providers of telecommunications service. These providers are no longer required to file city breakdowns with the Department of Revenue listing the receipts derived from service provided within the boundaries of each city.

Under this section, cities are divided into two categories. The first category, set out in subsections (b) and (d), consists of cities incorporated on or after January 1, 2001. This category includes cities served by telephone membership corporations, regardless of their actual date of incorporation. Cities served by telephone membership corporations are included in this category because the corporations were not subject to the franchise tax imposed by former G.S. 105-120 on providers of local telecommunications service. These cities therefore never received a distribution of franchise tax based on telecommunications service provided by a telephone membership corporation. Telephone membership corporations are subject to the tax imposed by G.S. 105-164.4(a)(4c), however.

Cities that are incorporated on or after January 1, 2001 receive a per capita share of part of the “pool” to be distributed. Their part of the “pool” is based on their percentage of the total population of all cities. If for example, their percentage of the total population of all cities is 8%, then they will receive a per capita share of 8% of the “pool.”

The second category, set out in subsection (c), consists of cities that were incorporated before January 1, 2001. These cities receive a proportionate share of part of the “pool” to be distributed. The amount of the “pool” to be distributed to these cities is the amount that is not distributed to the cities in the first category. For example, if 8% of the “pool” is to be distributed to the cities in the first category, then 92% of the “pool” is to be distributed to the cities in the second category.

The amount each individual city in the second category receives is based on the amount it last received under former G.S. 105-120 for the same quarter. All the cities incorporated before January 1, 2001 will have received a distribution under former G.S. 105-120 for every quarter of 2001.

Some cities are not entitled to a share. Subsection (e) describes the cities that are not eligible for a distribution.

(Effective January 1, 2002, HB 571, s. 10, S.L. 01-430; SB 1005. s. 34.25, S.L. 01-424; HB 338, ss. 67(d) and (f), S.L. 01-487.)

Subchapter VIII
Local Sales and Use Tax

Article 39 Name Change: The title of this Article was changed from "Local Government Sales and Use Tax" to "First One-Cent (1¢) Local Government Sales and Use Tax." The Article consists of G.S. 105-463 through G.S. 105-474.

(Effective September 26, 2002; SB 1292, s. 7(a), S.L. 02-123.)

G.S. 105-463 – Conforming Change: The name of Article 39, as set out in this section, was changed to conform to the new title of the Article. The General Assembly renamed the Article the "First One-Cent (1¢) Local Government Sales and Use Tax."

(Effective September 26, 2002; SB 1292, s. 7(b), S.L. 02-123.)

G.S. 105-466(c) – Uncodified Exceptions to Effective Date and Notice Requirements: The General Assembly enacted two exceptions to the requirements in this subsection. The first applies to the effective date of a tax. The second applies to the amount of notice a board of county commissioners must give the Department of Revenue before the Department begins to collect a tax on behalf of the county.

Under this subsection, the effective date of a local sales and use tax must be either January 1 or July 1. The General Assembly made an exception for the third one-half cent tax authorized by Article 44. It allowed that tax to become effective December 1, 2002.

Under this subsection, a county must give the Department of Revenue at least 90 days' advance notice of a tax levy. The General Assembly made an exception for the third one-half cent tax authorized by Article 44. It shortened the required notice to the Department to 30 days for taxes to become effective under that Article on either December 1, 2002, or January 1, 2003.

(Effective September 26, 2002; SB 1292, s. 3, S.L. 02-123.)

G.S. 105-467 – Scope and Sourcing of Local Tax: Five acts of the 2001 Session amended this section to make substantive, conforming, and technical changes, effective January 1, 2002, and one act of the 2002 General Assembly amended this section. The technical changes made by the 2001 General Assembly separate the section into subsections (a), (b), and (c) with the headings "Sales Tax," "Exemptions and Refunds," and "Sourcing" respectively, delete the sentence that followed the list of subdivisions in what is now subsection (a), and insert the same sentence before the list of subdivisions in subsection (a).

The substantive change made to this section by the 2001 General Assembly replaces origin-based sourcing with destination-based sourcing. Newly designated subsection (c) deletes the sentence that establishes the retailer's place of business as the situs of a transaction and adds a sentence stating that the sourcing principles in G.S. 105-164.4B apply in determining which local sales tax applies to a transaction. Under those principles, over-the-counter sales are sourced to the county of the location of the seller. For property that is shipped or delivered to a customer in another county, use tax for the destination county is due. A retailer that is required to collect State tax is required to collect the county use tax due for property that is shipped or delivered to a county other than the county in which the seller is located.

The change from origin-based sourcing to destination-based sourcing is one of the changes the General Assembly made to the sales and use tax laws to enable North Carolina to become a member of the national Streamlined Sales Tax Agreement. Under that Agreement, states must source both State and local sales and use taxes on a destination basis.

The conforming changes made by the 2001 General Assembly reflect changes made in the State sales and use tax laws. Subdivision (5) of newly designated subsection (a) was rewritten to match the revision of the State exemption for food in G.S. 105-164.13B. New subdivision (6) was added to include prepaid telephone calling arrangements in the local sales and use tax base. Newly designated subsection (b) was amended to add a reference to sales made during the new sales tax holiday set out in G.S. 105-164.13C. Sales made during the holiday are exempt from local sales and use taxes as well as State sales and use taxes.

The 2002 act made a conforming change in subdivision (b)(6) of this section. The change deletes the reference to "prepaid telephone calling arrangement" and substitutes a reference to "prepaid telephone calling service." This term was changed as part of the legislation establishing the sourcing principles for telecommunications. The term was revised to conform to the defined terms in the national Streamlined Sales Tax Agreement.

(2001 changes effective January 1, 2002; technical and sourcing changes set out in SB 144, s. 2.15, S.L. 01-347 and in HB 338, s. 67(e), S.L. 01-487; conforming change to subdivision (a)(5) set out in SB 165, ss. 29 and 53, S.L. 01-414; subdivision (a)(6) set out in HB 571, s. 13, S.L. 01-430; and change to subsection (b) set out in SB 1005, ss. 34.16(b) and (d), S.L. 01-424. 2002 change effective August 1, 2002, HB 1521, s. 12, S.L. 02-16.)

Article 40 Name Change: The title of this Article was changed from "Supplemental Local Government Sales and Use Taxes" to "First One-Half Cent (1/2¢) Local Government Sales and Use Tax." The Article consists of G.S. 105-480 through G.S. 105-487. The name was changed to enable this tax to be distinguished from the other ½ ¢ local taxes by its name.

(Effective September 26, 2002; SB 1292, s. 8(a), S.L. 02-123.)

G.S. 105-480 – Conforming Change: The name of Article 40, as set out in this section, was changed to conform to the new title of the Article. The General Assembly renamed the Article the "First One-Half Cent (1/2¢) Local Government Sales and Use Tax."

(Effective September 26, 2002; SB 1292, s. 8(b), S.L. 02-123.)

Article 42 Name Change: The title of this Article was changed from "Additional Supplemental Local Government Sales and Use Taxes" to "Second One-Half Cent (1/2¢) Local Government Sales and Use Tax." The Article consists of G.S. 105-495 through G.S. 105-502. The name was changed to enable this tax to be distinguished from the other ½ ¢ local taxes by its name.

(Effective September 26, 2002; SB 1292, s. 9(a), S.L. 02-123.)

G.S. 105-495 – Conforming Change: The name of Article 42, as set out in this section, was changed to conform to the new title of the Article. The General Assembly renamed the Article the "Second One-Half Cent (1/2¢) Local Government Sales and Use Tax."

(Effective September 26, 2002; SB 1292, s. 9(b), S.L. 02-123.)

G.S. 105-501 – Costs of Unauthorized Substance Tax Division Deducted: This section was amended to add another item that is deducted from the amount of second one-half cent local sales and use tax revenue collected by the Department before it is distributed to cities and counties. The amount deducted is retained by the State. The new deduction is for 70% of the costs during the preceding fiscal year of the Department's Unauthorized Substance Tax Division.

This change shifts 70% of the cost of administering the unauthorized substance tax to local governments. The General Assembly made this change because local law enforcement receives about 70% of the unauthorized substance tax revenue. Local governments receive the benefit of the tax revenue and now bear the cost of obtaining this revenue. The Department recommended this change.

G.S. 105-113.113(b) requires the Secretary to remit 75% of the unauthorized substance tax revenue to the law enforcement agency that conducted the investigation of a dealer that led to the assessment. Although most of the law enforcement agencies that receive revenue under this subsection are local law enforcement agencies, State law enforcement agencies occasionally receive funds under this subsection. Because local law enforcement agencies do not receive all of the revenue transferred to law enforcement agencies, the General Assembly required a deduction from sales tax revenue of only 70% of the cost of administering the tax rather than 75%.

One-fourth of the costs for the previous fiscal year are deducted from each quarterly distribution. The first distribution affected by this deduction is the distribution made by August 15, 2002, for the quarter ending June 30, 2002.

(Effective June 30, 2002, SB 1115, s. 30D, S.L. 02-126.)

Uncodified Exception to Liability Under Article 44, Third One-Half Cent Local Sales and Use Tax: The General Assembly advanced the earliest effective date of the tax authorized by this Article from July 1, 2003, to December 1, 2002, and made exceptions to the notice required for the levy. These exceptions allowed counties to impose the tax quickly.

The General Assembly was concerned about the ability of some retailers to comply with a sudden change in the law and provided unprecedented relief for liability for the tax for the month of December, 2002. A retailer is not liable for the amount of the third one-half cent tax it does not collect in December, 2002, if the retailer can demonstrate to the Secretary of Revenue that the failure was due to an inadvertent error on the part of the retailer. A delay in reprogramming point of sale equipment is considered an inadvertent error.

(Effective September 26, 2002; SB 1292, s. 6, S.L. 02-123.)

G.S. 105-517 – Effective Date of Tax Can Occur Sooner and With Shorter Public Notice: Two changes affect this section. The General Assembly enacted an uncodified exception to the public notice requirement in subsection (b) and amended subsection (c) to change the earliest effective date of the tax.

Subsection (b) requires a board of county commissioners to give at least 10 days public notice of its intent to adopt a resolution imposing the third one-half cent tax if it plans to impose the tax without a vote of the people. The uncodified exception shortens this notice period from 10 days to 48 hours.

The amendment to subsection (c) advances the earliest effective date of a tax imposed under Article 44. That Article authorizes counties to impose a third one-half cent local sales and use tax. Under prior law, the earliest effective date was July 1, 2003. As amended, the earliest effective date is December 1, 2002.

If the tax does not become effective on December 1, 2002, it can become effective on January 1 or July 1 of 2003 or any subsequent year. The limitations set in G.S. 105-466(c) on the effective date of a tax apply to the third one-half cent tax by application of G.S. 105-519.

The General Assembly advanced the earliest effective date of the tax to give counties a source of revenue to offset the loss of various State reimbursements. In its budget bill, the General Assembly repealed the following reimbursements, effective July 1, 2002:

- Local sales tax revenue not received on food stamp foods, set out in G.S. 105-164.44C.
- Property tax revenue not received on manufacturers' inventories and poultry and livestock, set out in G.S. 105-275.1.
- State-shared revenue not received on intangible personal property, set out in G.S. 105-275.2.
- Property tax revenue not received on retailers' and wholesalers' inventories, set out in G.S. 105-277.001.
- Property tax revenue not received as a result of the homestead exclusions, set out in G.S. 105-277.1A.

(Effective September 26, 2002; SB 1292, ss. 1 and 10, S.L. 02-123.)

G.S. 105-518(b) – Conforming Change: This subsection was amended to revise the language to be included on a ballot for a special election on the question of whether to levy the third one-half cent local sales and use tax. The amendment removes language stating that the third one-half cent local tax replaces the temporary one-half cent State tax imposed October 16, 2001, and replaces it with a statement that the third one-half cent tax is in addition to all current State and local sales and use taxes.

When the 2001 General Assembly enacted the legislation authorizing the third one-half cent local sales and use tax, it set July 1, 2003, as the earliest effective date of the tax. The 2001 General Assembly also set July 1, 2003 as the expiration date for the temporary one-half cent State tax and the repeal of various local reimbursements. The 2002 General Assembly advanced the earliest effective date of the local tax to December 1, 2002, and advanced the date of the repeal of the reimbursements to July 1, 2002.

The third one-half cent tax can be imposed without an election. Ballot language is included in the statute in the event a county chooses to hold an election.

(Effective September 26, 2002; SB 1292, s. 2, S.L. 02-123.)

Chapter 1096, 1967 Session Laws – Conforming Changes to Mecklenburg Local Act: Three acts of the 2001 Session amended this Chapter to make conforming changes, effective January 1, 2002, and two acts of the 2002 Session make technical and conforming changes. Chapter 1096 is a local act that governs Mecklenburg's 1% local sales and use taxes. The amendments to this Chapter reflect changes made in the State sales and use tax laws.

Two amendments made by the 2001 General Assembly affect the list of items that are subject to tax. Subdivision (5) of the first paragraph of Section 4 of this Chapter was amended to revise the description of food that is exempt from State tax but is subject to 1% Mecklenburg local sales and use taxes. G.S. 105-164.13B sets out the State exemption for food and is therefore the appropriate reference. The 2002 General Assembly made a technical correction to this subdivision to correct a grammatical error.

The 2001 General Assembly added subdivision (6) to the first paragraph of Section 4 of this Chapter and the 2002 General Assembly made a conforming change to the subdivision. Subdivision (6) was added to include prepaid telephone calling arrangements in the 1% Mecklenburg local sales and use tax base. Prepaid calling arrangements are taxable at the State's general rate of tax under G.S. 105-164.4(a)(4d). The 2002 General Assembly changed the term "prepaid telephone calling arrangement" to "prepaid telephone calling service" and changed the term as applied in this subdivision.

One amendment made by the 2001 General Assembly affects exemptions from the tax. The second paragraph of Section 4 of this Chapter was amended to add a reference to sales made during the new sales tax holiday set out in G.S. 105-164.13C. Sales made during the holiday are exempt from the 1% Mecklenburg local sales and use taxes as well as State sales and use taxes.

(Changes made by 2001 General Assembly effective January 1, 2002, SB 165, ss. 30 and 53, S.L. 01-414; HB 571, s.14, S.L. 01-430; and SB 1005, ss. 34.16(c) and (d), S.L. 01-424. Change made by 2002 General Assembly to subdivision (5) effective August 12, 2002, SB 1160, s. 2, S.L. 02-72; change made by 2002 Session to subdivision (6) effective August 1, 2002, HB 1521, s. 13, S.L. 02-16.)

XVI. HIGHWAY USE TAX

G.S. 105-187.1(4) – Definition of Recreational Vehicle: This subdivision was revised to cross-reference the definition of recreational vehicle in G.S. 20-4.01 rather than repeat the substance of the definition in this subdivision. The text of the two definitions varied, but their intent was the same.

(Effective August 12, 2002, SB 1160, s. 19(a), S.L. 02-72.)

G.S. 105-187.6(a) – Business Reorganization Partial Exemption Takes Effect: The 2001 General Assembly expanded the partial exemption in (b)(2) for transfers to entities upon their formation, merger, conversion, or consolidation, effective January 1, 2002. Under the partial exemption, a transfer of a certificate of title is subject to a maximum tax of $40.00. The prior exemption applied only to partnerships, limited liability companies, and corporations. The expanded exemption includes transfers to any entity when no gain or loss is recognized on the transfer for income tax purposes and transfers to entities that are "disregarded entities," such as single member limited liability companies, for income tax purposes.

(Effective January 1, 2002, SB 842, ss. 151 and 175, S.L. 01-387.)

XVII. SCRAP TIRE DISPOSAL TAX

G.S. 105-187.16 – No Rate Decrease: The 1997 General Assembly rewrote this section, effective July 1, 2002, to decrease the scrap tire disposal tax rate and to eliminate the subsection designations. Under the 1997 legislation, the tax rate on tires with a bead diameter of less than twenty inches was set to decrease from 2% to 1%, effective July 1, 2002, so that all tires would be taxed at the same rate regardless of their size.

The 2002 General Assembly repealed the scheduled decrease before it went into effect. The rate for tires with a bead diameter of less than 20 inches continues to be 2%, and the rate for tires with a bead diameter of at least 20 inches continues to be 1%.

The 2001 General Assembly made a conforming change to this section, effective January 1, 2002. The change deletes the term "cost price" and substitutes the term "purchase price." Other legislation in the 2001 Session enacted a new definition of "purchase price" in G.S. 105-164.3, and the new definition of "purchase price" replaces the prior definition of "cost price." The two terms have the same meaning. Under G.S. 105-187.15, the definitions in G.S. 105-164.3 apply to the Scrap Tire Disposal Tax statutes. This statute therefore needed to be amended to reflect the definition changes in G.S. 105-164.3.

(Repeal of rate decrease effective June 27, 2002; HB 1578, S.L. 02-10; 2001 conforming change effective January 1, 2002; SB 165, ss. 22 and 53, S.L. 01-414.)

XVIII. WHITE GOODS DISPOSAL TAX

No Changes: The 2002 General Assembly made no changes in the white goods disposal tax.

XIX. DRY-CLEANING SOLVENT TAX

No Changes: The 2002 General Assembly made no changes in the dry-cleaning solvent tax.

XX. PIPED NATURAL GAS EXCISE TAX

G.S. 105-187.43- Accelerated Payments: The 2001 General Assembly amended this section, effective January 1, 2002, to revise the payment schedule for entities subject to the piped natural gas excise tax. The purpose of the revised payment schedule is to require more frequent payments, thereby shifting the receipt of some tax revenue from the 2002-03 fiscal year into the end of the 2001-02 fiscal year. The 2001 General Assembly also made similar changes to the payment schedule for telecommunications companies and electric power companies.

Under the revised payment schedule, piped natural gas companies must pay the tax twice a month in accordance with the timetable for semimonthly sales tax payments. Under prior law, the tax was due on a monthly basis.

G.S. 105-164.16 sets out the payment schedule for sales and use taxes. Under the semimonthly payment schedule, a payment for activity in the first 15 days of a month is due by the 25th of that same month, and a payment for activity in the rest of the month is due by the 10th of the following month. Payments must be made by electronic funds transfer.

The change in the payment due dates does not affect the due date of the return. A return remains due on a quarterly basis by the last day of the month following the end of the quarter.

The penalty for underpayments has been revised to accommodate the new semimonthly payment periods. Before the change, a piped natural gas company was not subject to interest and penalty on an underpayment for a monthly payment period if it paid at least 95% of what was due and paid the remainder when filing the quarterly return. As revised, a piped natural gas company is not subject to interest and penalty on an underpayment for a semimonthly payment period if it timely pays at least ninety-five percent of the amount due for each period and includes the underpayment with next quarterly return.

(Effective January 1, 2002; HB 232, ss. 6(f) and (j), S.L. 01-427.)

G.S. 105-187.44(b) – Piped Gas Excise Tax Distribution Considered Local Revenue: This subsection was amended to declare that the portion of piped natural gas excise tax distributed to cities is local revenue rather than a State expenditure, and that the Governor may not reduce or withhold the distribution. Although this subsection prohibits the Governor from reducing or withholding the distribution, G.S. 143-25 authorizes the Governor to do so if the Governor has exhausted all other sources of revenue of the State, including surplus remaining in the treasury at the beginning of the fiscal period.

Article III, Section 5(3) of the North Carolina Constitution authorizes the Governor to “effect the necessary economies in State expenditures” if the Governor determines that the State will have a deficit in its budget without this action. The amendment to subsection (b) declares that the amount to be distributed to cities is not a State expenditure so that the Governor’s authority under the Constitution will not extend to the revenue to be distributed to cities.

It is clear from this change that the General Assembly does not consider local distribution amounts to be an expenditure under the Constitution. The meaning of the Constitution, however, is determined by the courts rather than the General Assembly.

The change to this subsection is the result of the Governor’s decision in the 01-02 fiscal year to withhold from cities and counties over $200 million in local reimbursements. The Governor took this action under the authority of Article III, Section 5(3) of the North Carolina Constitution.

(Effective September 24, 2002, HB 1490, ss. 3 and 7, S.L. 02-120.)

XXI. GIFT TAX

G.S. 105-188(d) – Annual Gift Tax Exclusion Increased: This subsection was amended to conform the annual gift tax exclusion amount for North Carolina to the federal inflation-adjusted amount provided in section 2503(b) of the Internal Revenue Code. For taxable years beginning on or after January 1, 2002, gifts of $11,000 or less per year to any individual are not taxable. Previously, the exclusion amount was $10,000.

(Effective January 1, 2002, and applies to gifts made on or after that date, SB 1115, s. 30C.5(a), S.L. 02-126.)

XXII. INSURANCE PREMIUMS TAX

G.S. 58-6-25 – Insurance Regulatory Charge; 2002 Rate and Conforming Change Regarding Payment Due Date: The percentage rate to be used in calculating the insurance regulatory charge under this statute is 6.5% for the 2002 calendar year. This charge is a percentage of gross premiums tax liability.

Subsection (c) was amended to conform with changes to G.S. 105-228.5 enacted by the 2001 General Assembly that subject HMOs to the gross premiums tax in Article 8B of Chapter 105 effective for tax years beginning on or after January 1, 2003. The change clarifies that an insurance company, including an HMO, must pay the insurance regulatory charge at the same time it pays the premium tax.

(2002 regulatory rate effective September 30, 2002; SB 1115, s.30E, S.L. 02-126; conforming change effective for taxable years beginning on or after January 1, 2003; SB 1160, s. 9(a), S.L. 02-72.)

G.S. 105-228.5 – Tax Scope, Rate, and Technical Changes: The 2001 General Assembly made numerous changes to this section that affect tax years 2002, 2003, and 2004. The section was amended several times to adjust its scope and rate. The first act that amended this section made health maintenance organizations (HMOs) subject to a gross premiums tax at the rate of 0.833% and increased the rate for Article 65 corporations from 0.5% to 0.833%. Both of these changes were effective for tax year 2002. In addition to these changes, the first act that amended this section increased the rate for both HMOs and Article 65 corporations to 1% effective for the 2003 tax year.

The changes made by the first act were undone by subsequent acts. The subsequent acts delayed the effective date of the application of the tax to HMOs and of the tax increase to Article 65 corporations until tax year 2003. Under these acts, the tax rate for both HMOs and Article 65 Corporations is 1.1% effective for the 2003 tax year. The rate decreases to 1% for tax years beginning on or after January 1, 2004. As a result, the tax rate for Article 65 corporations remains 0.5% for tax year 2002 and HMOs are not subject to the gross premiums tax for tax year 2002.

Subsection (f) of this section requires taxpayers to prepay their tax liability in three installments. Special rules apply to HMOs and Article 65 corporations for tax year 2003. HMOs and Article 65 corporations must prepay their 2003 tax liability in two installments, rather than three. One-half of the estimated liability is due with each installment. The installments are due on April 15 and June 15, 2003. An underpayment of estimated tax accrues interest. The penalties in Article 9 of Chapter 105 apply to these estimated tax payments.

In addition to these substantive changes, a clarifying change and several technical changes were made to this section. Subsection (c) was amended to add an exclusion for premiums from the Federal Employees Health Benefits Plan, Medicaid, or Medicare to the extent federal law prohibits their inclusion. This is a clarifying change that makes explicit the requirements of federal law.

The technical changes moved a sentence in subsection (c) so that it precedes rather than follows the subdivisions in that subsection, deleted an unnecessary sentence in subsection (e), and made stylistic changes in subsections (d), (e), and (f). The sentence in subsection (e) that was deleted required the gross premiums tax return to be verified by the oath of the individual transmitting the return. This sentence is unnecessary because G.S. 105-252 requires all returns and reports to be filed under affirmation.

(HMOs subject to tax originally effective January 1, 2002; SB 1005, s. 34.22, S.L. 01-424; revision to the effective date, the establishment of the 1.1% tax rate, and the exception to the provisions of G.S. 105-228.5(f) effective for tax year 2003; decrease in the 1.1% rate to 1% effective for tax years beginning on or after January 1, 2004; HB 748, s. 2, S.L. 01-489; technical change to G.S. 105-228.5(e) effective January 1, 2002; HB 338, s. 69, S.L. 01-487.)

XXIII. GENERAL ADMINISTRATION

G.S. 105-228.90(b)(1b)- Reference to the Internal Revenue Code Updated: This subdivision was amended to update the reference to the Internal Revenue Code from January 1, 2001 to May 1, 2002. Any amendments to the IRC enacted in 2001 that increase North Carolina taxable income for the 2001 taxable year become effective for taxable years beginning on or after January 1, 2002.

This implies that North Carolina has conformed to all of the tax provisions of the federal Economic Growth and Tax Relief Reconciliation Act of 2001 and the federal Job Creation and Worker Assistance Act of 2002. However, a separate provision in G.S. 105-32.2(b) results in the State effectively not conforming to the phase-out of the state death tax credit for estate tax purposes. Separate provisions in G.S. 105-130.5(a) and G.S. 105-134.6(c) result in the State not immediately conforming with the accelerated 30% bonus depreciation allowance.

A taxpayer is not subject to the penalty for underpayment of estimated tax for tax year 2002 for any increase in the taxpayer’s income tax liability for that year resulting from updating the State’s reference to the Internal Revenue Code.

(Effective September 30, 2002; SB 1115, ss 30C.1(a) and (b) and 30I, S.L. 02-126)

G.S. 105-228.90(b)(4) – Definition of Income Tax Return Preparer: Subsection (b) was amended by adding a definition for an "income tax return preparer" as subdivision (4). That subdivision had previously been reserved for future use.

An income tax return preparer is a person who prepares for compensation, or who employs one or more persons to prepare for compensation, any tax return or any claim for refund of tax. For purposes of this definition, the completion of a substantial portion of a return or claim for refund is treated as the preparation of the return or claim for refund. The term does not include a person merely because the person (i) furnishes typing, reproducing, or other mechanical assistance, (ii) prepares a return or claim for refund of the employer, or an officer or employee of the employer, by whom the person is regularly and continuously employed, (iii) prepares as a fiduciary a return or claim for refund for any person, or (iv) represents a taxpayer in a hearing regarding a proposed assessment.

This definition mirrors the definition in federal law. The definition was added as part of the legislation imposing harsher criminal penalties under G.S. 105-236(9a) for tax fraud committed by an income tax preparer.

(Effective December 1, 2002; SB 1218, s. 1, S.L. 02-106.)

G.S. 105-230(b) – Conforming Change: The 2001 General Assembly amended this subsection, effective January 1, 2002, to make otherwise invalid acts performed while a corporation or limited liability company was suspended valid upon the Secretary of State's reinstatement of the company's charter under the provisions of G.S. 105-232(a). Under G.S. 105-230, the Secretary of State suspends the charter of a company if the Department notifies the Secretary that the company has not filed a tax return with the Department.

(Effective January 1, 2002, but validates acts prior to that date, SB 842, ss. 152 and 175, S.L. 01-387.)

G.S. 105-232(a) – Reinstatement of Charter and Clarifying and Technical Changes: The 2001 General Assembly made substantive and technical changes to this subsection, effective January 1, 2002. The substantive changes make reinstatement of a suspended corporation or limited liability company effective back to the date of the suspension by the Secretary of State and clarify that notification of reinstatement to the entity is by mail. The corporation or limited liability company resumes its business as if the suspension had never occurred. The technical changes correct grammatical errors and make stylistic changes to the substantive changes.

(Substantive changes effective January 1, 2002, but validate acts prior to that date, SB 842, s. 153, S.L. 01-387; technical changes effective January 1, 2002; HB 338, s. 62(dd) and (gg), S.L. 01-487.)

G.S. 105-236(4) -- Uncodified Exception to Failure to Pay Penalty: The General Assembly enacted an uncodified exception to the failure to pay penalty set out in this subdivision. The exception applies to a taxpayer who underpaid tax for the 2001 tax year as a result of the incorrect application of the requirement to attribute expenses to nontaxed dividends. The exception applies only if the taxpayer pays all tax due pursuant to the attribution of expenses rules set out in new G.S. 105-130.6A by October 18, 2002.

(Effective for a taxable year beginning on or after January 1, 2001, and before January 1, 2002; HB 1670, s. 6(b) and (c), S.L. 02-136.)

G.S. 105-236(9a) – Stiffer Punishment for Fraud Committed by an Income Tax Return Preparer: This subdivision was revised to create two new offenses for certain kinds of fraud committed by an income tax preparer. The changes were made at the recommendation of the Department of Revenue. The Department has seen an increase in the number of fraudulent tax returns. The same income tax return preparer may be responsible for over 100 fraudulent returns.

Under the revisions made to this subsection, an income tax return preparer who prepares or advises a taxpayer to prepare a fraudulent return commits a Class C felony if the amount of all taxes evaded for a tax year on all fraudulent returns for which the preparer is responsible is at least $100,000. The threshold was set at $100,000 to match the threshold in the embezzlement statutes in Chapter 14 of the General Statutes. The damage caused by obtaining revenue from the State through the means of a fraudulent return is the same as that caused by the embezzlement of State property. Money or property has been stolen from the State in both cases.

If the amount of all taxes fraudulently evaded on returns for which the preparer is responsible is less than $100,000, the preparer commits a Class F felony. The level of this offense was set one level higher than the existing Class H level for the subsection to enable income tax return preparers to receive a stiffer punishment than those who are not income tax return preparers.

Tax fraud committed by those who are not income tax preparers remains a Class H felony. Subpart c of this subdivision sets out the Class H offense and corresponds to the offense under the prior law.

(Effective December 1, 2002; SB 1218, s. 2, S.L. 02-106.)

G.S. 105-236(10b) – New Offense for Misrepresentation Concerning Payment: G.S. 105-236 was amended by adding a new subdivision (10b) to address a problem encountered by the Department. The problem occurs when a taxpayer gives money to an accountant or another person to send to the Department in payment of the taxpayer's liability and the accountant or other person keeps the money rather than sending it to the Department. The General Assembly added this subdivision at the request of the Department to enable the Department to address this problem. The new subdivision makes it a Class F felony for a person to willfully retain money received from a taxpayer that was intended to be remitted in payment of the tax liability.

(Effective December 1, 2002; SB 1218, s. 4, S.L. 02-106.)

G.S. 105-241(b) – Semimonthly Tax Payments By EFT: The 2001 General Assembly amended this subsection, effective January 1, 2002, to add an additional category of taxpayer that must remit tax payments by electronic funds transfer (EFT) and to consolidate the EFT requirements into this subsection. The new category for mandatory EFT payments, set out in subdivision (b)(2), consists of taxpayers that are required to remit payments twice a month. This affects sales and use taxpayers that regularly remit at least $10,000 a month, electric power companies under G.S. 105-116, and piped natural gas companies under G.S. 105-187.43.

Subdivision (b)(1) sets out the EFT payment requirement that applies to corporations. This is not a new requirement; it is a restatement of the existing requirement in G.S. 105-163.40. The requirement is set out here as well so that all the EFT requirements are listed in this subsection.

Subdivision (b)(3) contains the prior language of subsection (b) with technical changes. The technical changes delete a reference to G.S. 105-163.40 that is unnecessary in light of new subdivision (b)(1) and make stylistic changes.

(Effective January 1, 2002; HB 232, ss. 6(b) and (j), S.L. 01-427.)

G.S. 105-243.1(f) – Tax Debt Report Changes: This subsection was amended to make two changes to the Department's reporting requirements concerning tax debts. The first change requires quarterly rather than semiannual reports for the period from November 1, 2002, through June 30, 2005. Before the change, quarterly reports were required until November 1, 2002, and semiannual reports were required after that. The second change requires the reports to itemize collections by type of tax debt, such as individual income tax and sales tax.

(Effective July 1, 2002, SB 1115, s. 22.2, S.L. 02-126.)

G. S. 105-256 – New Report on Local Expenses; Technical Changes: Two acts of the 2002 Session amended this section. One act requires a new report and the other adds cross-references to reports already required under other sections of the law.

New subsection (e) was added to require the Secretary to make a quarterly report to the Appropriations Committee, the Finance Committee, and the Fiscal Research Division of the General Assembly on the Department's expenditures of funds withheld from distributions to local governments to cover the Department's expenses in administering local taxes and local programs. The report must give detailed information and is due 20 days after the end of each quarter. The reporting requirement has no expiration date.

Subsection (a) was amended by adding subdivision (a)(7) to include the reports required under G.S. 105-129.19 (Article 3B) and new G.S. 105-129.44 (Article 3E) in the list of reports prepared by the Secretary of Revenue. The report required under G.S. 105-129.44 is not new. It was previously required under G.S. 105-129.19 but was moved from that section as part of the legislation revising the low-income housing tax credit and moving that credit to a new Article 3E. The addition of these references in subdivision (a)(7) is part of the continuing effort to consolidate the Department's reporting requirements.

(Legislation requiring new report effective July 1, 2002, SB 1115, s. 22.5, S.L. 02-126; technical change effective August 15, 2002; SB 1416, s. 8, S.L. 02-87.)

G. S. 105-259(b) – Additional Authority to Disclose: The 2001 General Assembly added subdivision (27) to this subsection, effective for taxable years beginning on or after January 1, 2002. The 2002 General Assembly added three new subdivisions authorizing the disclosure of certain tax information. The three new authorizations for disclosure that were added in 2002 are set out in subdivisions (15a), (28), and (29).

New subdivision (15a) authorizes the Department to disclose to the head of the appropriate State or federal law enforcement agency information concerning the commission of an offense within the agency's jurisdiction, if the Department discovered the information during a criminal investigation. This subdivision was added at the request of the Department to enable the Department to turn information about crimes over to the proper authorities.

Subdivision (27), added by the 2001 General Assembly, authorizes the Department to publish the names of taxpayers that qualify for Article 3A tax credits and certain information about these credits. G.S. 105-129.6 sets out the information about Article 3A credits that is to be disclosed.

New subdivision (28) authorizes the Department to disclose to the Housing Finance Agency information concerning the tax credit for low-income housing. That credit is set out in Article 3E of Chapter 105.

New subdivision (29) authorizes the Department to disclose information to the Economic Investment Committee established under G.S. 143B-437.48 when the disclosure is necessary to implement the Job Development Investment Grant Program. Under that new Program, the Economic Investment Committee makes grants to businesses to foster job creation and investment in the economy of this State. The grants are based on the amount of withholding tax paid by the business.

(Subdivision (15a) effective September 6, 2002; SB 1218, s. 5, S.L. 02-106; subdivision (27) effective for taxable years beginning on or after January 1, 2002, SB 748, s. 8(b), S.L. 01-476; subdivision (28) effective August 15, 2002; SB 1416, s. 8, S.L. 02-87; subdivision (29) effective October 31, 2002, HB 1734, s. 2.3, S.L. 02-172.)

G.S. 105-269.3 – Conforming Change: This section was amended to reflect the transfer of the Division of Motor Vehicles Enforcement Section from the Division of Motor Vehicles of the Department of Transportation to the Department of Crime Control and Public Safety. The legislation directed the Codifier of the Statutes to delete the reference to the Division of Motor Vehicles and substitute a reference to the Department of Crime Control and Public Safety.

(Effective December 1, 2002, HB 314, s.2, S.L. 02-190.)

G.S. 105-269.6 – Candidates Financing Fund Election Repealed: This statute allowed an individual to contribute all or part of the individual's income tax refund to the North Carolina Candidates Financing Fund. The statute was repealed, effective for the 2003 tax year. Few taxpayers contributed to the Fund and the revenue in the Fund was ever disbursed to candidates because they either did not meet the qualifications for receipt of the funds or did not apply for the funds.

The General Assembly repealed this statute as part of the legislation establishing nonpartisan judicial elections and a method for providing an alternative means of financing campaigns of candidates for the North Carolina Supreme Court or Court of Appeals who accept fundraising and spending limits. A new fund is established in Article 22D of Chapter 163 of the General Statutes, called the North Carolina Public Campaign Financing Fund. A new individual income tax check-off will appear on the 2003 income tax return for that Fund.

(Effective for taxable years beginning on or after January 1, 2003; SB 1054, s. 6(a), S.L. 02-126.)

G.S. 105-269.14(b) – Consumer Use Tax Distribution Revised: This subsection was amended to update the formula used to distribute to counties and cities their portion of the consumer use tax reported on the individual income tax return. The prior formula distributed one-third of the revenue to the local units in proportion to the amount of the first one cent, the first one-half cent, and the second one-half cent local sales and use tax revenue distributed to them.

With the enactment of the additional one-half cent State tax and the levy of the third one-half cent local tax, the formula no longer produces the desired result. The ratio of State tax to local tax is no longer one-third to two-thirds and the third one-half cent is not taken into account in determining proportionate shares.

The changes to this subsection correct these flaws. Under the revised subsection, the Secretary first determines the amount of local tax included in the amounts reported on the income tax return. The Secretary then determines the proportionate share of the local units based on local tax collections that include the third one-half cent tax.

(Effective August 12, 2002, SB 1160, s. 20, S.L. 02-72.)

G.S. 105-269.15(a) – Income Tax Credits of Partnerships: The 2001 General Assembly amended this subdivision, effective for the 2002 tax year, to treat partnerships the same as S corporations with respect to the application of dollar limits on tax credits. The Department recommended this change to the Revenue Laws Study Committee.

Under the change, any dollar limit on the amount of a tax credit will apply to the partnership as a whole instead of to the individual partners. Before the change, the dollar limits applied to each partner. A maximum tax credit for which a partnership qualifies will be allocated among the partners in proportion to their interest in the partnership.

The change makes North Carolina partnership law consistent with federal law and North Carolina S corporation law. The change also applies to limited liability companies that are taxed as partnerships.

The following tax credits have maximum dollar limits:

- Worker training in G.S. 105-129.11
- Investments in central administrative office property in G.S. 105-129.12
- Investments in business property in G.S. 105-129.16
- Investments in renewable energy property in G.S. 105-129.16A
- Real property donations in G.S. 105-151.12
- Conservation tillage equipment in G.S. 105-151.13
- Construction of a poultry composting facility in G.S. 105-151.25.

The change made to this subsection affects the calculation of all of the credits in this list that are taken by partnerships, except the tax credit for real property donations. The tax credit for real property donations is not affected until tax year 2005 because the General Assembly created a three-year exception in G.S. 105-151.12 for that credit.

(Effective for taxable years beginning on or after January 1, 2002; HB 146, ss. 1 and 3, S.L. 01-335.)

XXIV. PROPERTY TAX

G.S. 105-273(13) – Manufactured Home Changes Delayed: This subdivision sets out the definition of "real property." The 2001 General Assembly amended it, effective July 1, 2002, to make substantive changes concerning manufactured homes and to make technical changes. The 2002 General Assembly delayed the effective date of the changes until July 1, 2003. The effective date was delayed to give counties more time to ensure that manufactured homes are properly classified.

The substantive changes delete two requirements for a manufactured home to qualify as real property. One of the deleted requirements is that a manufactured home consist of more than one section. The other deleted requirement is that a manufactured home be on an enclosed foundation. Therefore, as amended, a manufactured home can be real property if it consists of one section and is on a permanent foundation that is not enclosed. The technical changes modernize the language of the subdivision.

(2001 legislation effective for taxable years beginning on or after July 1, 2002; HB 253, ss. 1 and 4, S.L. 01-506; 2002 legislation delaying the changes effective June 30, 2002; HB 1523, s. 4, S.L. 02-156.)

G.S. 105-275(8) – Exclusion Does Not Include Most Animal Waste Management Systems: Subpart a. of this subdivision excludes from the property tax base real and personal property used exclusively to abate, reduce, or prevent air or water pollution. The General Assembly amended this subdivision to add a new subpart a1., at the recommendation of the Environmental Review Commission.

The new subpart makes it clear that the exclusion in subpart a. does not apply to an animal waste management system, as defined in G.S. 143-215.10B, unless the Environmental Management Commission determines that the system accomplishes five purposes. The five purposes are elimination of the discharge of animal waste to surface water or ground water and substantial elimination of four items. The four items are atmospheric emissions of ammonia, the emission of odor detectable on other parcels of land, the release of disease-transmitting vectors and airborne pathogens, and nutrient and heavy metal contamination of soil and groundwater.

(Effective July 1, 2002; SB 1253, s. 1, S.L. 02-104.)

G.S. 105-275.1 – Repeal of Reimbursement For Manufacturers' Inventory Tax Occurs Sooner: The 2001 General Assembly repealed this statute, effective July 1, 2003. The 2002 General Assembly advanced the date of the scheduled repeal and made the repeal of the reimbursement effective July 1, 2002. The repeal of this reimbursement is part of the repeal of all local reimbursements and the replacement of these reimbursements with the authority given the counties in Article 44 of Subchapter VIII of Chapter 105 to levy additional ½% local sales and use taxes. The General Assembly advanced the date of the repeal of all the reimbursements to generate a revenue gain for the State of $333.4 million in fiscal year 2002-2003.

Before its repeal, this statute required the Department of Revenue to distribute annually to counties and cities the amount of tax revenue they "lost" as a result of the exclusion of manufacturers' inventories and poultry and livestock from the property tax base. The amount distributed was based on the amount of property tax received by a local unit before the repeal.

(Original repeal effective July 1, 2003; SB 1005, s. 34.15, S.L. 01-424; 2002 legislation advancing the date of the repeal to July 1, 2002 effective September 30, 2002, SB 1115, ss. 30A.1 and 30I, S.L. 02-126.)

G.S. 105-275.2 – Repeal of Reimbursement for Tax on Intangible Property Occurs Sooner: The 2001 General Assembly repealed this statute, effective July 1, 2003. The 2002 General Assembly advanced the date of the scheduled repeal and made the repeal of the reimbursement effective July 1, 2002. The repeal of this reimbursement is part of the repeal of all local reimbursements and the replacement of these reimbursements with the authority given the counties in Article 44 of Subchapter VIII of Chapter 105 to levy additional ½% local sales and use taxes. The General Assembly advanced the date of the repeal of all the reimbursements to generate a revenue gain for the State of $333.4 million in fiscal year 2002-2003.

Before its repeal, the statute required the Department of Revenue to distribute annually to counties and cities the amount of tax revenue they "lost" as a result of the exclusion of intangible personal property from the property tax base. The amount distributed was based on the amount of property tax received by a local unit before the repeal.

(Original repeal effective July 1, 2003; SB 1005, s. 34.15, S.L. 01-424; 2002 legislation advancing the date of the repeal to July 1, 2002 effective September 30, 2002, SB 1115, ss. 30A.1 and 30I, S.L. 02-126.)

G.S. 105-277.001 – Repeal of Reimbursement for Retailers' and Wholesalers' Inventory Tax Occurs Sooner: The 2001 General Assembly repealed this statute, effective July 1, 2003. The 2002 General Assembly advanced the date of the scheduled repeal and made the repeal of the reimbursement effective July 1, 2002. The repeal of this reimbursement is part of the repeal of all local reimbursements and the replacement of these reimbursements with the authority given the counties in Article 44 of Subchapter VIII of Chapter 105 to levy additional ½% local sales and use taxes. The General Assembly advanced the date of the repeal of all the reimbursements to generate a revenue gain for the State of $333.4 million in fiscal year 2002-2003.

Before its repeal, the statute required the Department of Revenue to distribute annually to counties and cities the amount of tax revenue they "lost" as a result of the exclusion of retailers' and wholesalers' inventories from the property tax base. The amount distributed was based on the amount of property tax received by all local units before the repeal and was allocated among the local units on a per capita basis.

(Original repeal effective July 1, 2003; SB 1005, s. 34.15, S.L. 01-424; 2002 legislation advancing the date of the repeal to July 1, 2002 effective September 30, 2002, SB 1115, ss. 30A.1 and 30I, S.L. 02-126.)

G.S. 105-277.1 – Homestead Exclusion: The 2001 General Assembly amended this section, effective July 1, 2002, to raise both the income eligibility threshold and the amount of the appraised value of a residence that is excluded from tax under the property tax "homestead exemption." The income threshold is increased from $15,000 to $18,000 for 2002 and is adjusted annually beginning in 2003 based on the Social Security cost-of-living adjustment. The amount of the appraised value that is excluded from tax is changed from a flat $20,000 to the greater of $20,000 or 50% of the appraised value of the residence. The change in the calculation of the amount excluded makes the exclusion more responsive to changes in value that occur when a county conducts a revaluation. With this change, the amount excluded will now increase or decrease in accordance with changes in the value of the property.

(Effective July 1, 2002; HB 42, S.L. 01-308.)

G.S. 105-277.1A – Repeal of Reimbursement for Homestead Exclusion Occurs Sooner: The 2001 General Assembly repealed this statute, effective July 1, 2003. The 2002 General Assembly advanced the date of the scheduled repeal and made the repeal of the reimbursement effective July 1, 2002. The repeal of this reimbursement is part of the repeal of all local reimbursements and the replacement of these reimbursements with the authority given the counties in Article 44 of Subchapter VIII of Chapter 105 to levy additional ½% local sales and use taxes. The General Assembly advanced the date of the repeal of all the reimbursements to generate a revenue gain for the State of $333.4 million in fiscal year 2002-2003.

Before its repeal, the statute required the Department of Revenue to distribute annually to counties and cities one-half of the amount of tax revenue they "lost" as a result of the property tax homestead exclusion. The amount distributed is one-half of the amount of property tax revenue that was not received in specified prior years as a result of the exclusion.

(Original repeal effective July 1, 2003; SB 1005, s. 34.15, S.L. 01-424; 2002 legislation advancing the date of the repeal to July 1, 2002 effective September 30, 2002, SB 1115, ss. 30A.1 and 30I, S.L. 02-126.)

G.S. 105-277.2. Present-Use Value Definitions Revised. Four definitions in this section were revised, a new definition of "unit" was added, and one definition was amended to make technical changes. The changes to this section were made as part of the legislation that reformed the present-use value system of taxation. The changes become effective beginning with the July 1, 2003, property tax year. The Department of Revenue and the Revenue Laws Study Committee recommended the changes. See the discussion of the changes to G.S. 105-277.7 for an explanation of the reasons for the changes.

The substantive definition changes and the addition of the new definition are described below. The technical change is a stylistic change to the definition of forestland in subdivision (2).

Agricultural land (1). This definition was amended to clarify that the requirement in the definition that agricultural land be under a sound management program does not apply to woodland in two circumstances. One circumstance is when the agricultural land includes less than 20 acres of woodland. The other circumstance is when the highest and best use of the woodland is diminish wind erosion of adjacent agricultural land, protect water quality of adjacent agricultural land, or serve as a buffer for adjacent livestock or poultry operations.

Horticultural land (2). This definition was amended to clarify that the requirement in the definition that horticultural land be under a sound management program does not apply to woodland in two circumstances. One circumstance is when the horticultural land includes less than 20 acres of woodland. The other circumstance is when the highest and best use of the woodland is to diminish wind erosion of adjacent horticultural land, protect water quality of adjacent horticultural land.

Individually owned (4). This definition was amended to add a new subpart e. The new subpart adds ownership as tenants in common as a form of individually owned property. G.S. 105-277.3 requires land classified for taxation at its present use-value to be individually owned. Under the definition, land held by tenants in common is individually owned if each tenant is either a natural person (a human being) or a business entity whose members are all natural persons.

Present use-value (5). This definition was amended to eliminate the 9% capitalization rate for agricultural land and horticultural land and replace it with a statement that the capitalization rate for this land is to be determined by the Use-Value Advisory Board under G.S. 105-277.7. The capitalization rate for forestland remains at 9%.

Unit (New)(7). Under G.S. 105-277.3, agricultural land, horticultural land, or forestland can contain one or more tracts of land. This new definition sets limits on the tracts that can be considered part of the same qualifying property for purposes of use-value taxation. The definition requires multiple tracts to have the same owner. If the tracts are located in different counties, the definition requires them to be within 50 miles of a tract that meets the acreage and income requirements set in G.S. 105-277.3 and to either share the same classification or use the same equipment or labor force.

(Effective for taxable years beginning on or after July 1, 2003, SB 1161, s. 1, S.L. 02-184.)

G.S. 105-277.3 – Ownership and Sound Management Requirements for Use-Value Classification: The 2002 General Assembly amended this subsection to make several substantive changes and a few technical changes. The substantive changes amend subsection (b2) and add new subsections (d1), (f) and (e). The amendment to subsection (b2) clarifies a change made to that subsection by the 2001 General Assembly, effective January 1, 2002. The substantive changes made by the 2002 General Assembly and the change made by the 2001 General Assembly are described below by subsection The technical changes make a stylistic change to the language in subsection (a) preceding the subdivisions and correct a reference in subsection (d) to the part of the United States Code that authorizes the federal Conservation Reserve Program. The changes made by the 2002 General Assembly are all effective for the property tax year beginning July 1, 2003.

The changes to this section were made as part of the legislation that reformed the present-use value system of taxation. The Department of Revenue and the Revenue Laws Study Committee recommended the changes. See the discussion of the changes to G.S. 105-277.7 for an explanation of the reasons for the changes.

Farmer-to-Farmer Transfer and Clarification (b2). The 2001 General Assembly amended this subsection, effective January 1, 2002, to encourage farmer-to-farmer transfers of land classified for present use-value. The amendment allows land that is under present use-value taxation and is transferred to someone who will continue to use the land at its current use to continue to qualify for present use-value taxation without the payment of the deferred taxes attributable to the land's past present use-value taxation. Under prior law, the deferred taxes were payable unless the new owner had other land already classified for taxation at its present use-value.

The 2002 General Assembly amended this subsection to clarify the farmer-to-farmer exception enacted the previous session. The 2002 amendments make it clear that liability for the deferred taxes is transferred to the new owner although no payment for deferred taxes is required upon the transfer. The new owner is liable for the deferred taxes that have accrued on the land and the previous owner is released from liability for the deferred taxes. The new owner's liability results from the treatment of the taxes as a lien on the land. New subdivision (3) in the subsection requires the new owner to file a timely application for continued taxation at use-value and to certify that the new owner accepts liability for the deferred taxes and intends to continue the present use of the land.

Conservation Easement Exception (d1). Land classified for taxation at its present use-value must meet ownership, acreage, income, and production requirements, unless the land falls within an exception to the requirements. This new subsection creates an exception to these requirements for land that is classified for taxation at its present use-value and then becomes subject to a conservation easement that would qualify for the conservation income tax credit in G.S. 105-130.34 or G.S. 105-151.12. The land that is subject to the easement continues to be taxable at its present use-value and the land is not required to meet the production or income requirements for use-value land. If the land with its easement is transferred, the land continues to qualify for taxation at present use-value.

Sound Management Program for Agricultural and Horticultural Land (f). The definitions for agricultural land and horticultural land in G.S. 105-277.2 require the land to be under a sound management program. The term "sound management program is defined in G.S. 105-277.2(6) as a program of production designed to obtain the greatest return from the land consistent with its conservation and long-term improvement.

This new subsection sets out factors that establish when agricultural or horticultural land is operated under a sound management program. Prior law contained the definition of sound management program in G.S 105-277.2(6), but did not specify any factors. The factors listed in the subsection are as follows; other similar factors can be considered:

(1) Enrollment in and compliance with an agency-administered and approved farm management plan.
(2) Compliance with a set of best management practices.
(3) Compliance with a minimum gross income per acre test.
(4) Evidence of net income from the farm operation.

(5) Evidence that farming is the farm operator's principal source of income.
(6) Certification by a recognized agricultural or horticultural agency within the county that the land is operated under a sound management program.

The new subsection also eliminates one circumstance from being used as a factor in the determination. The subsection provides that receipt by the owner of the property of income or rent from the property is irrelevant to a determination of whether the property is under sound management, if the farm operator meets the sound management requirements.

Sound Management Program for Forestland (g). The definition of forestland in G.S. 105-277.2 requires the land to be under a sound management program. The term "sound management program is defined in G.S. 105-277.2(6) as a program of production designed to obtain the greatest return from the land consistent with its conservation and long-term improvement.

This new subsection describes when forestland is considered to be under a sound management plan. Forestland is under a sound management plan if the owner has a written sound forest management plan for the production and sale of forest products and establishes that the land complies with the plan.

(2002 changes effective for taxable years beginning on or after July 1, 2003, SB 1161, s. 2, S.L. 02-184; 2001 farmer-to-farmer change effective for taxable years beginning on or after January 1, 2002; HB 1427, ss. 1 and 4, S.L. 01-499.)

G.S. 105-277.4 – Application After Transfer of Property and Prepayments: The 2002 General Assembly amended this section to set out requirements concerning an application for present-use value classification made as the result of a transfer of property. Under G.S. 105-277.3(b2) and (e), property under use-value taxation can be transferred and retain its use-value treatment, but the new owner must submit an application for the continuation of the classification. Two changes were made to this section concerning applications filed as the result of a transfer of land.

Subsection (a) was amended to allow an application for continued classification to be submitted at any time during the year. The application must be submitted within 60 days of the transfer, however. Generally, an application is required to be submitted within the regular listing period. Subsection (c) was amended to make disapproval of an application for continued classification grounds for disqualification of the property's use-value classification.

The 2002 General Assembly also made several technical changes to subsections (a), (b) and (c). The changes make the language of the section gender-neutral and make stylistic changes.

The 2001 General Assembly amended subsection (c) of this section, effective January 1, 2002, to allow prepayments of taxes deferred on land that is taxed under the present use-value system. Under that system, the difference in tax due based on a market value appraisal and a use-value appraisal are deferred until the property is transferred. A prepayment does not disqualify the land for continued taxation at present use-value.

(2002 changes effective for taxable years beginning on or after July 1, 2003, SB 1161, s. 3, S.L. 02-184; 2001 change to subsection (c) effective for taxable years beginning on or after January 1, 2002; HB 1427, ss. 2 and 4, S.L. 01-499.)

G.S. 105-277.7 -- Change in Membership and Duties of Use-Value Advisory Board: This section was rewritten as part of the legislation reforming the present use-value system of taxation. That legislation was the product of years of work by the local units, the North Carolina Association of Assessing Officers, and other interested groups. The centerpiece of the legislation is a change in the method of calculating present-use value for agricultural and horticultural land. Under prior law, the value was determined by applying a 9% capitalization rate to net income based on average yields of crops. For agricultural land, corn and soybeans were the crops used to determine average yields. For horticultural land and forestland, typical horticultural and forestland products were used to determine average yields.

Under the revised law, the value is determined by applying a specified capitalization rate to cash rental rates for agricultural land and horticultural land and net income for forestland. The capitalization rate for agricultural land and horticultural land is set by the Use-Value Advisory Board. The rate cannot be less than 6% nor more than 7%. The capitalization rate for forestland remains 9%.

The former method of determining present use-value was set in 1985 and had become outdated. Corn and soybeans were no longer representative of typical crops grown in the State and were not the major money crops. The values set on the basis of corn and soybean yields could not be supported by market evidence. The counties faced the choice of using the present-use value schedules developed on the basis of corn and soybean yields and creating inequities by establishing unrealistically low values to agricultural land or developing their own schedules. An increasing number of counties chose to develop their own schedules of value, which made the taxation of this land less uniform throughout the State.

This section was rewritten to reflect the extensive changes made concerning the taxation of property at its present use-value. The existing section was divided into subsections and then amended to incorporate the changes.

Newly designated subsection (a) increases the membership of the Board from four members to nine members. The five new members are the Director of the

Property Tax Division of the Department of Revenue, or a person designated by the Director, and a representative from each of the following four associations -- the Farm Bureau, the North Carolina Association of Assessing Officers, the North Carolina Association of County Commissioners, and the North Carolina Forestry Association. Members from these associations are designated by the president of the association.

Newly designated subsection (b) sets out the existing requirement of the Agricultural Extension Service to provide clerical support to the Board. The statement that all members serve ex officio is deleted from this subsection because it is incorporated in subsection (a).

Newly designated subsection (c) sets out the Board's duties. Under prior law, the Board's duties consisted of submitting a recommended use-value manual to the Department of Revenue each year. The Board was required to follow the guidelines in G.S. 105-289(a)(5) in developing the manual. Those guidelines required five net income per acre ranges for each type of land based on soil productivity and, for agricultural land, the yields of corn and soybeans over a period of at least the previous five years.

Rewritten subsection (c) continues the duty of the Board to submit a recommended use-value manual to the Department of Revenue each year and changes the guidelines the Board must follow in developing the manual. The new guidelines are set out in subdivisions (1) through (6) of that section.

Subdivision (c)(1) requires the Board to estimate the cash rental rates for agricultural land and horticultural land for the various classes of soils in the State. The rates must recognize productivity levels by class of soil or geographic area.

Subdivision (c)(2) requires the Board to incorporate in the manual the net income ranges for forestland recommended by the Forestry Section of the North Carolina Cooperative Extension Service. The subdivision sets out various factors, such as soil productivity, the Forestry Section must consider in developing the income ranges.

Subdivision (c)(3) maintains the capitalization rate for income from forestland at 9% and uses net income to determine income. The subdivision directs the Board to set a rate for agricultural land and horticultural land and uses cash rents to determine income. The rate must be at least 6% and cannot be higher than 7%. Under prior law, the capitalization rate for all types of land was 9% and net income was used to determine income for all types of land. The Board must set the rate for agricultural and horticultural land by February 1 of each year.

Subdivision (c)(4) imposes a limit on the per acre value for agricultural land. The limit is $1,200.

Subdivision (c)(5) requires the manual to contain the Board's recommendations on changes to the capitalization rate for agricultural land and horticultural land and the maximum per acre value for agricultural land. The General Assembly anticipates that these items may need to be changed over time and has provided this mechanism to initiate the change. The Board must also report its recommendations on these topics to the Revenue Laws Study Committee, the Speaker of the House, and the President Pro Tempore of the Senate.

Subdivision (c)(6) requires the manual to include recommendations on horticultural land used to grow Christmas trees, if the Department asks the Board to make recommendations on this subject. This requirement is the same as under the prior section.

(Effective for taxable years beginning on or after July 1, 2003, SB 1161, s. 4, S.L. 02-184.)

G.S. 105-287(a) – Clarifying Changes: The 2001 General Assembly amended this subsection, effective July 1, 2002, to clarify when an assessor can change the value of property in a non-revaluation year. The amendments specify that a change in value can occur whether or not the factor creating the change was within the control of the property owner and add two new subdivisions setting out reasons for a change. The statement that a change in value does not have to result from a factor within the control of the owner addresses a recent court case. In that case, the court indicated that a county cannot change a property value in a non-revaluation year unless the reason necessitating the change came as a result of some action taken by the property owner or at the request of the owner. The new subdivisions clarify that zoning changes, improvements to the property, boundary changes, and changes in the legally permitted use of the land can result in a value change in a non-revaluation year.

(Effective July 1, 2002; SB 162, ss. 2 and 11, S.L. 01-139.)

G.S. 105-289 – Conforming Changes and Study of Cash Rents: This section was amended as part of the legislation reforming the present use-value system of taxation. The amendments delete provisions that have been superseded or incorporated in other statutes and give the Department another duty concerning property taxes. Subdivision (a)(5) deletes the guidelines for the use-value manual and substitutes a cross-reference to the manual developed by the Use-Value Advisory Board under revised G.S. 105-277.7, which now establishes the guidelines for the manual. The manual is based on cash rental rates for agricultural and horticultural land and net income ranges for forestland.

New subdivision (7) requires the Department to conduct cash rent studies for agricultural land by county or region and to furnish the results of the study to the Board. The Department may conduct the studies on any reasonable basis and timetable that will be reflective of rents and values for each local area based on the productivity of the land.

(Effective for taxable years beginning on or after July 1, 2003, SB 1161, s.5, S.L. 02-184.)

G.S. 105-296(j) – Review of Property Classified at Use-Value: This subsection was amended to address two issues concerning the requirement this subsection imposes on an assessor to review periodically all property classified for taxation at its present use-value. The amendments to this subsection are part of the legislation reforming the present use-value system of taxation.

One issue is the number of parcels to be reviewed each year and the scope of the review. The changes clarify that the assessor must review at least one eighth of the parcels classified for taxation at present-use value each year and that the period of the review process is based on the average of the preceding three years' data. The assessor may review more than one-eighth of the parcels in a year, but all parcels must be reviewed in an eight-year period. Before the change, the subsection directed the assessor to review one-eighth of the parcels each year and did not specify the period of the review process.

Another issue is the role of the sound management program in the review. By definition in G.S. 105-277.2, each type of land classified for taxation at its present use-value must be under a sound management program. The changes clarify that the assessor may require an owner to submit information on the sound management plan for forestland and specify factors the assessor must consider in determining whether any type of land is under a sound management program. The factors include weather conditions or other acts of nature that prevent the growing or harvesting of crops or the realization of income from cattle, swine, or poultry operations.

(Effective for taxable years beginning on or after July 1, 2003, SB 1161, s. 6, S.L. 02-184.)

G.S. 105-299 – Experts Can Aid in Use-Value Review: This statute was amended to specify that counties may use county agencies or enter into a contract with State or federal agencies to assist them in two functions concerning use-value approval. One function is the approval of applications for use-value classification and the other is the review of all the parcels that have received this classification.

(Effective for taxable years beginning on or after July 1, 2003, SB 1161, s. 7, S.L. 02-184.)

G.S. 105-309(f) - Deadline for Homestead Exclusion Extended: The 2001 General Assembly amended this subsection, effective July 1, 2002, to extend from April 15 until June 1 the time allowed for submitting an application for the homestead exemption and to make conforming changes. The conforming changes revise the language of the required notice concerning the property tax homestead exemption to reflect the increases made in G.S. 105-277.1 to the income eligibility threshold and the amount excluded.

(Effective July 1, 2002; HB 42, S.L. 01-308.)

G.S. 105-317.1– Personal Property Appeals: Subsection (c) was added to this section to set out the procedure for an appeal concerning the value, situs, or taxability of personal property. Under this subsection, a taxpayer who owns personal property has 30 days after the date of the notice of value to appeal. If the tax bill is the first notice of value for personal property, then the bill serves as the notice of value and must contain a statement that the taxpayer may appeal within 30 days after the date of the notice.

The subsection requires the assessor to arrange a conference with a taxpayer who appeals and, within 30 days after the conference, give the taxpayer a written notice of the assessor's final decision. The written notice is not necessary if the taxpayer signs an agreement accepting the value, situs, or taxability of the property as a result of the conference. If no agreement is reached at the conference, the taxpayer has 30 days from the date of the assessor's final decision to request a hearing before the board of equalization and review or, if that board is no longer in session, before the board of county commissioners.

(Effective for taxable years beginning on or after July 1, 2003, HB 1523, s. 2, S.L. 02-156.)

G.S. 105-322(g)(5) – Conforming Change: This subdivision was amended to make a conforming change concerning personal property appeals. G.S. 105-317.1 was amended to add a new subsection (c) describing the appeal process applicable to personal property. Under that process, a taxpayer may appeal within 30 days of receiving a notice of value. That date might occur after the board of equalization and review has adjourned for the year.

This subdivision was amended to add a new subpart d. This subpart allows the board of equalization and review to meet after its adjournment date to hear personal property appeals.

(Effective July 1, 2003; HB 1523, s. 3, S.L. 02-156.)

G.S. 105-357(b)(2) – Minimum Bad Check Penalty: This subdivision was amended to increase the minimum penalty for submitting a bad check from $1.00 to $25.00. The maximum penalty of $1,000 did not change.

(Effective October 9, 2002; HB 1523, s. 1, S.L. 02-156.)

G.S. 105-358 – Waiver of Bad Check Penalty: -- This section was rewritten to allow a tax collector to waive the bad check penalty imposed under G.S. 105-357(b)(2). The penalty is 10% of the amount of the check, subject to a minimum of $25.00 and a maximum of $1,000. Under prior law, the penalty could not be waived. A tax collector who waives the penalty must make a record of the reasons for the waiver.

Several formatting changes were made to the section to add the authority to waive the penalty. The catchline of the section was amended to reflect the new authority, the existing language of the statute concerning partial payments was designated as subsection (b), and the waiver authority was added as subsection (a).

(Effective October 9, 2002; H.B. 1523, s. 1.2, S.L. 2002-156.)

XXV. MOTOR FUELS TAX

G.S. 105-449.41 – Unnecessary Misdemeanor Repealed: This statute was repealed because it is not needed. Under the statute, it is a Class 1 misdemeanor for a person to make a false statement or assist another person in making a false statement for the purpose of reducing the amount of road tax payable, if the person knows the statement is false. The behavior described under this section is also described in G.S. 105-236, which contains the penalties that apply to all taxes collected by the Department of Revenue.

Under G.S. 105-236(7), it is a Class H felony to willfully attempt or assist in another person in attempting to evade or defeat a tax. Under G.S. 105-236(9a), it is a Class H felony to assist in the preparation or filing of a return, claim for refund, or other document the person knows is false.

(Effective January 1, 2003; SB 1407; s. 2, S.L. 02-108.)

G.S. 105-449.47 – Record-Keeping Requirement: This statute was amended to require a motor carrier to keep records of identification markers issued to it by the Secretary of Revenue and to be able to account for all of these markers. The changes were accomplished by designating part of existing subsection (a) as (a1), adding the heading of “Registration and Identification Marker” to newly designated subsection (a1), and amending the subsection add the requirement.

The Department of Revenue recommended these changes. The Department has encountered motor carriers who do not have all of the markers the Department has issued to them and cannot explain what happened to them.

(Effective January 1, 2003; SB 1407; s. 3, S.L. 02-108.)

G.S. 105-449.52 – Two New Penalties: This statute was amended to establish two new civil penalties and to make technical changes. The new penalties are set out in subdivisions (a)(2) and (a)(3). The penalties were recommended by the Department of Revenue to prevent the illegal sale or other transfer of identification markers.

The penalty in subdivision (a)(2) applies to a motor carrier who is unable to account for identification markers issued to it by the Secretary, as required by G.S. 105-449.47. The amount of the penalty is $100 for each unaccounted for marker.

The penalty in subdivision (a)(3) applies to a motor carrier who displays on a motor vehicle an identification marker that was not issued to the carrier. The amount of the penalty is $1,000 for each marker unlawfully displayed.

The addition of the new penalties required several technical and conforming changes to the statute. The catchline to the section was rewritten to broaden the language to include the new penalties, the current penalty for operating a vehicle without a registration card or an identification marker was designated as subdivision (a)(1), and the authority to stop a vehicle was broadened to include a vehicle displaying a marker that was not issued for that vehicle.

(Effective January 1, 2003; SB 1407; s. 4., S.L. 02-108.)

G.S. 105-449.60 – Definitions: Four definitions were added, one was renumbered, and seven were revised. The changes are described below. The changes were recommended by the Department of Revenue.

Biodiesel (1). The term is defined as any fuel or mixture of fuels derived in whole or in part from agricultural products or animal fats or wastes from these products or fats. The definition was added to enable the product to be identified and taxed as a motor fuel. A business in North Carolina has indicated that it has plans to produce biodiesel in this State using discarded french fry grease from fast food restaurants and other fats. Before the addition of this definition and the other related definitions, the State's motor fuel laws did not address biodiesel. Federal law addresses biodiesel, and the definition in this subdivision mirrors the definition in federal law.

Biodiesel provider (1a). This definition was added in anticipation of the production of biodiesel by a business in this State. As defined, a biodiesel provider is a person who either produces no more than 500,000 gallons of biodiesel per month or imports biodiesel. A biodiesel provider who produces more than 500,000 gallons per month is a refiner.

A biodiesel provider is also a supplier. The gallonage threshold was established to enable different bonding requirements to apply to a biodiesel provider than to other suppliers.

Blended fuel (1e)(Was (1). This definition was renumbered to keep the list of definitions in this section in alphabetical order. The new terms "biodiesel" and biodiesel provider" precede this term when they are put in alphabetical order. The substance of the definition did not change. Designations (1b) through (1d) are reserved for future codification.

Diesel fuel (7). This definition was amended to incorporate biodiesel. The definition specifies that diesel includes biodiesel.

Fuel alcohol (12). This definition was amended to add alcohol. Alcohol was not previously included in the list because it was assumed that alcohol alone would not be used as a fuel and that it would be taxed as a blend.

Fuel alcohol provider (13). This definition was amended to mirror the new definition of biodiesel provider. Under the definition, a person who produces no more than 500,000 gallons of fuel alcohol per month is a fuel alcohol provider and a person who produces more than 500,000 gallons per month is a refiner. A person who imports fuel alcohol by any means, including a tank wagon, is also a fuel alcohol provider.

A fuel alcohol provider is also a supplier. The gallonage threshold was established to enable different bonding requirements to apply to a fuel alcohol provider than to other suppliers.

Gasoline (15). The list of items that are considered gasoline was amended in subpart d. to include alcohol and methanol. These items are included due to the deletion of the term "fuel grade ethanol" and the substitution of the term "fuel alcohol."

Motor fuel transporter (22). This definition was amended to include a person who transports motor fuel by pipeline. The prior definition included only those who transported fuel outside the terminal transfer system. The pipeline is part of the terminal transfer system.

Refiner (27a). This new definition was added in anticipation of the production of biodiesel by a business in this State. Currently, there are no refiners in North Carolina. The definition was not added previously because it was not needed. A refiner is a person who owns or operates a refinery. The term includes a person who produces more than 500,000 gallons of biodiesel or fuel alcohol a month.

Refinery (27b). This new definition was added in anticipation of the production of biodiesel by a business in this State. Currently, there are no refineries in North Carolina. The definition was not added previously because it was not needed. A refinery is a facility that processes hydrocarbons into motor fuel and from which fuel may be removed by pipeline or vessel or from a rack. The term does not include a facility that produces only blended fuel or gasohol

Supplier (31). This definition was amended to add a biodiesel provider and a refiner. This is a conforming change that reflects the introduction of these categories into the law.

Tank wagon (33). This definition was amended to add a gallonage threshold for a vehicle to be considered a tank wagon. As amended, a vehicle must have a compartment designed or used to carry at least 1,000 of motor fuel to be a tank wagon. Prior law required a tank wagon to have multiple compartments and did not set a gallonage threshold.

(Effective January 1, 2003; SB 1407; ss. 5 and 6, S.L. 02-108.)

G.S. 105-449.72(a)(2) – Bond of Biodiesel Provider: Subpart a. of this subdivision was amended to set the amount of bond required of a biodiesel provider. The bond amount is the same as that for a fuel alcohol provider. The required bond is two times the average expected monthly liability, subject to a minimum of $2,000 and a maximum of $250,000. Prior law did not address biodiesel providers and therefore did not set a bond amount for them.

(Effective January 1, 2003; SB 1407; s. 7, S.L. 02-108.)

G.S. 105-449.72(d) – Notice Requirement Revised: This subsection sets out the procedure the Department must follow when a person who holds a motor fuel license files a replacement bond for a previously filed bond. A replacement bond releases the person who issued the original bond from liability. This subsection was amended to delete the requirement to give the license holder notice of the liability release under the original bond when a replacement bond is filed. The requirement to notify the person liable on the previously filed bond of their release from liability is not changed.

The Department recommended this change. The replacement bond was filed by the license holder, who therefore does not need notice from the Department of the liability release under the previous bond.

(Effective January 1, 2003; SB 1407; s. 8, S.L. 02-108.)

G.S. 105-449.77 – Lists of License Holders: This statute was amended to simplify the requirements to provide lists of license holders to other license holders and to provide periodic updates of these lists. Subsection (b) was rewritten and subsection (c) was deleted to establish one list of all license holders, to require the Department to give refiners and suppliers monthly updates of the list, and to require the Department to send monthly updates to other license holders only when requested to do so. The Department recommended these changes.

Prior law required separate lists to be maintained for various categories of license holders. It also required the Department to send the lists to the license holders annually and, for most lists, to send monthly updates. The Department complied with these requirements by mailing the lists and their updates to the specified groups. Based on feedback from license holders, the Department concluded that most license holders do not need or want monthly updates and that the cost of sending the lists was an unnecessary expense.

(Effective January 1, 2003; SB 1407; s. 9, S.L. 02-108.)

G.S. 105-449.87 – Changes in Backup Tax: This statute was amended to impose tax on fuel in one circumstance and clarify who is responsible for payment of a tax in another. The amendments impose tax on dyed diesel fuel used to operate special mobile equipment on the highways. The amendments specify who is liable for the motor fuel tax due on motor fuel destined for another state and then diverted to this State.

Subdivision (a)(1) of the prior law exempted from tax dyed diesel used by special mobile equipment to operate on the highway. The federal excise tax applied to this fuel, however. This difference resulted in confusion and, in some instances, the assessment of federal tax. The General Assembly deleted this exemption for highway operations of special mobile equipment to eliminate this confusion.

Most fuel used by special mobile equipment is for an off-highway purpose. Under the revised statute, the portion that is used for a highway purpose is now subject to the per gallon excise tax and is to be reported on the backup tax form.

New subdivision (a)(5) was added to make motor fuel destined for another state and then diverted to North Carolina subject to the backup tax and therefore reported on the backup tax form. Subsection (c) was revised to specify who is responsible for reporting and paying the tax. The person who authorizes the diversion from another state to this State is liable for the tax. If motor fuel was destined for this State and then diverted to another state, the person who authorized the diversion is the only person that can claim a refund of the North Carolina tax paid.

Under prior law, it was clear that motor fuel destined for another state and then diverted to this State was subject to tax. The responsibility and reporting requirements for the tax were not clear, however. In practice, the distributor would notify the supplier of the diversion and the supplier would adjust its records to account for the tax. The supplier would then account for the diversion on its returns, which do not accommodate this type of “after the terminal” adjustment.

In making the substantive changes to this section, a few formatting changes were made in subsections (b) and (c). The heading to subsection (b) was changed from “Liability” to “General Liability,” references to subdivisions (a)(1) through (a)(3) were added in subsection (b) to avoid expanding the vehicle operator’s liability to include liability for tax on diverted fuel, and a sentence on imputed knowledge that was previously in subsection (c) was moved to the end of subsection (b). Subsection (c) was revised to apply only to diverted fuel. The text of the existing section was moved to subsection (b).

(Effective January 1, 2003; SB 1407; s. 10, S.L. 02-108.)

G. S. 105-449.88(7) – Community College Exemption: The 2001 General Assembly amended this statute, effective January 1, 2002, to add an exemption for motor fuel sold to a community college to be used for community college purposes. G.S. 115D-5 requires the Community Colleges System to send the Department a list of the community colleges and to update the list as needed.

(Effective January 1, 2002; HB 232, s. 9, S.L. 01-427.)

G.S. 105-449.88(8) – Local Government Exemption: This statute was amended to add new subdivision (8) to exempt a county or a municipal corporation from the per gallon excise tax. Under prior law, counties and cities were subject to tax but were eligible under G.S. 105-449.106 for quarterly refunds of the amount of tax paid, less one cent per gallon.

(Effective January 1, 2003; SB 1407; s. 11, S.L. 02-108.)

G.S. 105-449.101(a) – Conforming Change: This subsection was amended to apply the revised definition of "motor fuel transporter" in G.S. 105-449.60. As revised, the definition includes a person who transports motor fuel by pipeline as well as marine vessel, railroad tank car, and transport truck. The statute therefore applies to the same persons as before.

(Effective January 1, 2003; SB 1407; s. 12, S.L. 02-108.)

G.S. 105-449.106(a) – Conforming Change: This subsection was amended to remove counties and municipal corporations from the list of entities eligible to receive quarterly refunds of the per gallon excise tax. They are removed from this list because, under revised G.S. 105-449.88(8), they are exempt from the tax.

(Effective January 1, 2003; SB 1407; s. 13, S.L. 02-108.)

G.S. 105-449.114(c) – Technical Change: This statute was amended to delete the references to special fuels and substitute references to alternative fuels. Before the 1995 rewrite of the motor fuel laws, the statutes classified fuel as either gasoline or special fuel and diesel was a type of special fuel. Under the 1995 rewrite, the categories of fuel are motor fuel, which includes gasoline and diesel, and alternative fuel, which includes fuels such as compressed natural gas. The change to this subsection applies the correct terminology.

(Effective January 1, 2003; SB 1407; s. 14, S.L. 02-108.)

G.S. 105-449.115(f) – Penalty Change: This subsection was amended to change the amount of the civil penalty for transporting motor fuel without a shipping document or delivering motor fuel to a destination state that is not the state listed on the shipping document. As revised, the penalty is a flat $5,000 for each failure to have a shipping document and each unauthorized diversion of motor fuel.

Under prior law, the amount of the penalty varied depending on whether the person assessed the penalty had previously been assessed a penalty under this subsection. If the person had no previous penalties under this subsection, the amount of the penalty was $1,500. If the person had a previous penalty, the amount of the penalty was $7,500.

This methodology for determining the amount of the penalty proved difficult to apply in practice and resulted in the penalty not being imposed. An enforcement officer could not impose a penalty on the spot due to lack of information on prior penalties. To apply the penalty, the enforcement officer obtained identifying information from the person against whom a penalty was proposed and then forwarded the information to the Motor Fuels Tax Division so that Division could check its records and then apply the correct penalty.

(Effective January 1, 2003; SB 1407; s. 15, S.L. 02-108.)

G.S. 105-449.115A – Tank Wagon Shipping Document: This new statute was added to require a shipping document for motor fuel transported by means of a tank wagon and to authorize a civil penalty for failure to comply with the requirement. The shipping document must set out information about the source of the fuel, the type and quantity of the fuel, and the date the fuel was loaded into the tank wagon. A person transporting the fuel must carry the shipping document and must show the document upon request.

A person who transports motor fuel in a tank wagon without a shipping document is subject to a civil penalty of $1,000. The penalty is payable by the person in whose name the tank wagon is registered. The penalty is less than the penalty for transporting motor fuel in a transport truck without a shipping document because of the difference in the quantity of fuel a transport truck and tank wagon can carry.

(Effective January 1, 2003; SB 1407; s. 16, S.L. 02-108.)

G.S. 105-449.118 – Penalty Change: This statute was amended to establish a flat penalty for dispensing or allowing the dispensing of non-tax-paid motor fuel into the supply tank of a highway vehicle. The flat penalty is $250 for each occurrence.

Before this change, the amount of the penalty varied depending on the amount of fuel dispensed. The penalty ranged from $75 for amounts less than 25 gallons to $300 for amounts of 300 gallons or more.

The sliding scale penalty proved difficult to apply. An enforcement officer who observed a violation had no way of knowing exactly how much fuel was dispensed.

(Effective January 1, 2003; SB 1407; s. 17, S.L. 02-108.)

XXVI. DEBT SET-OFF

G.S. 105A-5 – Notice of Local Collection Assistance Fee: This section was amended to reflect the new local collection assistance fee imposed under G.S. 105A-13. Subsection (b) was amended to require the written notice that a local agency sends to a debtor before a setoff can occur to include notice that the $15.00 local collection assistance fee will be added to the debt if the debt is submitted to the Department for setoff. Subsection (e) was amended in three places to expand references to the fees that apply to a setoff to include the $15.00 local collection assistance fee.

(Effective January 1, 2003; H.B. 1523, s. 5(b), S.L. 02-156.)

G.S. 105A-13 – Local Agency Collection Assistance Fee Authorized: This statute was amended to impose a $15.00 local collection assistance fee on each local agency debt submitted by a local clearinghouse to the Department and to specify the order in which an amount that is offset is applied to the Department's fee and the local fee. The local collection assistance fee is added to the debt. If the Department collects only part of the debt, the State fee has priority over the local fee and both fees have priority over the debt.

To accomplish these changes, subsection (c) was added to impose the fee, subsection (d) was added to specify the priority order that applies to a setoff, and subsection (a) was amended to delete a sentence that addressed priority order. The sentence was deleted from subsection (a) because its substance is incorporated in new subsection (d).

(Effective January 1, 2003; H.B. 1523, s. 5(c), S. L. 02-156.)

XXVII. STUDIES

Property Tax Study Commission Never Appointed: The 2001 General Assembly established a study commission devoted to property tax issues. The Commission was to consist of 16 members, eight to be appointed by the President Pro Tempore of the Senate and eight to be appointed by the Speaker of the House. The appointments were not made and the Commission never materialized.

The Commission's charge was to study the property tax system and recommend any needed changes. The legislation establishing the Commission directed the Commission to study the following:

- All exemptions and exclusions.
- The taxability of nonprofit charitable hospitals.
- The present use-value system.
- Ways to encourage agricultural, forestry, and horticultural uses of land.
- Tax incentives to encourage conservation and environmental protection.

The 2002 General Assembly established a Property Tax Subcommittee of the Revenue Laws Study Committee. See the discussion of the Revenue Laws Study Committee for an explanation of that subcommittee.

(Legislation authorizing commission effective December 19, 2001; HB 1427, ss. 3 and 4, S.L. 01-499; legislation establishing Property Tax Subcommittee effective October 31, 2002, SB 1161, s. 8, S.L. 02-184.)

Legislative Tax Policy Commission Never Appointed: Part XXIX of Chapter 491 of the 2001 Session Laws re-established the North Carolina Tax Policy Commission. The Commission was originally established in 1999 by Chapter 395 of the 1999 Session Laws. The 1999 Commission expired in 2001 before the Commission completed its work.

The Governor, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate each have 6 appointments to the Commission, for a total of 18 members. Members of the 1999 Commission must be reappointed if they are to serve on the 2001 Commission. The Governor made appointments to the Commission but the other officials did not make their appointments.

Like the 1999 Commission, the 2001 Commission was directed to establish the principles of taxation on which the State's tax structure should be based, review the tax structure to determine if it meets these principles, and recommend changes needed to align the tax structure in accordance with the principles. The Commission was to make a final report to the General Assembly, the Governor, and the citizens of the State by March 1, 2003.

(Legislation re-establishing Commission effective December 19, 2002; SB 166, Part XXIX, S.L. 01-491.)

Revenue Laws Study Committee: This Committee is a permanent Committee whose membership is appointed every two years. The 2002 Committee is a continuation of the 2001 Committee. The membership changes in each odd-numbered year.

The 2002 General Assembly created a permanent Property Tax Subcommittee of this Committee. The Property Tax Subcommittee consists of six members of the Committee, three of whom are appointed by the Speaker of the House of Representatives and three of whom are appointed by the President Pro Tempore of the Senate.

The purpose of the Subcommittee is to study the property tax system and make recommendations on any changes needed. The Subcommittee is to examine exemptions and exclusions from the property tax base, the present use-value system of taxation, and whether tax credits to encourage certain land uses should be enacted.

Various acts list topics of study for the full Committee. Some acts direct the Committee to study a certain topic and others state that the Committee may study a topic. The Committee does not study all topics chosen for it by the General Assembly, however, due to time limitations.

The 2002 General Assembly directed the Committee to study the following topics:

- The treatment of expenses related to dividends received and other income not taxed and the taxation of affiliated corporations, of holding companies, and of financial institutions (HB 1670, s. 5, S.L. 02136).
- The extent to which animal waste management facilities should be included in the property tax exclusion in G.S. 105-275(8) for property used to prevent air or water pollution (SB 1253, s. 2, S.L. 02-104).
- The use, effectiveness, and cost versus benefits of the Job Development Investment Grant Program, the Bill Lee Act credits, and the Industrial Recruitment Competitive Fund (HB 1734, s. 2.7, S. L. 02-172).

The 2002 General Assembly authorized, but did not direct, the Committee to study the following topics:

- How sales and use tax should be applied to asphalt and cement used in the performance of contracts (SB 98, PART IX, S.L. 02-180).
- The collection of property tax on mobile homes (SB 98, PART IX, S.L. 02-180).

The committee is also authorized in G.S. 120-70.106 to study any aspect of the tax laws. The committee is authorized to report its findings and recommendations to the 2003 General Assembly.

Governor's Commission to Modernize State Finances: Governor Easley established the Commission to Modernize State Finances. The Commission held its first meeting on March 5, 2002, and submitted its final report in December, 2002. The Commission's report can be obtained from the website of the Office of State Budget and Management at www.osbm.state.nc.us/files/pdf_files/final_rpt_gov_comm.pdf

The Commission organized itself into three subcommittees – Intergovernmental Finance, New Economy, and Tax Simplification. The goal of the Intergovernmental Finance Subcommittee was to examine the federal-state-local relationship in the context of taxing authority, service responsibility, and shared revenue streams. The goal of the New Economy Subcommittee was to examine revenue sources that are consistent with the direction of the New Economy, including the effect of growth in the service sector and the Internet, to examine strategies to reduce the volatility of the tax structure, and to develop policies to maintain North Carolina's economic competitiveness. The goal of the Tax Simplification Subcommittee was to examine ways to simplify the tax code by eliminating tax preferences, reducing complexity, and reworking economic development tax credits.

The Commission's report contains general recommendations about the State's tax structure. It does not contain specific legislative proposals. In general, the Commission recommends broadening tax bases and lowering the rates. The Commission's proposals include a recommendation to expand the sales tax base to include services, to adopt the sales tax changes needed to implement the national Streamlined Sales Tax Agreement, to align the individual income tax more closely to the federal income tax, to move toward combined reporting for corporate income and franchise tax purposes, and to provide future tax relief only through one-time rebates or temporary rate reductions.