



RESTRICTED

CIRCULATION

REVENUE LAWS STUDY
COMMITTEE



REPORT TO THE 2003
GENERAL ASSEMBLY OF NORTH CAROLINA
2004 SESSION

A LIMITED NUMBER OF COPIES OF THIS REPORT IS AVAILABLE
FOR DISTRIBUTION THROUGH THE LEGISLATIVE LIBRARY

ROOMS 2126, 2226
STATE LEGISLATIVE BUILDING
RALEIGH, NORTH CAROLINA 27611
TELEPHONE: (919) 733-7778

OR

ROOM 500
LEGISLATIVE OFFICE BUILDING
RALEIGH, NORTH CAROLINA 27603-5925
TELEPHONE: (919) 733-9390

THE REPORT IS ALSO AVAILABLE ON-LINE:
<http://www.ncleg.net/LegLibrary/>

TABLE OF CONTENTS

Letter of Transmittal.....	i
Revenue Laws Study Committee Membership.....	ii
Preface.....	1
Committee Proceedings.....	3
Committee Recommendations and Legislative Proposals.....	23
1. AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS.....	25
2. AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE PROVISIONS THAT COULD RESULT IN FRANCHISE TAXES ON ASSETS NOT INDIRECTLY OWNED BY CORPORATIONS.....	35
3. AN ACT TO REQUIRE LOCAL GOVERNMENTS TO PAY MONETARY COMPENSATION FOR REMOVAL OF LAWFULLY ERECTED OFF-PREMISES OUTDOOR ADVERTISING SIGNS, AND TO AUTHORIZE LOCAL GOVERNMENTS TO ENTER INTO RELOCATION AND RECONSTRUCTION AGREEMENTS WITH OWNERS OF NONCONFORMING OFF-PREMISES OUTDOOR ADVERTISING SIGNS.....	46
4. AN ACT TO MODIFY THE TAXATION OF MOTOR FUELS; TO ALLOW THE SECRETARY OF REVENUE TO APPOINT EMPLOYEES OF THE MOTOR FUELS TAX DIVISION AS REVENUE LAW ENFORCEMENT OFFICERS; AND TO TRANSFER THE AUDIT FUNCTIONS FOR THE INTERNATIONAL REGISTRATION PLAN TO THE DEPARTMENT OF REVENUE FROM THE DIVISION OF MOTOR VEHICLES.....	53

5. AN ACT TO ALLOW FARMLAND OWNED BY A FAMILY BUSINESS TO KEEP ITS PRESENT-USE VALUE TAX STATUS WHEN LEASED FOR FARM USE	66
6. AN ACT TO ADOPT A FLAT COLLECTION ASSISTANCE FEE UNDER THE SETOFF DEBT COLLECTION ACT	78
7. AN ACT TO REQUIRE THAT SELLERS BE PROVIDED WITH NOTICE AND A 60-DAY-PERIOD TO RESPOND TO A REQUEST FOR A REFUND OF OVER-COLLECTED SALES OR USE TAXES BEFORE A PURCHASER MAY BRING A CAUSE OF ACTION AGAINST THE SELLER.....	84
8. AN ACT TO MAKE TECHNICAL AND CLARIFYING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES.....	91

Appendices

A. Authorizing Legislation, Article 12L of Chapter 120 of the General Statutes	
B. Disposition of Committee's Recommendations to the 2003 Session	
C. State Budget Outlook	
D. State Revenue Outlook	
E. Department of Revenue Report on the Collection of Tax Debt	
F. Memos by Martha Walston and Trina Griffin, Staff Attorneys to the Revenue Laws Study Committee, Regarding Recent Court Cases Involving Taxation Issues	
G. Testimony to the Revenue Laws Study Committee by William Schweke Regarding Wage and Benefit Performance Standards for Business Incentives	
H. Wireless 911 Board Executive Summary	
I. Memo from Linda Millsaps, Fiscal Analyst to the Revenue Laws Study Committee, Regarding Voice-over Internet Protocol	
J. PC World Article: <i>Senate Weighs Rules for Internet Phones</i>	
K. Presentation by the Department of Revenue on the Present-Use Value Program	
L. Statement of the Conservation Trust for North Carolina and the North Carolina Land Trust Council to the Property Tax Subcommittee	
M. Southern Environmental Law Center and Environmental Defense Comments to the Property Tax Subcommittee	
N. Memo from Linda Millsaps, Fiscal Analyst to the Revenue Laws Study Committee, Regarding State-Owned Conservation Property	
O. Presentations and Proposals Regarding Monetary Compensation for Outdoor Advertising	



REVENUE LAWS STUDY COMMITTEE
State Legislative Building
Raleigh, North Carolina 27603

Senator John H. Kerr, III, Cochair

Representative Paul Luebke, Cochair
Representative David Miner, Cochair

May 6, 2004

TO THE MEMBERS OF THE 2004 GENERAL ASSEMBLY (2003 Regular Session):

The Revenue Laws Study Committee submits to you for your consideration its report pursuant to G.S. 120-70.106.

Respectfully Submitted,

Handwritten signature of Paul Luebke in black ink, written over a horizontal line.

Rep. Paul Luebke, Co-Chair

Handwritten signature of John Kerr in black ink, written over a horizontal line.

Sen. John Kerr, Co-Chair

Handwritten signature of David Miner in black ink, written over a horizontal line.

Rep. David Miner, Co-Chair

2003-2004

REVENUE LAWS STUDY COMMITTEE

MEMBERSHIP

Senator John H. Kerr, III, Cochair

Representative Paul Luebke, Cochair
Representative David Miner, Cochair

Senator Daniel Clodfelter
Senator Walter H. Dalton
Senator Fletcher L. Hartsell, Jr.
Senator David W. Hoyle
Mr. Leonard Jones
Mr. J. Micah Pate, III
Senator Hugh Webster

Rep. Gordon Allen
Rep. Harold Brubaker
Rep. Dewey L. Hill
Rep. William McGee
Rep. William Wainwright
Rep. Steve Wood

Staff:

Susan Phillips, Committee Clerk

Cindy Avrette, Staff Attorney
Richard Bostic, Fiscal Analyst
David Crotts, Fiscal Analyst
Trina Griffin, Staff Attorney
Martha H. Harris, Staff Attorney
Y. Canaan Huie, Staff Attorney
Linda Millsaps, Fiscal Analyst
Martha Walston, Staff Attorney

PREFACE

The Revenue Laws Study Committee is established in Article 12L of Chapter 120 of the General Statutes to serve as a permanent legislative commission to review issues relating to taxation and finance. The Committee consists of sixteen members, eight appointed by the President Pro Tempore of the Senate and eight appointed by the Speaker of the House of Representatives. Committee members may be legislators or citizens. The co-chairs for 2003-2004 are Senator John Kerr and Representatives Paul Luebke and David Miner.

G.S. 120-70.106 gives the Revenue Laws Study Committee's study of the revenue laws a very broad scope, stating that the Committee "may review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable." A copy of Article 12L of Chapter 120 of the General Statutes is included in Appendix A. A committee notebook containing the committee minutes and all information presented to the committee is filed in the Legislative Library.

In 2002, the General Assembly established a permanent subcommittee under the Revenue Laws Study Committee to study and examine the property tax system.¹ The subcommittee was to consist of six members, three appointed by the Senate chair of the Revenue Laws Study Committee and three appointed by the House chair of the Committee. The subcommittee may recommend changes in the property tax system to the full Committee for its consideration in its final report to the General Assembly. The

¹ S.L. 2002-184, s. 8.

chairs to the Revenue Laws Study Committee appointed the following eight members to the Property Tax Subcommittee: Co-Chairmen Senator Dan Clodfelter and Representative Harold "Bru" Brubaker; Senators Walter Dalton and Fletcher Hartsell; Representative Gordon Allen, Dewey Hill, and Bill McGee; and public member Leonard Jones. ²

Before it was created as a permanent legislative commission, the Revenue Laws Study Committee was a subcommittee of the Legislative Research Commission. It has studied the revenue laws every year since 1977.

² Legislative Proposal #8, *Revenue Laws Technical Changes*, provides that the Property Tax Subcommittee of the Revenue Laws Study Committee may consist of up to eight members.

COMMITTEE PROCEEDINGS

The Revenue Laws Study Committee met five times after the 2003 Regular Session of the 2001 General Assembly adjourned on July 20, 2003. The Committee considered all proposed tax changes in light of general principles of tax policy and as part of an examination of the existing tax structure as a whole.

REVIEW OF THE RECOMMENDATIONS MADE TO THE 2003 GENERAL ASSEMBLY

The 2003 General Assembly enacted five of the Revenue Laws Study Committee's seven legislative proposals in whole or in part. Appendix B lists the Committee's recommendations and the action taken on them in 2003. A document entitled "2003 Tax Law Changes" summarizes all of the tax legislation enacted in 2003. It is available in the Legislative Library located in the Legislative Office Building.

BUDGET AND REVENUE OUTLOOK

At its first meeting on January 13, 2004, the Revenue Laws Study Committee began its work with a briefing on the current year's budget and an overview of the revenue outlook for fiscal year 2003-2004 from Jim Johnson and David Crotts with the Fiscal Research Division.

While the continuation budget for fiscal year 2004-2005 is balanced, high priority commitments, such as funding for higher education enrollment increases, State employee and teacher pay raises, teacher performance initiatives, repairs and renovations, the Rainy Day Fund, and Water Resources Development projects, remain

unfunded. Two items that pose a serious risk to the budget are the ABC bonus payouts for teachers, which has exceeded the current year's budget by \$44 million, and the volatile growth rate of Medicaid.

Despite an anticipated shortfall, the fiscal analysts did identify areas that have seen dramatic improvement in recent months. Withholding taxes were up dramatically in the fourth quarter of 2003 and sales tax collections continue to rise. Collection data indicates that for the first six months of fiscal year 2003-2004, net General Fund revenues are running \$25.8 million ahead of the \$7.0 billion target for the period. More importantly, the State moved from a \$41.4 million shortfall to a \$25.8 million surplus, a turnaround of \$67.2 million. Although the economic outlook is the brightest that it has been in the past three years, the recovery has been plagued with inconsistencies and analysts continue to be cautious for several reasons. First, the revenue growth rates must continue to increase if the State is going to meet its budget target. Second, external events, such as the war in Iraq, have the potential to sidetrack economic recovery. Third, the market continues to experience carryover losses from the stock market crash. Data from some states indicate that the backlog of losses is the highest since the 1973-1974 bear market. Finally, many of the North Carolina jobs lost to overseas locations will not be replaced, stunting employment growth. Appendices C and D contain a discussion of the issues and prospects for the State Revenue and Budget Outlook for 2003-2004 presented to the Committee.

Among the State's tools for generating revenue is the program known as "Project Collect Tax" established within the Department of Revenue for collecting back taxes. The Department is required to report on a quarterly basis to the Revenue Laws Study Committee its progress regarding the collection of tax debt. At the February 3, 2004 meeting, Secretary Norris Tolson reported that the Department had generated \$47

million in revenue as of January 2004 and is well on its way to generating the goal figure of \$115 million. Project Collect Tax has collected \$275 million in delinquent taxes in this biennium, with \$78 million in the first seven months. A copy of the Department's report on the collection of tax debt is included as Appendix E.

In addition to reporting on Project Collect Tax, Secretary Tolson identified for the Committee members several of the Department's enforcement concerns. First, the Department has detected an increase in efforts to avoid taxes by fraudulent methods, including an increase in fraudulent tax preparers. Investigating these cases is time-consuming and expensive and places a significant burden on the Department's resources. Second, the Department has identified a number of people working in North Carolina, especially among the immigrant labor pool, who are claiming maximum deductions but not filing a tax return. Secretary Tolson estimates this failure to file accounts for a loss of revenue to the State of approximately \$30-\$50 million per year. Third, there are a growing number of taxpayers claiming William S. Lee Act credits who are not eligible for or qualified to receive the credits resulting in a significant outflow of money. After examining 149 corporations that claimed credits under the Bill Lee Act in 2003, the Department recovered \$10 million in taxes owed by the corporations and reduced future installments in subsequent tax years by \$78 million.

The Committee continues to monitor several ongoing court cases involving tax matters that have the potential to affect the State's budget and revenue outlook. At its first meeting, the Committee heard updates on four cases, all of which are ongoing. Memoranda summarizing these cases and detailing their status is included in Appendix F.

INCOME TAX

The Revenue Laws Study Committee spent considerable time reviewing two income and franchise tax issues.

North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.¹ The General Assembly determines each year whether to update its reference to the Internal Revenue Code.² Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. Legislative Proposal #1, *IRC Update*, changes the statutory reference to the Code from June 1, 2003, to January 1, 2004. Congress enacted two bills between June 1, 2003, and January 1, 2004, that would affect State tax provisions. The Military Family Tax Relief Act of 2003, P.L. 108-121, enacted on November 11, 2003, makes numerous changes to personal income tax provisions primarily affecting members of the uniformed services or the Foreign Service and their families. The Medicare Prescription Drug, Improvement, and Modernization Act of 2003, P.L. 108-173, enacted on December 8, 2003, created Health Savings Accounts, which allow persons to accumulate funds on a tax-preferred basis to pay for certain medical expenses.

The Committee continued discussions, begun in 2000, on the applicability of the corporate franchise tax to various types of business entities. In 2001, the Revenue Laws

¹ North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

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

Study Committee recommended changes to the franchise tax in order to correct what was perceived to be a loophole in the law. Under North Carolina law, limited liability companies (LLCs) are not subject to the franchise tax. In 1997, the North Carolina law was amended to allow for a single-member LLC. This change had the unintended consequence of allowing a corporation to avoid the franchise tax, without affecting liability for other taxes, by holding assets in a single-member LLC. In 2001, the Revenue Laws Study Committee proposed legislation that was later enacted to close this perceived loophole. That legislation required a corporation to include in its franchise tax base all or a portion of the assets of an LLC in which the corporation was a member under certain circumstances. That legislation was fine-tuned by legislation enacted during the 2002 Session. After the 2002 Session, the Department of Revenue reported that tax practitioners had discovered alternative entity structures to overcome the General Assembly's attempt to close the perceived loophole. Due to time constraints, the Revenue Laws Study Committee could not fully develop a proposal before the convening of the 2003 General Assembly. During 2003, legislation was introduced in the General Assembly to further close the perceived loophole; however, that legislation ultimately was not enacted.

Over the course of several meetings after the conclusion of the 2003 Session, the Revenue Laws Study Committee heard updates on attempts to close the perceived loophole. Some members recommended the franchise tax be extended to business entities other than corporations while others recommended a repeal of the franchise tax and an overhaul of corporate taxation. Ultimately a working group advising the Revenue Laws Study Committee recommended a proposal that would amend the attribution rules of the 2001-2002 legislation and exempt smaller LLCs. Legislative Proposal #2, *Amend Franchise Tax Loophole*, incorporates these recommendations.

SALES AND USE TAX

A. Streamlined Sales Tax Project

The Revenue Laws Study Committee continues to support the efforts of and monitor the progress of the Streamlined Sales Tax Project. The Project is an effort created by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax administration for both Main Street and remote sellers for all types of commerce. Forty-two of the 45 states with a sales and use tax, as well as the District of Columbia, are involved in the Project. As of April 2004, 20 states have enacted all or part of the conforming legislation, and the process of compliance certification has begun. In order for North Carolina to be in full compliance with the Agreement, the General Assembly will have to eliminate multiple rates, caps, and thresholds by December 31, 2005.

At this point, participation by vendors is voluntary; states cannot require out-of-state vendors to collect sales and use taxes without Congressional action. However, in late 2003, H.R. 3184 and S. 1736 were introduced in Congress, which would authorize member states to require all sellers, except those qualifying for the small business exception, to collect and remit sales and use taxes with respect to remote sales to purchasers located in the member states. Those bills are still pending.

The Revenue Laws Study Committee considered two Streamlined-related items in a bill draft titled, *Sales and Use Tax Changes*. The first item would exempt bakery items from the definition of "prepared food," thus exempting those items from the State sales tax. The bakery item exemption is not required by the Agreement, but is a permissible exemption. There was considerable debate over this issue. In support of the exemption, members argued that certain grocery items traditionally considered staples, like bread, should be taxed at the lower 2% rate regardless of whether it is

purchased from a store's bakery or from its bread aisle. On the other hand, the exemption as approved by the Agreement covers a broad range of bakery items including donuts, muffins, pies, croissants, and pastries, which may be considered more like "prepared food" that should be taxed at the 7% rate. The Committee expressed concern that the exemption may create inconsistent results or exempt items that are not supported by the rationale for exempting food staples. Ultimately, the Committee did not recommend this proposal.

The second item in the bill draft was a provision that would codify existing Department policy regarding refunds of overcollected sales and use tax. Under the Agreement, states must require purchasers seeking a refund of overcollected sales and use tax to provide sellers with written notice and a 60-day period to respond prior to bringing a cause of action against the seller. The Department has already adopted this policy, promulgated in a February 2004 technical bulletin, but retailers would prefer that the provision be codified in statute. This item was recommended by the Committee and is found in Legislative Proposal #7, *Notice Period for Sales and Use Tax Refunds*.

B. Electricity Sold to Manufacturers

Sales of electricity, along with sales of piped natural or artificial gas and sales of motor vehicles, aircraft, watercraft, and manufactured or modular homes, are exempt from the provisions of the Streamlined Sales Tax Agreement. However, this Committee has previously identified as a feature of an equitable and effective tax structure the absence of multiple rates, caps, and exemptions. To further its efforts to modernize, simplify, and equalize North Carolina's tax code, the Committee examined the graduated tax rates applicable to sales of electricity to manufacturers.

Prior to July 1, 2002 electricity that was sold to a manufacturer for use at a

manufacturing facility and that was separately metered or measured was subject to the sales and use tax at a rate of 2.83% (most other sales of electricity are taxed at the rate of 3%). On February 14, 2000 the Secretary of Revenue issued a Directive ruling that electricity is a form of energy, not a form of matter or tangible property that the Legislature intended to exempt from tax. The Directive overruled previous private letter rulings from the Sales and Use Tax Division of the Department of Revenue that allowed a sales tax exemption for arc furnaces. Effective March 1, 2000, electricity used in arc furnaces once again became subject to the 2.83% sales tax. The state's only aluminum smelter, Alcoa Badin Works, began paying the 2.83% tax in March 2000.

Two bills were introduced during the 2001 General Assembly to reverse the Revenue decision. Although neither of those measures passed, a floor amendment to Senate Bill 748, Bill Lee Act Changes, included a .17% tax rate beginning July 1, 2002 for manufacturers who use over 900,000 megawatt hours of power each year. At the time, the only firm eligible for this lower rate was Alcoa Badin Works. Alcoa has since closed its North Carolina plant, and according to the Department of Revenue, there are no taxpayers currently claiming the .17% tax rate. Senate Bill 748 also included the following additional rates, beginning in July 1, 2005, based on volume of electricity used by manufacturers:

- 2% = 250,000 - 900,000 megawatt hours each year
- 2.25% = 5,000 - 250,000 megawatt hours each year
- 2.83% = less than 5,000 megawatt hours each year (current tax)

The bill draft titled *Sales and Use Tax Changes* would make the following changes with regard to the taxation of electricity:

- It would repeal the .17% tax rate that currently applies to sales of electricity to manufacturers who use more than 900,000 megawatt-hours of electricity annually;
- It would repeal the graduated tax rate provisions (specifically the 2% and the 2.25% rates) that are scheduled to take effect July 1, 2005; and

- It would re-enact the law as it existed prior to July 1, 2002, which provided for a 2.83% tax rate on electricity sold to manufacturers and separately metered or measured, regardless of the volume of electricity used annually.

At its May 6, 2004 meeting, the Committee heard from Chuck Neely, representing Alcoa, and Sharon Miller, representing the Carolina Utility Customers Association, Inc., who both opposed the repeal of the reduced rates. Mr. Neely indicated that although Alcoa is not currently operating its smelting facility, which if in operation, would be able to take advantage of the .17% rate, it continues to employ approximately 140 people in its other operations. He further indicated that given the right economic conditions, Alcoa intends to re-open its smelting facility. However, without the .17% rate in place, it may not be economically feasible. There was considerable debate on this issue, but ultimately the Committee decided not to recommend the proposal to repeal the reduced rates on certain sales of electricity.

MOTOR FUELS TAX

The Revenue Laws Study Committee received several proposals from the Motor Fuels Tax Division of the Department of Revenue. At the first meeting of the Committee, the Motor Fuels Tax Division made a brief presentation in which the Division Director, Julian Fitzgerald introduced senior staff and promised a proposal that would enhance the ability of the Division to carry out its mission. At a later meeting, the Committee reviewed the proposal of the Division and had a lively discussion related to several provisions of that proposal. Two provisions in particular drew a great deal of discussion.

First, the Committee had concerns about exempting the American Red Cross from the motor fuels tax that it currently pays on dyed diesel fuel used for highway purposes. Dyed diesel fuel is exempt from the federal motor fuels tax and, therefore, generally may not be used in highway vehicles. There are some exceptions to this

however, in that governmental vehicles, intercity buses, private school buses, and vehicles operated by the American Red Cross may use dyed diesel fuel on the highways. With the exception of vehicles owned by governmental entities, these users of dyed diesel fuel are currently required to pay the State motor fuels tax on dyed diesel fuel used for highway purposes.³ Some members of the Committee were concerned about the erosion in the motor fuels tax base resulting from continued exemptions from the motor fuel taxes. The Motor Fuels Tax Division felt, however, that the exemption was required in order to comply with federal law.

Second, there was a great deal of discussion about several penalties that would be increased or created by the proposal. Particular concern was expressed about a penalty that would be imposed upon terminal operators for failure to issue a proper shipping document. Some of the members expressed a concern that failure to issue a proper shipping document may be the result of taxpayer error rather than malevolent intent and that the penalty seemed harsh for this type of error. The Motor Fuels Tax Division stated that the Division has repeatedly provided education on the matter of issuing proper shipping documents and that the problem has persisted with certain terminal operators. The Division reported that it has had problems with terminal operators issuing one shipping document that showed fuel to be delivered in more than one State. With such a shipping document, it is permissible for the transporter to deliver the fuel to either destination. Without a proper shipping document it is difficult for the Division to verify whether the proper amount of tax has been paid.

Some concerns were also raised about a penalty that would be assessed against a provider, bulk-end user, or retailer of alternative fuel that fails to obtain a license. Some members felt that the imposition of this penalty could stifle research involving

³ Local governments were made exempt from the motor fuels tax on dyed diesel fuel used in highway vehicles during the 2002 Session.

alternative fuels. The Motor Fuels Tax Division indicated a willingness to work with taxpayers to avoid the imposition of a penalty, but felt that the authority to assess a penalty was needed to ensure enforcement of the motor fuels taxes.

Few concerns were raised about a provision that would abolish a hold harmless provision that was created in 1996. However, the Motor Fuels Tax Division and representatives of the petroleum marketing industry indicated an intent to further review this proposal. Similarly, few concerns were raised about a proposal to allow the Secretary of Revenue to appoint employees of the Motor Fuels Tax Division as revenue law enforcement officers.

A pared down version of the proposal of the Motor Fuels Tax Division is incorporated in Legislative Proposal #4, *Motor Fuels Tax Changes*.

PRIVILEGE LICENSE TAX

At its February 3, 2004 meeting, the Committee was presented with an overview of the privilege license tax system, an analysis of the system's deficiencies, and options to consider for revising the current system. Historically, this system of taxation has been considered an outmoded, inefficient, and arbitrary method of raising revenue largely because it places a tax burden on only a limited portion of businesses. For these reasons, the majority of State privilege license taxes, as set out in "Schedule B" of Chapter 105, were repealed in 1997. However, the problems that plagued the State privilege license tax system still exist at the local level and continue to be a source of confusion for local governments and taxpayers alike. Specifically, cities and counties are authorized to levy privilege license taxes only to the extent cities and counties were authorized to tax the businesses before Schedule B was repealed. Therefore, in order to determine the scope of a city's or county's authority to levy a privilege license tax, one must refer to the law as it existed in 1995 before the repeal. Consequently, there are

inconsistencies in the administration of these local taxes.

The Committee was presented with two possible options for improving the privilege license tax system. It could codify the former Schedule B provisions into the current statutes, or it could repeal the local privilege license tax exemptions and restrictions and replace them with a more uniform system. The Committee, however, did not take any further action on this issue during the interim.

ECONOMIC DEVELOPMENT

The Revenue Laws Study Committee spent some time looking at a specific economic development issue. The Committee studied the issue of the wage standard as it relates to economic development programs, particularly the Job Development Investment Grant (JDIG) program. JDIG is a program that was created in 2002 under which grants are made to selected businesses based on a percentage of the personal income tax withholdings associated with eligible new positions created by the business. As the program was originally enacted, in order to be eligible for participation in the JDIG program, grantee businesses had to pay an average weekly wage that met the wage standard set out under the Bill Lee Act. In the 2003 2nd Extra Session, however, that wage standard requirement was removed from the JDIG program. The Committee heard presentations from the Department of Commerce and the Governor's Office about why they felt the removal of the wage standard was necessary. The Committee also heard a presentation on alternative ways of establishing a wage standard that could utilize a sector-based approach. A paper prepared on this matter by William Schweke with the Corporation for Enterprise Development is included as Appendix G. The Revenue Laws Study Committee recognized that two other legislative committees were studying economic development issues and decided to take no further action on this matter.

TELECOMMUNICATIONS

The Enhanced 911 Wireless Fund Act, enacted by the 1998 General Assembly, established a system for charging cellular telephone users for enhanced 911 service and established a method of administering and distributing the funds collected. An enhanced 911 system is one that provides cellular users with 911 service, directs wireless 911 calls to the appropriate dispatch agency based on where the calls originate, and enables the dispatch agency to determine the location and telephone number of the caller. The Act provides for a service charge of \$.80 per month on each commercial mobile radio service (CMRS) connection. The funds are then disbursed to CMRS providers and public safety answering points (PSAPs) in North Carolina. The Wireless 911 Board is required to report biannually to the Revenue Laws Study Committee regarding receipts and expenditures of all funds received by the Board. At its March 16, 2004 meeting, Richard Taylor, Executive Director of the Wireless 911 Board, reported a \$51 million fund balance as of December 31, 2003. A summary of the Board's report is attached in Appendix H.

The Committee was briefed on a new area of technology that has generated a great deal of activity - Voice over Internet Protocol (VoIP). VoIP is a technology that allows users to make telephone calls using a broadband Internet connection instead of a regular (or "analog") phone line. The possibility of VoIP becoming a central part of our nation's telecommunications infrastructure is extremely high. Given the uncertain nature of its tax status, the growth of this technology has the potential for significant revenue implications for the State and its municipalities.

The Department of Revenue's position is that, under current law, VoIP telecommunication services are subject to sales tax in North Carolina. In other states, at least one company offering these services, Vonage, Inc., has filed suit maintaining that

its product is not a telephone service subject to telecommunications taxes, but rather an information service. Under federal law, information services are not subject to state regulation or taxation. Fiscal analysts conclude that the advent of VoIP will likely reduce the amount of telecommunications tax revenue available to the State and municipalities. Currently, the State collects about \$310-\$360 million in telecommunications taxes annually, with approximately \$50-\$60 million going to municipalities under a tax sharing program. If VoIP were found to be an information service, the State and municipalities would potentially lose all the revenue associated with VoIP services. Even if VoIP were found to be a telecommunications service that could be taxed, the cost savings associated with using VoIP would likely reduce the taxable base.

At this time, most of the activity regarding the tax status of VoIP is occurring at the federal level. The Internet Tax Freedom Act, defining VoIP as an information service, is pending before Congress. A federal district court ruling that Vonage is an information service provider is currently on appeal. Most significant, however, is likely to be Federal Communication Commission activity. In 2003, the FCC started a massive rulemaking process to consider the regulatory status of VoIP. Many industry watchers believe it will be the FCC that ultimately makes the decision on the taxability of VoIP. A memorandum and a PC World article with additional detail on this issue can be found in Appendices I and J.

GENERAL TAX LAW ADMINISTRATION

The Setoff Debt Collection Act is a mechanism for State and local agencies to collect debts owed to the agencies through setoff against an individual's income tax refund. This collection remedy is mandatory for State agencies and optional for local agencies. Each year, the Department of Revenue determines its costs of running the

program and recovers these costs by charging a collection assistance fee as a percentage of each debt collected. According to the Department, the process is very tedious and quite cumbersome because many different areas of the Department are affected. Thus, the "actual cost" is an estimate at best. G.S. 105A-13 caps the fee at no more than \$15.00 per debt, but for the last four years, the fee has been just under \$5.00. Therefore, the Department recommends, and the Committee is proposing, that G.S. 105A-13 be amended to establish a flat \$5.00 collection assistance fee on each debt collected through setoff. This change can be found in Legislative Proposal #6, *Adopt Flat Fee for Debt Collection*.

The Revenue Laws Study Committee also recommends Legislative Proposal #8, *Revenue Laws Technical Changes*, which makes several technical and clarifying changes to the revenue laws and related statutes.

PROPERTY TAX SUBCOMMITTEE

The Property Tax Subcommittee, established by the Revenue Laws Study Committee in G.S. 120-70.108, has been given broad instruction to recommend changes to the property tax system and to examine the taxation of all classes of property, including exemptions and exclusions of property from the property tax base. The Subcommittee is also directed by the statute to study the present-use value system. In S.L. 2003-284, Sec. 117, the Subcommittee was directed to "study the positive and negative impacts of the acquisition of land by the State and non-profit organizations using money from the Clean Water Management Trust Fund and other State funds for conservation purposes on local government ad valorem tax revenues." The Subcommittee examined a number of proposals and voted to recommend one proposal to change the present-use value appraisal of farmland owned and leased by a family business.

A. Present-use value appraisal of farmland

The Subcommittee began its study of the property tax system by examining the present-use valuation of farmland. The Department of Revenue presented an overview of the system which values farmland (agricultural land, horticultural land, and forestland) for property tax purposes at its present-use value as opposed to its fair market value. This presentation can be found in Appendix K. The Subcommittee was also given a summary of present-use value legislation enacted by the General Assembly in 2001 and 2002. S.L. 2001-499 expanded the applicability of the present-use value program to farmer-to-farmer transfers. This change provides that the owner of farmland can transfer the property, regardless of whether the new owner already has property in the present-use value system, without losing the property's use value tax status and having to pay deferred taxes. However, the new owner must acquire the land for the purposes of and continue to use the land for the purposes it was classified under the use-value program. S.L. 2002-184 implemented changes recommended by the Revenue Laws Study Committee. These changes amended the present-use value laws to provide an updated method of determining the value of farmland in its present use, clarified the sound management requirement for qualifying for use value taxation, and allowed land subject to a conservation easement to continue to qualify for use value taxation.

The Subcommittee heard from Jim Dobson, an Iredell County farmer, who expressed his concern about farmers in the county who had lost the present-use value tax benefit when they leased their land. Under current law, farmland may be owned by a natural person or by a business entity. If the land is owned by a business entity, then the land may keep its present-use value status if the business entity is engaged in the

principal business of farming and all members of the business entity meet one or more of the following conditions:

1. The member is actively engaged in the business of the entity.
2. The member is a relative of a member who is actively engaged in the business of the entity.
3. The member is a relative of, and inherited the membership interest from, a decedent who met one or both of the preceding conditions after the land qualified for classification in the hands of the business entity.

If farmland, owned by a business entity, is leased to a non-member of the business entity for farming purposes, then the present-use value status is lost. In this situation, the county tax assessor would deny present-use value status because the business of the entity is deemed to be leasing land rather than agriculture. By contrast, the current law allows a natural person to lease his or her farmland without losing the preferential tax status. This means that a widow who inherits farmland from her husband will not lose present-use value tax status on the land if she decides to lease it for farming purposes. The Subcommittee voted to amend the present-use value statutes to allow farmland owned by a business entity to keep its present-use value status if its members lease the land for the purpose of agriculture, horticulture, or forestry and if all members of the business entity are relatives. This proposal would allow a family business's property to keep its present-use value status if the members of the business do not want to physically participate in farming the land or to make decisions about the farming activity. The recommendation of the Property Tax Subcommittee is incorporated as Legislative Proposal #5, *Allow Family Business to Lease Farmland*.

The Subcommittee looked at one other proposal to amend the present-use value statutes. This proposal would exempt agricultural land from the ownership requirements in the statutes and extend the roll back period for agricultural land from

three years to six years. The consensus of the members was that the bill needed more study to determine its impact on county revenues.

B. Conservation Working Group

The Subcommittee heard from a number of conservation groups who presented their proposals to benefit conservation including making it easier for taxpayers to donate land for conservation purposes, developing a comprehensive statewide conservation plan, and expanding present-use value status to lands managed for wildlife and other conservation purposes. Statements from these groups can be found in Appendices L and M. After hearing from the interested parties, the Subcommittee agreed that a working group should be formed to study conservation lands, present-use value, and related tax incentives. The working group met on April 19 and began discussing issues of interest. The group decided to focus on the following four issues: (1) types of conservation incentives that property owners want, (2) improving the administration of the present-use value system, (3) revenue issues for local governments, and (4) improving data collection efforts.

C. Improve Property Tax Collection on Repossessed Mobile Homes

The Subcommittee began studying the ongoing problem of collecting delinquent property taxes on repossessed mobile homes. Under current law, it is unlawful for anyone, other than a mobile home manufacturer or retailer, to move a mobile home from one location to another without first obtaining a county tax permit. In order to obtain this permit, the owner of the mobile home must pay all taxes due to the county or taxing unit. It is also unlawful for a lienholder to take possession of a mobile home without first applying for a tax permit and paying taxes due on the mobile home within seven days of issuance of the permit. A violation of the law is a Class 3 misdemeanor. County tax collectors are having trouble enforcing the law for several reasons.

Lienholders are increasingly taking possession of and selling the mobile homes on site without obtaining a tax permit. Once the home is transferred to a new owner for value, the county's ability to collect delinquent property taxes on the mobile home ends. County tax collectors also stated that the penalty for violation of the statutes is too lenient and not prohibitive. The manufactured housing industry argued that the law does not require a permit when the lienholder takes possession and does not move the mobile home. The industry also argued that since many of the mobile homes cannot be sold or can be sold only at a significant loss, a lienholder should not be liable for all delinquent taxes on the home. A working group composed of representatives of the manufactured housing industry, county tax collectors, the Association of County Commissioners, the League of Municipalities, the Department of Revenue, and the Department of Transportation has met twice to examine ways of improving the collection to property taxes on repossessed mobile homes. The Subcommittee will continue to work on a solution to this problem.

D. Update on State owned conservation property.

As directed by S.L. 2003-284, Sec. 117, the Subcommittee began examining the value and associated property tax loss from the acquisition of land by the State and non-profit organizations using money from the Clean Water Management Trust Fund and other State funds for conservation purposes. Tentative findings of a status report provided to the Subcommittee show that since 1995, the State has acquired 193,696 acres for conservation purposes and that the total sales price for these properties was \$198,285,088. The total potential lost local tax revenue is projected to be at least \$1.4 million statewide, although the actual amount may be much higher. This update on State owned conservation property can be found in Appendix N.

E. Other issues examined by the Property Tax Subcommittee

The Subcommittee also looked at but took no action on the following issues:

- Requiring qualifications for county and city tax collectors similar to current statutory qualifications for county tax assessors.
- Valuation of partially improved, undeveloped lots in subdivisions for property tax purposes. Under G.S. 105-287(d), an assessor has the option to appraise unsold lots in a subdivision as land acreage rather than as lots if the tract of land has been subdivided into lots and more than five acres of the tract remain unsold.
- Changes to the property tax homestead exclusion and to the annexation statute delaying the annexation of present-use value property by a city as long as the property remains eligible for present-use value classification.
- Exempting property under construction and held by exempt religious, educational, and various charitable organizations if the property, when finished, will be used for the exempt purpose.
- Changes to the appeal process in property tax valuation cases.

JUST COMPENSATION SUBCOMMITTEE

Session Law 2003-349 directed the Revenue Laws Study Committee to study the issue of just compensation for the removal of lawfully erected, nonconforming, off-premises outdoor advertising. Under current law, local governmental entities are not required, under most circumstances, to pay monetary compensation to an owner of outdoor advertising when that advertising is required to be removed in order to conform to a local ordinance.⁴ Under case law, the payment of monetary compensation is generally not required when the owner of the outdoor advertising is allowed to remove the advertising over a reasonable period of time. However, most states require, by statute, local governments to pay monetary compensation for the removal of outdoor advertising. The Committee heard testimony from representatives of local government and of the outdoor advertising industry. The Committee established a Just

⁴ The payment of just compensation is required when the advertising is located along federal-aid primary and interstate highways, in compliance with federal and State law.

Compensation Subcommittee to study the issue in depth.

The Subcommittee reviewed negotiations between the interested parties involving a variety of issue. After months of negotiations, the interested parties reached agreement on most provisions regarding the payment of monetary compensation for the removal of outdoor advertising. During final negotiations, representatives of local government recommended setting monetary compensation at the fair market value of the property subject to a cap of three times the gross annual revenues associated with the property: Representatives of the outdoor advertising industry recommended setting monetary compensation at the fair market value of the property which would be represented by six and one-half times the gross annual revenues associated with the property. Copies of the proposals submitted by the North Carolina League of Municipalities and the North Carolina Outdoor Advertisers Associations are included as Appendix O. The Subcommittee voted to set the amount of monetary compensation required as the fair market value of the property to be removed, subject to a cap of five times the gross annual revenues associated with the property. The recommendation of the Just Compensation Subcommittee is incorporated as Legislative Proposal #3, *Monetary Compensation – Outdoor Advertising*.



COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee makes the following eight recommendations to the 2004 General Assembly. Each proposal is followed by an explanation and, if it has a fiscal impact, a fiscal note or memorandum indicating any anticipated revenue gain or loss resulting from the proposal.

1. IRC Update
2. Amend Franchise Tax Loophole
3. Just Compensation - Outdoor Advertising
4. Motor Fuels Tax Changes
5. Allow Family Business to Lease Farmland
6. Adopt Flat Fee for Debt Collection
7. Notice Period for Sales and Use Tax Refunds
8. Revenue Laws Technical Changes



LEGISLATIVE PROPOSAL #1

IRC UPDATE

LEGISLATIVE PROPOSAL #1

IRC UPDATE

LEGISLATIVE PROPOSAL #1:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS.

SHORT TITLE: IRC Update

SPONSORS: Miner, G. Allen, Brubaker, Hill, Luebke, McGee, Wainwright,
Wood

BRIEF OVERVIEW: This bill would update to January 1, 2004, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. This bill would be effective when it becomes law.

FISCAL IMPACT: This bill would result in a loss to the General Fund of approximately \$5 million to \$7 million annually.

EFFECTIVE DATE: This bill would become effective when it becomes law, except to the extent that it would increase taxable income for the 2003 taxable year.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page



GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

U D
BILL DRAFT 2003-LYxz-135 [v.6] (1/20)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
3/25/2004 2:24:44 PM

Short Title: IRC Update. (Public)

Sponsors: .

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE
3 CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX
4 PROVISIONS.

5 The General Assembly of North Carolina enacts:

6 **SECTION 1.** G.S. 105-228.90(b)(1b) reads as rewritten:

7 "(b) Definitions. – The following definitions apply in this Article:

8 ...

9 (1b) Code. – The Internal Revenue Code as enacted as of ~~June 1,~~
10 ~~2003,~~ January 1, 2004, including any provisions enacted as of that
11 date which become effective either before or after that date."

12 **SECTION 2.** Notwithstanding Section 1 of this bill, any amendments to
13 the Internal Revenue Code enacted after June 1, 2003, that increase North Carolina
14 taxable income for the 2003 taxable year become effective for taxable years
15 beginning on or after January 1, 2004.

16 **SECTION 3.** Notwithstanding the time limitations of G.S. 105-266 and
17 G.S. 105-266.1, a refund for an overpayment of tax resulting from a change in the
18 law enacted by this act regarding the exclusion of gain on the sale or exchange of a
19 principal residence by a member of the uniformed services or the Foreign Service of
20 the United States is timely if a demand for the refund is filed on or before November
21 11, 2004.

22 **SECTION 4.** This act is effective when it becomes law.



BILL ANALYSIS OF LEGISLATIVE PROPOSAL #1: IRC UPDATE

BY: Y. CANAAN HUIE, BILL DRAFTING DIVISION

SUMMARY: This bill would update to January 1, 2004, the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. This bill would be effective when it becomes law.

CURRENT LAW: North Carolina's tax law tracks many provisions of the federal Internal Revenue Code, by reference to the Code.¹ The General Assembly determines each year whether to update its reference to the Internal Revenue Code.² Updating the Internal Revenue Code reference makes recent amendments to the Code applicable to the State to the extent that State law tracks federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes and is normally enacted in the following year, rather than in the same year the federal changes are made. Under current law, the reference date to the Code is June 1, 2003.

BILL ANALYSIS: This bill would update the reference to the Code to January 1, 2004. Congress enacted two bills between June 1, 2003, and January 1, 2004, that would affect State tax provisions. These bills are the Military Family Tax Relief Act of 2003 (P.L. 108-121), which was signed into law on November 11, 2003, and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173), which was signed into law on December 8, 2003.

Military Family Tax Relief Act of 2003 (MFTRA) (P.L. 108-121).

The Military Family Tax Relief Act of 2003 makes numerous changes to the tax laws. These changes are discussed separately below.

¹ North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

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

Exclusion of gain on sale of a principal residence by a member of the uniformed services or the Foreign Service. Under current law, an individual taxpayer is allowed to exclude up to \$250,000 (\$500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To qualify for this exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the last five years. MFTRA provided special rules for members of the uniformed services³ or the Foreign Service of the United States. Under MFTRA the member may elect to suspend for a maximum of ten years the five-year test for period for ownership and use during certain periods of absence due to service in the uniformed services or the Foreign Service. If the election is made, the five-year period ending on the date of the sale or exchange does not include any period, up to ten years, in which the taxpayer or the taxpayer's spouse is on qualified official extended duty.⁴ The effect of this provision will make it easier for military families to qualify for this exclusion. This provision is effective for sales or exchanges occurring on or after May 6, 1997. MFTRA also provides for a one-year period for taxpayers to claim refunds as a result of this provision that would otherwise be barred because of the statute of limitations. This bill provides a similar exception to the State statute of limitations.

Exclusion from gross income of certain death gratuity payments. Federal law provides that qualified military benefits are not included in gross income. Qualified military benefits include certain death gratuities. Under previous law, the amount of the military death gratuity benefit was \$6,000 of which \$3,000 was excluded from gross income. MFTRA increases the amount of the military death gratuity benefit to \$12,000 and provides that all of it is excluded from gross income. This provision is effective for deaths occurring after September 10, 2001.

Exclusion for amounts received under the Department of Defense Homeowners Assistance Program. The Department of Defense Homeowners Assistance Program (HAP) provides payments to certain employees and members of the Armed Forces to offset the effects on housing values related to military base realignment or closure. Under the program, an eligible individual can either receive a cash payment related to the decrease in value or sell the property for a price based on the fair market value of the property before the announcement of the base realignment or closure. Previously, to the extent these payments exceeded the fair market value of any property relinquished, they were considered income. MFTRA excludes these

³ The uniformed services include the Army, Navy, Air Force, Marine Corps, and Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the Public Health Service.

⁴ "Qualified official extended duty" is any period of extended duty while serving at a place of duty at least 50 miles from the taxpayer's principal residence or under orders compelling residence in government furnished quarters. "Extended duty" is a period of duty pursuant to a call to order for a period in excess of 90 days or for an indefinite period.

payments from gross income. This provision is effective for payments made after November 11, 2003.

Expansion of combat zone filing rules to contingency operations. Generally, under Section 7058 of the Code the period of time for performing various acts under the Code is suspended for any individual serving in the Armed Forces of the United States in an area designated as a combat zone. North Carolina law prohibits the Secretary of Revenue from assessing penalties or interest for any period that is disregarded under Section 7058 of the Code. State law also provides that the taxpayer is granted an extension of time to file a return or take any other action regarding a State tax during this period. The federal legislation extends the special suspension rules to include persons who are not serving in a combat zone but who are deployed outside of the United States and away from the individual's permanent duty station while participating in an operation designated by the Secretary of Defense as a contingency operation or that becomes a contingency operation.⁵ This provision applies to any period for performing and action that had not expired before November 11, 2003.

Veterans' organizations tax exemption membership requirement modification. In order to be tax-exempt as a veterans' organization under Section 501(c)(19) of the Code, certain membership requirements must be met. Under previous law, at least 75% of members were required to be past or present members of the Armed Forces and "substantially all" of the other members were required to be spouses, widows, or widowers of present or past members of the Armed Forces or cadets. MFTRA enlarged the class of individuals who must make up substantially all of the remaining membership by including ancestors and lineal descendants of present or past members of the Armed Forces or cadets. This provision became effective November 11, 2003.

Dependent Care Assistance Program payments to members of the uniformed services. As mentioned earlier, certain qualified military benefits are not included in gross income. MFTRA clarifies that dependent care assistance provided under a dependent care assistance program to a member of the uniformed services by reason the member's status or service is excludable from gross income as a qualified military benefit. This provision is effective for taxable years beginning on or after January 1, 2003.

Suspension of tax-exempt status of terrorist organizations. Under current law, the revocation of an organization's tax-exempt status is accompanied by administrative

⁵ A contingency operation is a military operation that is designated by the Secretary of Defense as an operation in which members of the Armed Forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States or against an opposing military force, or results in the call or order to active duty of members of the uniformed services during a war or a national emergency declared by the President or Congress.

or judicial rights of appeal. Prior to the enactment of MFTRA, there was no procedure for suspending the tax-exempt status of an organization. MFTRA suspends the tax-exempt status of any organization that is exempt from tax under Section 501(a) of the Code for any period during which the organization is designated or identified by U.S. authorities as a terrorist organization or a supporter of terrorism. During the period of suspension, no deduction for any contribution to the organization is allowed under the Code. No organization or other person may directly challenge the suspension of tax-exempt status. In order to challenge the suspension of tax-exempt status, a person must challenge the underlying designation that the organization is a terrorist organization or a supporter of terrorism. Tax-exempt status is reinstated when all underlying designations have been rescinded. If it is determined that a designation was erroneous, tax-exempt status is reinstated retroactively. This provision is effective for all designations – past, present, or future. Suspension of tax-exempt status becomes effective when the designation becomes effective or November 11, 2003, whichever is later. Because this provision became effective during 2003 and could have the effect of raising taxes in the 2003 tax year for some taxpayers, this bill contains language in Section 2 that clarifies that any change in this bill that could increase taxes in the 2003 taxable year will not take effect until the 2004 taxable year.

Above-the-line deduction of overnight travel expenses of National Guard and Reserve members. Under previous law, National Guard and Reserve members could claim itemized deductions for their nonreimbursable expenses for transportation, meals, and lodging for overnight travel associated with National Guard or Reserve meetings. These expenses were only deductible to the extent they exceeded 2% of the taxpayers adjusted gross income. MFTRA allows for an above-the-line deduction so that National Guard or Reserve members may claim a deduction for these expenses regardless of whether they itemize deductions. The deduction is allowed only to the extent it does not exceed the federal per diem rate and only when the member must travel at least 100 miles from home. The deduction allowed by MFTRA is not limited to the portion that exceeds 2% of adjusted gross income.

Extension of certain tax relief provisions to astronauts. In 2001, Congress enacted the Victims of Terrorism Tax Relief Act of 2001. That act provided certain income and estate tax relief to individuals who died as a result of the terrorist attacks on September 11, 2001 or April 19, 1995 (the bombing of the Alfred P. Murrah Federal Building in Oklahoma City) or as a result of an illness that occurred as a result of an anthrax attack that occurred between September 11, 2001, and January 1, 2002. In general, under that act, qualified individuals are exempt from federal income tax for the taxable years starting with the taxable year preceding the attack until the taxable year including death. This income tax exemption does not apply to certain deferred compensation payment or to amounts that would not have been otherwise payable without some other action occurring after September 11, 2001. That act also

provides that certain death benefits are excludable from gross income and provides for a reduction in estate taxes. MFTRA extended these benefits to astronauts who lose their lives on a space mission, including those who lost their lives in the space shuttle Columbia disaster. This provision is effective for individuals whose lives are lost after December 31, 2002.

Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173).

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173) contains one significant tax provision. As part of that law, Congress enacted Health Savings Accounts (HSA). The federal legislation will allow a person to accumulate funds on a tax-preferred basis to pay for certain medical expenses. Contributions to the fund may be made by an employer, an eligible individual, or both. The earnings in the fund grow tax-free. Employer contributions to a HSA are excludable from gross income and contributions by an eligible individual are deductible in computing adjusted gross income.

Distributions from a HSA for medical expenses would be excludable from income, except for amounts distributed to pay most health insurance premiums. However, tax-free distributions from a HSA may be used to pay the following health insurance premiums: retiree health insurance premiums for individuals who have reached Medicare eligibility; premiums for COBRA coverage; premiums for qualified long-term care insurance contracts; and premiums for a health plan during a period in which an individual is receiving unemployment. Distributions from a HSA for non-medical expenses would be includible in income.



**INTERNAL REVENUE CODE UPDATE FOR 2003 FEDERAL TAX CHANGES
ESTIMATED BUDGET EFFECTS - PRELIMINARY**

Fiscal Years 2004 - 2009

[Millions of Dollars]

Provision	Effective	2004-05	2005-06	2006-07	2007-08
I. H.R. 3365 "THE MILITARY FAMILY TAX RELIEF ACT OF 2003"					
1. Exclusion of gain on sale of a principal residence by a member of the uniformed and foreign services	soea 5/6/97	-0.5	-0.1	-0.1	-0.1
2. Exclusion from gross income of certain death gratuity payments to deceased members of the armed forces	doa 9/10/01	-----Negligible Revenue Effect-----			
3. Exclusion for amounts received under Department of Defense Homeowners Assistance Program	pma DOE	-----Negligible Revenue Effect-----			
4. Expansion of combat zone filing rules to contingency operations	[1]	-----Negligible Revenue Effect-----			
5. Modification of membership requirement for exemption from tax for certain veterans' organizations	tyba DOE	-----Negligible Revenue Effect-----			
6. Clarification of treatment of certain dependent care assistance programs provided to members of the uniformed services of the United States	tyba 12/31/02	-----No Revenue Effect-----			
7. Treatment of service academy appointments as scholarships for purposes of qualified tuition programs and Coverdell Education Savings Accounts	tyba 12/31/02	-----Negligible Revenue Effect-----			
8. Suspension of tax-exempt status of terrorist organizations	dmb/a DOE	-----Negligible Revenue Effect-----			
9. Above-the-line deduction for overnight travel expenses (not exceeding per diem levels) of National Guard and reserve members traveling more than 100 miles from home	apota 12/31/02	-0.7	-0.6	-0.6	-0.6

10. Tax relief and assistance for families of astronauts who lose their lives in the line of duty

[2]

-----Negligible Revenue Effect-----
-1.2 -0.7 -0.7 -0.7

NET TOTAL FOR H.R.3365

Provision	Effective	2004	2005	2006	2007
II. H.R.1 "THE MEDICARE PRESCRIPTION DRUG, IMPROVEMENT, AND MODERNIZATION ACT OF 2003"					
1. Health Savings Accounts	tyba 12/31/03	-1.4	-4.3	-4.8	-5.4
TOTAL COST OF IRC UPDATE		-2.6	-5.0	-5.5	-6.1

Legend:

- apoi/a = amounts paid or incurred after soea = sales or exchanges after
- DOE = date of enactment pma = payments made after
- dimbo/a = designations made before, on, or after tyba = taxable years beginning after
- doa = deaths occurring after

Notes:

- [1] The provision applies to any period for performing an act which has not expired before the date of enactment.
- [2] Generally effective for qualified individuals whose lives are lost in the line of duty after December 31, 2002.

Source:

The Fiscal Research Division of the General Assembly worked with Revenue's Tax Research Division on these estimates. North Carolina estimates are based on a percentage of a federal estimate computed by the Congressional Joint Committee on Taxation. Approximately 2.44% of the active military personnel in the US claim North Carolina as their residence (Dept. of Defense - 2001 Statistical Report of Personnel and Readiness) and 2.57% of the active US reserve and national guard are residents of NC (Dept. of Defense - 2002 Atlas/Data abstract for the US and Selected Areas). The average federal tax rate used is 21.9% (IRS Statistics of Income Bulletin Fall 2003) and the average NC income tax is 6.8% (2001 tax year detail data). For the Health Savings Account, NC has 2.9% of the US population (US Census Bureau).

LEGISLATIVE PROPOSAL #2

AMEND FRANCHISE TAX LOOPHOLE



LEGISLATIVE PROPOSAL #2:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE PROVISIONS THAT COULD RESULT IN FRANCHISE TAXES ON ASSETS NOT INDIRECTLY OWNED BY CORPORATIONS.

SHORT TITLE: Amend Franchise Tax Loophole.

SPONSORS: Clodfelter, Kerr, Dalton, Hartsell, Hoyle, Webster

BRIEF OVERVIEW: This draft bill would amend 2001-2002 legislation that established attribution rules intended to close a loophole that allows corporations to escape franchise tax by having a controlled limited liability company (LLC) hold their assets. The changes will further close the loophole, exempt small LLCs, and remove from the franchise tax LLC assets not controlled indirectly by a corporation.

FISCAL IMPACT: No fiscal impact estimate is available. The intent of the legislation is to prevent the further erosion of the tax base and to remedy problems with previous legislation

EFFECTIVE DATE: For taxes due on or after January 1, 2003.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

H

D

BILL DRAFT 2003-LCxz-178J [v.1] (1/21)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
5/6/2004 10:55:07 AM

Short Title: Modify Franchise Tax Loophole.

(Public)

Sponsors: Representative.

Referred to:

1 A BILL TO BE ENTITLED
2 AN ACT TO CLOSE A LOOPHOLE THAT ALLOWS CORPORATIONS TO
3 CONTINUE AVOIDING FRANCHISE TAXES AND TO REMOVE
4 PROVISIONS THAT COULD RESULT IN FRANCHISE TAXES ON ASSETS
5 NOT INDIRECTLY OWNED BY CORPORATIONS.

6 The General Assembly of North Carolina enacts:

7 SECTION 1. G.S. 105-114.1 reads as rewritten:

8 "§ 105-114.1. Limited liability companies.

9 (a) Definitions. – The definitions in G.S. 105-130.7A apply in this section. In
10 addition, the following definitions apply in this section:

11 (1) Affiliated group. – Defined in section 1504 of the Code.

12 (2) Capital interest. – The right under a limited liability company's
13 governing law to receive a percentage of the company's assets upon
14 dissolution after payments to creditors.

15 (3) Entity. – A person that is not a human being.

16 (4) Governing law. – A limited liability company's governing law is
17 determined under G.S. 57C-6-05 or G.S. 57C-7-01, as applicable.

18 (2) Owned indirectly. – A person owns indirectly assets of a limited
19 liability company if the limited liability company's governing law
20 provides that seventy percent (70%) or more of its assets, after
21 payments to creditors, must be distributed upon dissolution to the
22 person as of the last day of the principal corporation's taxable year.

1 (3) ~~Principal corporation.~~—A corporation that is a member of a limited
2 liability company or has a related member that is a member of a
3 limited liability company.

4 (b) ~~Controlled Companies.~~ – If a corporation or an affiliated group of
5 corporations owns seventy percent (70%) or more of the capital interests in a limited
6 liability company, the corporation or group of corporations must include in its three
7 tax bases under this Article the same percentage of the limited liability company's net
8 assets, a related member of the corporation is a member of a limited liability
9 company and the principal corporation and any related members of the principal
10 corporation together own indirectly seventy percent (70%) or more of the limited
11 liability company's assets, then the following provisions apply:

12 (1) ~~A percentage of the limited liability company's income, assets,~~
13 ~~liabilities, and equity is attributed to that principal corporation and~~
14 ~~must be included in the principal corporation's computation of tax~~
15 ~~under this Article.~~

16 (2) ~~The principal corporation's investment in the limited liability~~
17 ~~company is not included in the principal corporation's computation~~
18 ~~of tax under this Article.~~

19 (3) ~~The attributable percentage is equal to the percentage of the limited~~
20 ~~liability company's assets owned indirectly by the principal~~
21 ~~corporation divided by the percentage of the limited liability~~
22 ~~company's assets owned indirectly by related members of the~~
23 ~~principal corporation that are corporations.~~

24 (c) Constructive Ownership. – Ownership of the capital interests in a limited
25 liability company is determined by reference to the constructive ownership rules for
26 partnerships, estates, and trusts in section 318(a)(2)(A) and (B) of the Code with the
27 following modifications:

28 (1) The term 'capital interest' is substituted for 'stock' each place it
29 appears.

30 (2) A limited liability company and any noncorporate entity other than
31 a partnership, estate, or trust is treated as a partnership.

32 (3) The operating rule of section 318(a)(5) of the Code applies without
33 regard to section 318(a)(5)(C).

34 ~~Other Companies.~~—~~In all other cases, none of the limited liability company's~~
35 ~~income, assets, liabilities, or equity is attributed to a principal corporation under this~~
36 ~~Article.~~

37 (d) No Double Inclusion. – If a corporation is required to include a percentage
38 of a limited liability company's assets in its tax bases under this Article pursuant to
39 subsection (b) of this section, its investment in the limited liability company is not
40 included in its computation of capital stock base under G.S. 105-122(b).

1 (e) Affiliated Group. – If the owner of the capital interests in a limited liability
2 company is an affiliated group of corporations, the percentage to be included
3 pursuant to subsection (b) of this section by each group member that is doing
4 business in this State is determined by multiplying the capital interests in the limited
5 liability company owned by the affiliated group by a fraction. The numerator of the
6 fraction is the capital interests in the limited liability company owned by the group
7 member and the denominator of the fraction is the capital interests in the limited
8 liability company owned by all group members that are doing business in this State.

9 (f) Exemption. – This section does not apply to assets owned by a limited
10 liability company if the total book value of the limited liability company's assets
11 never exceeded one hundred fifty thousand dollars (\$150,000) during its taxable year.

12 (g) Timing. – Ownership of the capital interests in a limited liability company
13 is determined as of the last day of its taxable year. The adjustments pursuant to
14 subsections (b) and (d) of this section must be made to the owner's next following
15 return filed under this Article. If a limited liability company and a corporation or an
16 affiliated group of corporations have engaged in a pattern of transferring assets
17 between them with the result that each did not own the capital interests on the last
18 day of its taxable year, the ownership of the capital interests in the limited liability
19 company must be determined as of the last day of the corporation or group of
20 corporations' taxable year.

21 (h) Penalty. – A taxpayer who, because of fraud with intent to evade tax,
22 underpays the tax under this Article on assets attributable to it under this section is
23 guilty of a Class H felony in accordance with G.S. 105-236(7)."

24 **SECTION 2.** G.S. 105-114.1(b), as amended by this act, reads as
25 rewritten:

26 "(b) Controlled Companies. – If a corporation or an affiliated group of
27 corporations owns ~~seventy percent (70%) or more~~ more than fifty percent (50%) of
28 the capital interests in a limited liability company, the corporation or group of
29 corporations must include in its three tax bases under this Article the same
30 percentage of the limited liability company's net assets. "

31 **SECTION 3.** Section 1 of this act becomes effective January 1, 2003, and
32 applies to taxes due on or after that date. Section 2 of this act becomes effective
33 January 1, 2005, and applies to taxes due on or after that date. The remainder of this
34 act is effective when it becomes law.



BILL ANALYSIS OF LEGISLATIVE PROPOSAL #2: AMEND FRANCHISE TAX LOOPHOLE

BY: MARTHA H. HARRIS, BILL DRAFTING DIVISION

SUMMARY: This draft bill would make the following changes to 2001-2002 legislation that established attribution rules intended to close a loophole that allows corporations to escape franchise tax by having a controlled limited liability company (LLC) hold their assets. The changes would become effective for taxes due on or after January 1, 2003.

- Remove attribution rules for certain related members and for individuals. Ownership interests in LLC assets would be attributed to corporations and to and from partnerships, estates, trusts, LLCs, and other entities.
- Provide that federal rules relating to constructive ownership of stock govern attribution of ownership interests in LLC assets.
- Attribute only a proportion of the LLC assets to the controlling corporation, rather than all of the assets.
- Exempt LLCs that have no more than \$150,000 of assets.
- Simplify and correct the test for determining whether an LLC's assets are attributable to a corporation.
- Beginning in 2005, change from "70% or more" to "more than 50%" the minimum percentage of an LLC's assets a corporation must control to trigger the franchise tax requirement.
- Remove membership in the LLC as an additional condition for attribution.

CURRENT LAW: Under North Carolina law, limited liability companies¹ (LLCs) are not subject to the franchise tax. In 1997, the North Carolina law regarding LLCs was changed to allow for a single-member LLC. This change had the unintended consequence of allowing a corporation subject to North Carolina franchise tax to set up an LLC and transfer assets to the LLC in a tax-free transfer. The assets then held by the LLC would not be subject to the franchise tax. Thus, the corporation could avoid a significant portion of its franchise tax liability by transferring assets into a wholly owned LLC without affecting its income tax liability.

¹ A limited liability company is a business entity that is essentially a hybrid of a partnership and a corporation. Like a corporation, an LLC limits the liability of its owners. Like a partnership, an LLC is usually not subject to entity-level taxation.

In 2001, the General Assembly enacted S.L. 2001-327 to close this loophole. The 2001 legislation tried to address the problem by requiring a corporation to pay tax on assets owned by the LLC if the corporation, including its affiliated corporations, indirectly owned² at least 70% of the LLC's assets. Unfortunately, tax planners found that the tax could still be avoided by using an additional paper transaction. If the corporation interposed a partnership between itself and the LLC holding its assets, then technically the 2001 legislation would not apply and the assets would continue to escape franchise tax.

In 2002, the General Assembly enacted S.L. 2002-126 to tighten the 2001 law. The 2002 legislation required attribution through "related members" (other entities and individuals) who may partner with one or more corporate entities to own the LLC that will hold the corporate assets. "Related members" is a defined term and includes shareholders, partnerships, etc. If a corporation and its related members together indirectly own at least 70% of an LLC's assets, the 2002 legislation provides that each corporation pays franchise tax on its relative share of the LLC's assets. The relative share is calculated after excluding those related members that are not corporations. Thus, the entire assets are subject to franchise tax, with the tax burden shared proportionally by the corporations that are involved in the ownership scheme.

After the 2002 legislation was enacted, it became apparent that it not only failed to close the loophole but also extended the franchise tax to situations that did not involve corporate control of LLC assets. The loophole remained open because there are additional paper transactions that can be interposed between the corporation and the LLC in order to circumvent the attribution of the LLC's assets to the corporation. For example, control may be passed through a business trust.³

The 2002 legislation apparently went too far because it extended the franchise tax to assets owned by individuals or entities over which the corporation has no control. If a corporation controls assets owned by a related LLC, then franchise tax would be appropriate. If a corporation gives up both control and ownership of assets, however, it would seem that the corporation should not have to pay franchise tax on the assets.

BILL ANALYSIS: This draft bill would close the loophole by extending the franchise tax to LLC assets the corporation controls through trusts and other entities. The bill would also trim back the scope of the 2002 legislation by limiting its reach to LLC assets the corporation controls and by exempting small LLCs. These changes are retroactive to 2003.

² Indirect ownership of an LLC's assets is determined based on who is entitled to receive those assets upon dissolution of the LLC.

³ A business trust is not considered a related member, as that term is defined in G.S. 105-130.7A, because it would be the corporation, not the shareholders, that would form the trust.

The concept of control is determined by tracing ownership the capital interests in the LLC's assets. A capital interest is the right to receive some or all of the assets under the LLC's governing law if it were dissolved. Ownership of the capital interests in an LLC is traced, using the principles of constructive ownership, through any noncorporate entities. The chain of constructive ownership can run through layers of noncorporate entities but not through individuals. The franchise tax is payable by the corporation or affiliated group of corporations to which ownership of the capital interests is traced.

Ownership of capital interests in an LLC is determined as of the last day of the LLC's tax year. If an LLC and a corporation engage in a pattern of trading assets back and forth so that neither owns them on its respective trigger date, the Secretary may require the determination to be made as of the last day of the corporation's tax year.

If the capital interests in an LLC are owned by an affiliated group of corporations, the value of the assets is allocated among the members of the group for franchise tax purposes so that there will not be double taxation of any assets. The allocation is in proportion to each affiliate's ownership interest.

The bill would exempt from the attribution rules those LLCs whose total assets do not exceed \$150,000. Under current law, an LLC pays an annual report fee of \$200 while corporations pay an annual report fee of \$20. The approximate threshold at which there would be no tax advantage from transferring corporate assets to an LLC is \$130,000.

The bill would also make a number of other changes to the law. It would reduce the threshold percentage of an LLC's assets that a corporation must control before the franchise tax is triggered. The current threshold is 70% or more but applies to a much broader realm of parties through whom ownership may be attributed. This bill would set the threshold at more than 50% beginning in 2005. The bill would also correct the formula for tracing ownership to remove the current law's potential effect of attributing 100% of an LLC's assets when the corporation controls less than 100%. Finally, the bill would remove membership in the LLC as an additional condition for attribution. That condition created a loophole and served no purpose.

BACKGROUND: The State franchise tax is among the oldest taxes in North Carolina. It is a tax on S Corporations and C Corporations for the privilege of doing business in the State. The tax rate is \$1.50 per \$1,000 of value of the greatest of (1) apportioned net book value of the corporation; (2) 55% of appraised value of real and tangible personal property in N.C.; or (3) total actual investment in tangible property in N.C.

The Department of Revenue, in its 2003 reports to the Revenue Laws Study Committee, noted that there exists a general franchise tax inequity because the

imposition of the tax depends on the type of entity. The Governor's Commission to Modernize State Finances recommended that the State impose the franchise tax on all types of business entities, not just on traditional corporations. The Commission recommended that the revenues generated from this base broadening could be used to establish a minimum net worth threshold for payment of the tax.

The 2003 Revenue Laws Study Committee recommended legislation to the 2003 legislative session on the issue of the LLC franchise tax loophole. The proposal was introduced by Senator Clodfelter and passed the Senate. Senate Bill 51 was revised in the House of Representatives. Although Senate Bill 51 is eligible for further consideration in 2004, the conference committee appears to be unable to resolve its differences.

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: April 19, 2004
TO: Revenue Laws Study Committee
FROM: David Crofts
Fiscal Research Division
RE: Amend Franchise Tax Loophole

FISCAL IMPACT

Yes () No () No Estimate Available (x)

PRINCIPAL DEPARTMENTS AFFECTED: The franchise tax is collected by the Department of Revenue. The enactment of the bill should not affect the budget requirements of the Department.

EFFECTIVE DATE: The loophole closing provisions are effective for taxes due on or after January 1, 2003. The change to the franchise tax "ownership trigger" language is effective for taxes due on or after January 1, 2005.

ISSUE BACKGROUND: Under North Carolina law, limited liability companies (LLC's) are not subject to the franchise tax. In 1997, single-member LLC's were authorized in North Carolina. This allowed a corporation to set up an LLC and transfer assets to the LLC in a tax-free transfer. The assets then held by the LLC would not be subject to the franchise tax.

The 2001 General Assembly attempted to correct this situation by requiring a corporation to pay tax on assets owned by the LLC if the corporation, including its affiliated corporations, indirectly owned at least 70% of the LLC's assets. However, tax planners found that the tax could still be avoided by using an additional paper transaction. For example, if the corporation interposed a

partnership between itself and the LLC holding its assets, the assets would continue to escape the franchise tax.

In 2002, the General Assembly addressed this issue by including "related members" (other entities and individuals) who may partner with one or more corporate entities to own the LLC to which the corporate assets are transferred. If a corporation and its related members together indirectly own at least 70% of an LLC's assets, each corporation would pay the franchise tax on its relative share of the LLC's assets.

Since that time, it has been discovered that there are other paper transactions that can be interposed between the corporation and the LLC to avoid the franchise tax. One example is a business trust. The tax does not apply in this situation because the trust is not considered a "related member". At the same time concerns have been raised that the tax had been extended to situations that did not involve corporate control of LLC assets.

BILL SUMMARY: (1) extends the franchise tax to LLC assets that a corporation controls through trusts and other entities; (2) reduces the scope of the 2002 legislation by limiting its reach to LLC assets the corporation controls and by exempting LLCs whose total assets are \$130,000 or less; (3) reduces the threshold percentage of an LLC's assets that a corporation must control before the franchise tax is triggered from 70% to 50%; (4) corrects the definition of indirect ownership to remove the current law's potential effect of attributing 100% of an LLC's assets when the corporation controls less than 100%; and (5) removes membership in the LLC as an additional condition for attribution.

ASSUMPTIONS AND METHODOLOGY: A discussion with the Department of Revenue indicated that there is no data available on this issue. In addition, the intent of the legislation is to prevent the further erosion of the franchise tax base before it occurs and to eliminate unintended consequences of the 2002 legislative remedy.

LEGISLATIVE PROPOSAL #3

MONETARY COMPENSATION - OUTDOOR ADVERTISING



LEGISLATIVE PROPOSAL #3:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO REQUIRE LOCAL GOVERNMENTS TO PAY MONETARY COMPENSATION FOR REMOVAL OF LAWFULLY ERECTED OFF-PREMISES OUTDOOR ADVERTISING SIGNS, AND TO AUTHORIZE LOCAL GOVERNMENTS TO ENTER INTO RELOCATION AND RECONSTRUCTION AGREEMENTS WITH OWNERS OF NONCONFORMING OFF-PREMISES OUTDOOR ADVERTISING SIGNS.

SHORT TITLE: Monetary Compensation - Outdoor Advertising

SPONSORS: Dalton, Kerr, Hartsell, Hoyle, Webster

BRIEF OVERVIEW: This bill requires a local governmental entity to pay monetary compensation when the entity requires the owner of legally-erected, nonconforming, off-premises outdoor advertising to remove the advertising. Monetary compensation may be determined based on a number of factors, but may not exceed five times the annual gross revenue related to the advertising, unless the local government consents to a higher amount.

FISCAL IMPACT: No State fiscal impact.

EFFECTIVE DATE: This bill would become effective when it became law.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page



GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

U

D

BILL DRAFT 2003-LYz-148 [v.7] (3/30)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/27/2004 7:17:17 PM

Short Title: Monetary Compensation - Outdoor Advertising.

(Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REQUIRE LOCAL GOVERNMENTS TO PAY MONETARY
COMPENSATION FOR REMOVAL OF LAWFULLY ERECTED OFF-
PREMISES OUTDOOR ADVERTISING SIGNS, AND TO AUTHORIZE
LOCAL GOVERNMENTS TO ENTER INTO RELOCATION AND
RECONSTRUCTION AGREEMENTS WITH OWNERS OF
NONCONFORMING OFF-PREMISES OUTDOOR ADVERTISING SIGNS.

The General Assembly of North Carolina enacts:

SECTION 1. Article 11 of Chapter 136 of the General Statutes is
amended by adding the following section to read:

**"§ 136-131.2 Acquisition by local governments of nonconforming off-premises
outdoor advertising.**

(a) As used in this section, the term 'outdoor advertising' has the same
meaning as in G.S. 136-128(3), except that it includes outdoor advertising visible
from the main-traveled way of any road.

(b) A local governmental entity may require the removal of an off-premises
outdoor advertising sign that is nonconforming under a local ordinance; and may
regulate the use of off-premises outdoor advertising within the jurisdiction of the
local governmental entity in accordance with the applicable provisions of Chapter
153A and Chapter 160A of the General Statutes.

(c) No local governmental entity may enact or amend an ordinance to require
the removal of any non-conforming, lawfully erected off-premises outdoor
advertising sign without the payment of monetary compensation to the owners of the

1 off-premises outdoor advertising. The payment of monetary compensation is not
2 required in the following cases:

- 3 (1) The advertising is determined to be a public nuisance or detrimental
4 to the health or safety of the populace.
- 5 (2) The local governmental entity allows the removal and relocation of
6 the advertising to an equally visible and comparable location for
7 purposes of road widening or other governmental development
8 projects.

9 (d) Monetary compensation is the fair market value of the off-premises
10 outdoor advertising in place immediately prior to its removal and without
11 consideration of the effect of the ordinance or any diminution in value caused by the
12 ordinance requiring its removal, less the fair market value of the off-premises
13 outdoor advertising immediately after its removal. Monetary compensation may be
14 determined based on the factors listed in this subsection. Unless agreed to by the
15 local governmental entity, the amount of monetary compensation required to be paid
16 under this section shall not exceed five times the average amount of the annual gross
17 revenue associated with the advertising, less any placement or agency fees, over the
18 preceding five years.

- 19 (1) The factors listed in G.S. 105-317.1(a).
- 20 (2) The cost of materials and labor used in constructing the advertising.
- 21 (3) The purchase price of the rights to erect and maintain the
22 advertising.
- 23 (4) The income derived from the advertising.
- 24 (5) The sales price of similar property.
- 25 (6) The listed property tax value of the property and any documents
26 regarding value submitted to the taxing authority.

27 (e) In lieu of monetary compensation, a local governmental entity may enter
28 into relocation, reconstruction, or removal agreements with owners of
29 nonconforming off-premises outdoor advertising signs, provided that the terms of the
30 agreement are agreeable to the owners of the off-premises outdoor advertising to be
31 removed. An agreement under this subsection may allow for the removal of the
32 advertising after a set period of time in lieu of monetary compensation. A local
33 governmental entity may adopt an ordinance or resolution providing for a relocation
34 or reconstruction agreement.

35 (f) A local governmental entity shall give written notice of its intent to require
36 removal of outdoor advertising by sending a letter by certified mail to the last known
37 address of the owners of the outdoor advertising and the owners of the property on
38 which the outdoor advertising is located.

39 (g) If the parties fail to enter into an agreement under subsection (e) of this
40 section within 120 days after the initial notification by the local governmental entity,
41 either party may request mandatory nonbinding arbitration under American

1 Arbitration Association rules to resolve the disagreements between the parties. If no
2 agreement to arbitrate is reached, jurisdiction under this section shall be in the
3 Superior Court. The Superior Court shall determine the amount of monetary
4 compensation to be paid to the owner of the outdoor advertising in accordance with
5 the provisions of subsection (d) of this section.

6 (h) A local governmental entity may take up to three years from the effective
7 date of an ordinance requiring payment of monetary compensation under this section
8 to make the compensation, if the ordinance allows the affected property to remain
9 until the compensation is paid.

10 (i) This section does not apply to any ordinance in effect on the effective date
11 of this section. Nothing in this section prohibits a local governmental entity from
12 amending an ordinance in effect on the effective date of this section, so long as the
13 amendment to the existing ordinance does not reduce the period of amortization in
14 effect on the effective date of this section. No provision of this section applies to
15 outdoor advertising located in the extraterritorial jurisdiction, or the territory acquired
16 by annexation within three years of the effective date of this section, of a local
17 governmental entity with an ordinance in effect on the effective date of this section."

18 **SECTION 2.** This act is effective when it becomes law.
19



BILL ANALYSIS OF LEGISLATIVE PROPOSAL #6: MONETARY COMPENSATION – OUTDOOR ADVERTISING

BY: Y. CANAAN HUIE, BILL DRAFTING DIVISION

SUMMARY: This bill requires a local governmental entity to pay monetary compensation when the entity requires the owner of legally-erected, nonconforming, off-premises outdoor advertising to remove the advertising. Monetary compensation may be determined based on a number of factors, but may not exceed five times the annual gross revenue related to the advertising, unless the local government consents to a higher amount. This bill would become effective when it became law.

ANALYSIS: Under current law, local governments may require owners of property with a nonconforming structure to remove the structure over a specified time period without the payment of compensation. This practice is commonly referred to as "amortization." State law does not allow use of amortization for removal of outdoor advertising located along federal-aid primary and interstate highways, in compliance with federal law. (G.S. 136-131.1)

This bill would require a local government to pay monetary compensation when it requires an owner to remove nonconforming, off-premises outdoor advertising. The payment of monetary compensation would not be required when the advertising is determined to be a public nuisance or detrimental to the health or safety of the populace or when the local government allows the removal or relocation of the advertising to an equally visible location for purposes of road widening or another governmental development project. Monetary compensation is defined as the fair market value of the advertising and is determined based on the following factors: a) the factors listed in G.S. 105-317.1(a) for determining the value of personal property, b) the cost of materials and labor used in constructing the advertising, c) the purchase price of the rights to erect and maintain the advertising, d) the income derived from the advertising, e) the sales price of similar property, and f) the listed property tax value of the property. Unless agreed to by the local government, the amount of monetary compensation could not exceed five times the average amount of the annual gross revenues associated with the advertising, less any placement or agency fees, over the preceding five years.

In lieu of monetary compensation, a local government could enter into a relocation, reconstruction, or removal agreement, so long as the terms of the agreement were agreeable to the owner of the advertising. A local government could take up to

three years to pay the monetary compensation, so long as the advertising was allowed to remain in place until monetary compensation is paid.

The requirement that the local government pay monetary compensation would not apply to any ordinance limiting outdoor advertising in effect at the time this bill becomes law or to advertising located in the extraterritorial jurisdiction of the locality or in a territory acquired by annexation within three years of the enactment of this bill.

LEGISLATIVE PROPOSAL #4

MOTOR FUELS TAX CHANGES



LEGISLATIVE PROPOSAL #4:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO MODIFY THE TAXATION OF MOTOR FUELS AND TO ALLOW THE SECRETARY OF REVENUE TO APPOINT EMPLOYEES OF THE MOTOR FUELS TAX DIVISION AS REVENUE LAW ENFORCEMENT OFFICERS.

SHORT TITLE: Motor Fuels Tax Changes

SPONSORS: Kerr, Clodfelter, Dalton, Hartsell, Hoyle, Webster

BRIEF OVERVIEW: This bill makes numerous changes to the motor fuels tax statutes and allows the Department of Revenue to appoint employees of the Motor Fuels Tax Division as revenue law enforcement officers.

FISCAL IMPACT: There is an estimated impact of \$1.5 million annually on the Highway Fund and the Highway Trust Fund combined.

EFFECTIVE DATE: There are various effective dates for this bill. Most provisions become effective when the bill becomes law.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page



GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

U

D

BILL DRAFT 2003-LYxz-141 [v.15] (3/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

5/5/2004 10:27:16 AM

Short Title: Motor Fuels Tax Changes.

(Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MODIFY THE TAXATION OF MOTOR FUELS; TO ALLOW THE SECRETARY OF REVENUE TO APPOINT EMPLOYEES OF THE MOTOR FUELS TAX DIVISION AS REVENUE LAW ENFORCEMENT OFFICERS; AND TO TRANSFER THE AUDIT FUNCTIONS FOR THE INTERNATIONAL REGISTRATION PLAN TO THE DEPARTMENT OF REVENUE FROM THE DIVISION OF MOTOR VEHICLES.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-236(2) reads as rewritten:

"§ 105-236. Penalties.

Penalties assessed by the Secretary under this Subchapter are assessed as an additional tax. Except as otherwise provided by law, and subject to the provisions of G.S. 105-237, the following penalties shall be applicable:

- ...
- (2) Failure to Obtain a License. – For failure to obtain a license before engaging in a business, trade or profession for which a license is required, the Secretary shall assess a penalty equal to five percent (5%) of the amount prescribed for the license per month or fraction thereof until paid, not to exceed twenty-five percent (25%) of the amount so prescribed, but in any event shall not be less than five dollars (\$5.00). In cases in which the taxpayer fails to obtain a license as required under G.S. 105-449.65 or G.S. 105-449.131, the Secretary may assess a penalty of one thousand dollars (\$1,000)."

SECTION 2. G.S. 105-236.1(a) reads as rewritten:

1 "(a) General. – The Secretary may appoint employees of the Unauthorized
2 Substances Tax Division to serve as revenue law enforcement officers having the
3 responsibility and subject-matter jurisdiction to enforce the excise tax on
4 unauthorized substances imposed by Article 2D of this Chapter.

5 The Secretary may appoint employees of the Motor Fuels Tax Division to serve
6 as revenue law enforcement officers having the responsibility and subject-matter
7 jurisdiction to enforce the taxes on motor fuels imposed by Articles 36B, 36C, and
8 36D of this Chapter and by Chapter 119 of the General Statutes.

9 The Secretary may appoint employees of the Criminal Investigations Division to
10 serve as revenue law enforcement officers having the responsibility and
11 subject-matter jurisdiction to enforce the following tax violations and criminal
12 offenses:

- 13 (1) The felony and misdemeanor tax violations in G.S. 105-236.
- 14 (2) The misdemeanor tax violations in G.S. 105-449.117 and G.S.
15 105-449.120.
- 16 (3) The following criminal offenses when they involve a tax imposed
17 under Chapter 105 of the General Statutes:
 - 18 a. G.S. 14-91 (Embezzlement of State Property).
 - 19 b. G.S. 14-92 (Embezzlement of Funds).
 - 20 c. G.S. 14-100 (Obtaining Property By False Pretenses).
 - 21 d. G.S. 14-119 (Forgery).
 - 22 e. G.S. 14-120 (Uttering Forged Paper).
 - 23 f. G.S. 14-401.18 (Sale of Certain Packages of Cigarettes)."

24 **SECTION 3.** G.S. 105-449.46 reads as rewritten:

25 "**§ 105-449.46. Inspection of books and records.**

26 The Secretary and his authorized agents and representatives shall have the right at
27 any reasonable time to inspect the books and records of any motor carrier subject to
28 the tax imposed by this ~~Article~~ Article or to the registration fee imposed by Article 3
29 of Chapter 20 of the General Statutes."

30 **SECTION 4.** G.S. 105-449.95 is repealed.

31 **SECTION 5.** G.S. 105-449.115 reads as rewritten:

32 "**§ 105-449.115. Shipping document required to transport motor fuel by**
33 **railroad tank car or transport truck.**

34 (a) Issuance. – A person may not transport motor fuel by railroad tank car or
35 transport truck unless the person has a shipping document for its transportation that
36 complies with this section. A terminal operator and the operator of a bulk plant must
37 give a shipping document to the person who operates a railroad tank car or a
38 transport truck into which motor fuel is loaded at the terminal rack or bulk plant rack.

39 (b) Content. – A shipping document issued by a terminal operator or the
40 operator of a bulk plant must contain the following information and any other
41 information required by the Secretary:

- 1 (1) Identification, including address, of the terminal or bulk plant from
2 which the motor fuel was received.
- 3 (2) The date the motor fuel was loaded.
- 4 (3) The gross gallons loaded.
- 5 (4) The destination state of the motor fuel, as represented by the
6 purchaser of the motor fuel or the purchaser's agent.
- 7 (5) If the document is issued by a terminal operator, the document must
8 be machine printed and it must contain the following information:
 - 9 a. The net gallons loaded.
 - 10 b. A tax responsibility statement indicating the name of the
11 supplier that is responsible for the tax due on the motor fuel.

12 (c) Reliance. – A terminal operator or bulk plant operator may rely on the
13 representation made by the purchaser of motor fuel or the purchaser's agent
14 concerning the destination state of the motor fuel. A purchaser is liable for any tax
15 due as a result of the purchaser's diversion of fuel from the represented destination
16 state.

17 (d) Duties of Transporter. – A person to whom a shipping document was
18 issued must do all of the following:

- 19 (1) Carry the shipping document in the conveyance for which it was
20 issued when transporting the motor fuel described in it.
- 21 (2) Show the shipping document to a law enforcement officer upon
22 request when transporting the motor fuel described in it.
- 23 (3) Deliver motor fuel described in the shipping document to the
24 destination state printed on it unless the person does all of the
25 following:
 - 26 a. Notifies the Secretary before transporting the motor fuel into
27 a state other than the printed destination state that the person
28 has received instructions since the shipping document was
29 issued to deliver the motor fuel to a different destination
30 state.
 - 31 b. Receives from the Secretary a confirmation number
32 authorizing the diversion.
 - 33 c. Writes on the shipping document the change in destination
34 state and the confirmation number for the diversion.
- 35 (4) Give a copy of the shipping document to the distributor or other
36 person to whom the motor fuel is delivered.

37 (e) Duties of Person Receiving Shipment. – A person to whom motor fuel is
38 delivered by railroad tank car or transport truck may not accept delivery of the motor
39 fuel if the destination state shown on the shipping document for the motor fuel is a
40 state other than North Carolina. To determine if the shipping document shows North
41 Carolina as the destination state, the person to whom the fuel is delivered must

1 examine the shipping document and must keep a copy of the shipping document. The
2 person must keep a copy at the place of business where the motor fuel was delivered
3 for 90 days from the date of delivery and must keep it at that place or another place
4 for at least three years from the date of delivery. A person who accepts delivery of
5 motor fuel in violation of this subsection is jointly and severally liable for any tax
6 due on the fuel.

7 (f) Sanctions Against Transporter. – The following acts are grounds for a civil
8 penalty payable to the ~~Department of Transportation, Division of Motor~~
9 ~~Vehicles~~Department of Crime Control and Public Safety, or the Department of
10 Revenue:

- 11 (1) Transporting motor fuel in a railroad tank car or transport truck
12 without a shipping document or with a false or an incomplete
13 shipping document.
- 14 (2) Delivering motor fuel to a destination state other than that shown on
15 the shipping document.

16 The penalty imposed under this subsection is payable by the person in whose
17 name the conveyance is registered, if the conveyance is a transport truck, and is
18 payable by the person responsible for the movement of motor fuel in the conveyance,
19 if the conveyance is a railroad tank car. The amount of the penalty is five thousand
20 dollars (\$5,000). A penalty imposed under this subsection is in addition to any motor
21 fuel tax assessed.

22 (g) Sanctions Against Terminal Operator. – The Secretary may assess a civil
23 penalty of five thousand dollars (\$5,000) against a terminal operator for issuing a
24 shipping document that does not satisfy the requirements of subsection (b) of this
25 section."

26 **SECTION 6.** G.S. 119-15 is amended by adding the following two new
27 subdivisions:

28 "**§ 119-15. Definitions that apply to Article.**

29 The following definitions apply in this Article:

- 30 ...
- 31 (1a) Dyed diesel fuel distributor. – A person who acquires dyed diesel
32 fuel from either of the following:
 - 33 a. A person who is not required to be licensed under Part 2 of
34 Article 36C of Chapter 105 of the General Statutes and who
35 maintains storage facilities for dyed diesel fuel to be used for
36 nonhighway purposes.
 - 37 b. Another dyed diesel fuel distributor.
 - 38 (1b) Dyed diesel fuel. – Defined in G.S. 105-449.60."

39 **SECTION 7.** G.S. 119-15.1(a) reads as rewritten:

1 "(a) License. – A person may not engage in business in this State as any of the
2 following unless the person has a license issued by the Secretary authorizing the
3 person to engage in business:

- 4 (1) A kerosene supplier.
- 5 (2) A kerosene distributor.
- 6 (3) A kerosene terminal operator.
- 7 (4) A dyed diesel fuel distributor."

8 **SECTION 8.** G.S. 20-91 reads as rewritten:

9 "**§ 20-91. Audit of vehicle registrations under the International Registration**
10 **Plan.**

11 (a) Repealed by Session Laws 1995 (Regular Session, 1996), c. 756, s. 9.

12 (b) The ~~Division~~Department of Revenue may audit a person who registers or
13 is required to register a vehicle under the International Registration Plan to determine
14 if the person has paid the registration fees due under this Article. A person who
15 registers a vehicle under the International Registration Plan must keep any records
16 used to determine the information provided to the Division when registering the
17 vehicle. The records must be kept for three years after the date of the registration to
18 which the records apply. The ~~Division~~Department of Revenue may examine these
19 records during business hours. If the records are not located in North Carolina and an
20 auditor must travel to the location of the records, the registrant shall reimburse North
21 Carolina for per diem and travel expense incurred in the performance of the audit. If
22 more than one registrant is audited on the same out-of-state trip, the per diem and
23 travel expense may be prorated.

24 The ~~Commissioner~~Secretary of Revenue may enter into reciprocal audit agreements
25 with other agencies of this State or agencies of another jurisdiction for the purpose of
26 conducting joint audits of any registrant subject to audit under this section.

27 (c) If an audit is conducted and it becomes necessary to assess the registrant
28 for deficiencies in registration fees or taxes due based on the audit, the assessment
29 will be determined based on the schedule of rates prescribed for that registration year,
30 adding thereto and as a part thereof an amount equal to five percent (5%) of the tax to
31 be collected. If, during an audit, it is determined that:

- 32 (1) A registrant failed or refused to make acceptable records available
33 for audit as provided by law; or
- 34 (2) A registrant misrepresented, falsified or concealed records, then all
35 plates and cab cards shall be deemed to have been issued
36 erroneously and are subject to cancellation. The ~~Commissioner~~
37 Commissioner, based on information provided by the Department of
38 Revenue audit, may assess the registrant for an additional
39 percentage up to one hundred percent (100%) North Carolina
40 registration fees at the rate prescribed for that registration year,
41 adding thereto and as a part thereof an amount equal to five percent

1 (5%) of the tax to be collected. The Commissioner may cancel all
2 registration and reciprocal privileges.

3 As a result of an audit, no assessment shall be issued and no claim for refund shall
4 be allowed which is in an amount of less than ten dollars (\$10.00).

5 The results of any audit conducted under this section shall be provided to the
6 Division. The notice of any assessments ~~will~~shall be sent by the Division to the
7 registrant by registered or certified mail at the address of the registrant as it appears
8 in the records of the Division of Motor Vehicles in Raleigh. The notice, when sent in
9 accordance with the requirements indicated above, will be sufficient regardless of
10 whether or not it was ever received.

11 The failure of any registrant to pay any additional registration fees or tax within
12 30 days after the billing date, shall constitute cause for revocation of registration
13 license plates, cab cards and reciprocal privileges.

14 (d) Repealed by Session Laws 1995 (Regular Session, 1996), c. 756, s. 9."

15 **SECTION 9.** Sections 3 and 8 of this act become effective July 1, 2004.
16 Sections 1, 4, and 5 of this act become effective January 1, 2005. The remainder of
17 this act is effective when it becomes law.
18

BILL ANALYSIS OF LEGISLATIVE PROPOSAL #4: MOTOR FUELS TAX CHANGES

BY: Y. CANAAN HUIE, BILL DRAFTING DIVISION

SUMMARY: This bill makes numerous changes to the motor fuels tax statutes and allows the Department of Revenue to appoint employees of the Motor Fuels Tax Division as revenue law enforcement officers.

ANALYSIS: Section 1 of this act allows the Secretary to impose a \$1,000 penalty for failure to obtain a license under G.S. 105-449.65 or G.S. 105-449.131¹. Currently, the Secretary has general authority to impose a penalty for failure to obtain a license. Under that general authority, the amount of the penalty imposed is equal to 5% of the amount prescribed for the license for each month the taxpayer fails to obtain the license, with a maximum penalty of 25% of the amount prescribed for the license. Because this general authority limits the penalty to a percentage of the amount prescribed for the license, it effectively bars assessing a penalty when there is no charge to obtain a license. There is no charge for the licenses issued pursuant to G.S. 105-449.65 or G.S. 105-449.131.

Section 2 of the bill allows the Secretary of Revenue to appoint employees of the Motor Fuels Tax Division as revenue law enforcement officers. The employees would have subject matter jurisdiction to enforce the motor fuels taxes imposed by Articles 36B, 36C, and 36D of Chapter 105. As law enforcement officers, these Department of Revenue employees would be entitled to increased pension benefits such as a 5% contribution to a 401(k) plan, early retirement, enhanced compensation for work-related disability, and a separation allowance that increases benefits for an officer who retires before becoming eligible for social security (the allowance ends when the officer begins receiving social security).

Sections 3 and 8 of the bill transfer audit functions related to the International Registration Plan from the Department of Transportation, Division of Motor Vehicles to the Department of Revenue, Motor Fuels Tax Division. The International Registration Plan is the mechanism through which interstate motor carriers are licensed. It helps to ensure that the proper amount of motor fuels tax is

¹ G.S. 105-449.65 is contained in the Article dealing with gasoline, diesel fuel, and blended fuel, and requires the following to have a license: refiners, suppliers, terminal operator, importers, exporters, blenders, motor fuel transporters, and distributors who purchase motor fuel from an elective or permissive supplier at an out-of-state terminal for import into this State. G.S. 105-449.131 is contained in the Article dealing with alternative fuels and requires the following to have a license: providers of alternative fuel, bulk-end users, and retailers.

credited to each jurisdiction in which the motor carrier travels. It has been suggested that the Department of Revenue has more expertise in auditing taxpayers and would be a more appropriate home for these audit functions. The positions associated with these audit functions will be transferred July 1, 2004, through an administrative transfer.

Section 4 eliminates a hold harmless provision that was created in 1996. This provision was enacted in 1996 as part of the overhaul of motor fuels taxation. It ensured that a licensed distributor or licensed importer would not receive less of a discount under the new system that it did under the old. Currently, 20% of licensed distributors were not licensed in 1996. These distributors are able to take advantage of the hold harmless provision even though they never received the benefit of the discount in place prior to 1996.

Section 5 of this bill allows the Secretary of Revenue to assess a penalty of \$5,000 on a terminal operator who fails to issue a shipping document that satisfies the requirements for the shipping document. Under G.S. 105-449.115, shipping documents issued by a terminal operator must contain the following information: 1) identification of the terminal or bulk plant from which the fuel was received, 2) the date the fuel was loaded, 3) the gross gallons loaded, 4) the destination state of the motor fuel, 5) the net gallons loaded, and 6) a tax responsibility statement indicating the name of the supplier that is responsible for the tax. The Motor Fuels Tax Division has noticed a problem with some terminal operators failing to issue proper shipping documents. Without an accurate shipping document, it is difficult, if not impossible, for the Department to ensure that the proper amount of tax is being paid.

Sections 6 and 7 of this act make changes to Chapter 119 necessitated by legislation enacted in 2003. In 2003, the General Assembly voted to apply the inspection tax to dyed diesel fuels. The inspection tax is imposed on all fuel types at the rate of 1/4¢ per gallon. Proceeds of the tax are used to offset the expenses of administering the motor fuels taxes. The changes in these two sections are needed to apply the tax to distributors who purchase only dyed diesel fuel.

FISCAL ANALYSIS MEMORANDUM

[This fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note.]

DATE: May 5, 2004
TO: Revenue Laws Study Committee
FROM: Richard Bostic
 Fiscal Research Division
RE: Motor Fuels Tax Changes (LYxz-141[v.15])

FISCAL IMPACT

	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>
REVENUES					
Highway Fund					
Penalties			No estimate available		
Refund Repeal	\$562,500	\$1,125,000	\$1,125,000	\$1,125,000	\$1,125,000
Dyed Fuel Distributors			No fiscal impact		
Highway Trust Fund					
Refund Repeal	\$187,500	\$375,000	\$375,000	\$375,000	\$375,000
EXPENDITURES					
Highway Fund					
Law Enforcement	\$35,311	\$12,289	\$12,289	\$12,289	\$12,289
Highway Trust Fund					
IRP Positions			No fiscal impact		

PRINCIPAL DEPARTMENT(S) &

PROGRAM(S) AFFECTED: Department of Revenue, Department of Transportation – Division of Motor Vehicles, Department of Crime Control and Public Safety

EFFECTIVE DATE: Sections 1 (Penalty), 4(Repeal Refund), and 5 (Penalty) become effective January 1, 2005. Sections 3 and 8 (Transfer of Audit Responsibility) become effective July 1, 2004. The remainder of the act is effective when it becomes law.

BILL SUMMARY: The act modifies the penalties charged for violation of motor fuel tax laws; allows the Secretary of Revenue to appoint employees of the Motor Fuels Tax Division as Revenue Law Enforcement Officers; repeals a refund to licensed distributors; and transfers the audit functions for the International Registration Plan from the Division of Motor Vehicles to the Department of Revenue.

ASSUMPTIONS AND METHODOLOGY:

Penalties

Sections 1 and 5 create new penalties. Section 1 allows the Secretary of Revenue to impose a \$1,000 penalty on refiners, suppliers, terminal operators, importers, exporters, blenders, motor fuel transporters and certain distributors that fail to obtain a license. The current law bars the Department from charging a penalty because there is no fee for the license. The Department estimates a maximum of 5 violators a year. Since the penalty is discretionary, this fiscal analysis will not estimate any revenue resulting from this section. If penalty revenue were received it would be deposited into the Highway Fund as non tax revenue according to G.S. 105-449.127.

Section 5 allows the Secretary of Revenue to impose a penalty of \$5,000 on an oil terminal operator who fails to issue a bill of laden that does not meet departmental requirements. Without an accurate bill of laden, the Department cannot ensure that the proper tax amount is being charged. The Department has experienced regular noncompliance by one terminal operator and thinks this provision will remedy the situation. Again, no estimate is possible due to the discretionary nature of the penalty.

Law Enforcement

Section 2 allows the Secretary of Revenue to appoint employees of the Motor Fuels Tax Division to serve as revenue law enforcement officers. The Motor Fuels Tax Division currently employs the following six investigator positions: a Motor Fuels Tax Investigator Supervisor, 4 Motor Fuels Tax Investigators, and a Tax Fraud Investigator. Giving these employees law enforcement authority will require an appropriation of \$35,311 in FY 2004-05. Of this amount, \$12,289 is recurring for an employer contribution to a 401K plan the State makes on behalf of sworn law enforcement officers. The \$23,022 in non-recurring expense is for needed equipment and for enrollment in the Basic Law Enforcement Training course at a community college. This increased appropriation would come from the Highway Fund.

Transfer Positions

On May 4, 2004, the Office of State Budget and Management (OSBM) approved the transfer of \$375,932 and six positions responsible for International Registration Plan vehicle registration

audits from the Division of Motor Vehicles of the Department of Transportation to the Department of Revenue. Sections 3 and 8 conform the statutory language to this administrative change. The transfer will not increase the budget for this unit, thus there is no fiscal impact for these sections of the bill.

Refund Repeal

Section 4 repeals the hold harmless provision enacted in 1996 to ensure that licensed motor fuel distributors and certain licensed importers would not receive less of a tare discount under the new system (Tax at the Rack) than they did under the old system. Currently 250 distributors receive \$1.5 million in refunds each year due to this provision. The Department states that 20% of the current licensed distributors that benefit from this hold harmless provision were not licensed in 1996. Since the gas tax is distributed 75% to the Highway Fund and 25% to the Highway Trust Fund, the savings from repealing this refund will be apportioned to the funds in the same ratio. The Highway Fund will gain \$1,125,000 each year and the Highway Trust Fund will gain \$375,000. With a January 1, 2005 effective date, each fund will receive only half of these amounts in FY 2004-05.

Dyed Fuel Distributors

Sections 6 and 7 amend statutes to conform to legislation on dyed diesel fuel that was approved in the 2003 Session. There is no fiscal impact from these sections.

SOURCES OF DATA: Department of Revenue

TECHNICAL CONSIDERATIONS:



LEGISLATIVE PROPOSAL #5

ALLOW FAMILY BUSINESS TO LEASE FARMLAND

LEGISLATIVE PROPOSAL #5:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO ALLOW FARMLAND OWNED BY A FAMILY BUSINESS TO KEEP ITS PRESENT-USE VALUE TAX STATUS WHEN LEASED FOR FARM USE.

SHORT TITLE: Allow Family Business to Lease Farmland.

SPONSORS: Brubaker, G. Allen, Hill, Luebke, McGee, Miner, Wainwright,
Wood

BRIEF OVERVIEW This bill would allow farmland owned by a business entity to keep its present-use value status when the land is leased to a nonmember of the entity, as long as all members of the business entity are relatives and the land is leased for agricultural, horticultural, or forestry purposes.

FISCAL IMPACT: No General Fund impact is expected.

EFFECTIVE DATE: The bill is effective for taxes imposed for taxable years beginning on or after July 1, 2004.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page



GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

U

D

BILL DRAFT 2003-LAz-13 [v.6] (3/5)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
5/5/2004 11:50:04 AM

Short Title: Allow Family Business to Lease Farmland.

(Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ALLOW FARMLAND OWNED BY A FAMILY BUSINESS TO
KEEP ITS PRESENT-USE VALUE TAX STATUS WHEN LEASED FOR
FARM USE.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-277.2 reads as rewritten:

"§ 105-277.2. Agricultural, horticultural, and forestland – Definitions.

The following definitions apply in G.S. 105-277.3 through G.S. 105-277.7:

- (1) **Agricultural land.** – Land that is a part of a farm unit that is actively engaged in the commercial production or growing of crops, plants, or animals under a sound management program. Agricultural land includes woodland and wasteland that is a part of the farm unit, but the woodland and wasteland included in the unit must be appraised under the use-value schedules as woodland or wasteland. A farm unit may consist of more than one tract of agricultural land, but at least one of the tracts must meet the requirements in G.S. 105-277.3(a)(1), and each tract must be under a sound management program. If the agricultural land includes less than 20 acres of woodland, then the woodland portion is not required to be under a sound management program. Also, woodland is not required to be under a sound management program if it is determined that the highest and best use of the woodland is to diminish wind erosion of adjacent agricultural land, protect water quality of adjacent

1 agricultural land, or serve as buffers for adjacent livestock or
2 poultry operations.

- 3 (1a) Business entity. – A corporation, a general partnership, a limited
4 partnership, or a limited liability company.
- 5 (2) Forestland. – Land that is a part of a forest unit that is actively
6 engaged in the commercial growing of trees under a sound
7 management program. Forestland includes wasteland that is a part
8 of the forest unit, but the wasteland included in the unit must be
9 appraised under the use-value schedules as wasteland. A forest unit
10 may consist of more than one tract of forestland, but at least one of
11 the tracts must meet the requirements in G.S. 105-277.3(a)(3), and
12 each tract must be under a sound management program.
- 13 (3) Horticultural land. – Land that is a part of a horticultural unit that is
14 actively engaged in the commercial production or growing of fruits
15 or vegetables or nursery or floral products under a sound
16 management program. Horticultural land includes woodland and
17 wasteland that is a part of the horticultural unit, but the woodland
18 and wasteland included in the unit must be appraised under the
19 use-value schedules as woodland or wasteland. A horticultural unit
20 may consist of more than one tract of horticultural land, but at least
21 one of the tracts must meet the requirements in G.S.
22 105-277.3(a)(2), and each tract must be under a sound management
23 program. If the horticultural land includes less than 20 acres of
24 woodland, then the woodland portion is not required to be under a
25 sound management program. Also, woodland is not required to be
26 under a sound management program if it is determined that the
27 highest and best use of the woodland is to diminish wind erosion of
28 adjacent horticultural land or protect water quality of adjacent
29 horticultural land.
- 30 (4) Individually owned. – Owned by one of the following:
- 31 a. A natural person. For the purpose of this section, a natural
32 person who is an income beneficiary of a trust that owns land
33 may elect to treat the person's beneficial share of the land as
34 owned by that person. If the person's beneficial interest is not
35 an identifiable share of land but can be established as a
36 proportional interest in the trust income, the person's
37 beneficial share of land is a percentage of the land owned by
38 the trust that corresponds to the beneficiary's proportional
39 interest in the trust income. For the purpose of this section, a
40 natural person who is a member of a business entity, other
41 than a corporation, that owns land may elect to treat the

1 person's share of the land as owned by that person. The
2 person's share is a percentage of the land owned by the
3 business entity that corresponds to the person's percentage of
4 ownership in the entity.

5 b. A business entity having as its principal business one of the
6 activities described in subdivisions (1), (2), and (3) and
7 whose members are all natural persons who meet one or
8 more of the ~~following conditions:~~conditions listed in this
9 sub-subdivision. For the purpose of this sub-subdivision, the
10 terms 'having as its principal business' and 'actively engaged
11 in the business of the entity' include the leasing of the land
12 for one of the activities described in subdivisions (1), (2),
13 and (3) only if all members of the business entity are
14 relatives.

- 15 1. The member is actively engaged in the business of the
16 entity.
- 17 2. The member is a relative of a member who is actively
18 engaged in the business of the entity.
- 19 3. The member is a relative of, and inherited the
20 membership interest from, a decedent who met one or
21 both of the preceding conditions after the land
22 qualified for classification in the hands of the business
23 entity.

24 c. A trust that was created by a natural person who transferred
25 the land to the trust and each of whose beneficiaries who is
26 currently entitled to receive income or principal meets one of
27 the following conditions:

- 28 1. Is the creator of the trust or the creator's relative.
- 29 2. Is a second trust whose beneficiaries who are
30 currently entitled to receive income or principal are all
31 either the creator of the first trust or the creator's
32 relatives.

33 d. A testamentary trust that meets all of the following
34 conditions:

- 35 1. It was created by a natural person who transferred to
36 the trust land that qualified in that person's hands for
37 classification under G.S. 105-277.3.
- 38 2. At the time of the creator's death, the creator had no
39 relatives as defined in this section as of the date of
40 death.

- 1 3. The trust income, less reasonable administrative
2 expenses, is used exclusively for educational,
3 scientific, literary, cultural, charitable, or religious
4 purposes as defined in G.S. 105-278.3(d).
- 5 e. Tenants in common, if each tenant is either a natural person
6 or a business entity described in sub-subdivision b. of this
7 subdivision. Tenants in common may elect to treat their
8 individual shares as owned by them individually in
9 accordance with G.S. 105-302(c)(9). The ownership
10 requirements of G.S. 105-277.3(b) apply to each tenant in
11 common who is a natural person, and the ownership
12 requirements of G.S. 105-277.3(b1) apply to each tenant in
13 common who is a business entity.
- 14 (4a) Member. – A shareholder of a corporation, a partner of a general or
15 limited partnership, or a member of a limited liability company.
- 16 (5) Present-use value. – The value of land in its current use as
17 agricultural land, horticultural land, or forestland, based solely on
18 its ability to produce income and assuming an average level of
19 management. A rate of nine percent (9%) shall be used to capitalize
20 the expected net income of forestland. The capitalization rate for
21 agricultural land and horticultural land is to be determined by the
22 Use-Value Advisory Board as provided in G.S. 105-277.7.
- 23 (5a) Relative. – Any of the following:
- 24 a. A spouse or the spouse's lineal ancestor or descendant.
25 b. A lineal ancestor or a lineal descendant.
26 c. A brother or sister, or the lineal descendant of a brother or
27 sister. For the purposes of this sub-subdivision, the term
28 brother or sister includes stepbrother or stepsister.
29 d. An aunt or an uncle.
30 e. A spouse of a person listed in paragraphs a. through d.
31 For the purpose of this subdivision, an adoptive or adopted
32 relative is a relative and the term "spouse" includes a surviving
33 spouse.
- 34 (6) Sound management program. – A program of production designed
35 to obtain the greatest net return from the land consistent with its
36 conservation and long-term improvement.
- 37 (7) Unit. – One or more tracts of agricultural land, horticultural land, or
38 forestland. Multiple tracts must be under the same ownership. If the
39 multiple tracts are located within different counties, they must be
40 within 50 miles of a tract qualifying under G.S. 105-277.3(a) and
41 share one of the following characteristics:

1 a. Type of classification.

2 b. Use of the same equipment or labor force."

3 **SECTION 2.** This act is effective for taxes imposed for taxable years
4 beginning on or after July 1, 2004.

BILL ANALYSIS OF LEGISLATIVE PROPOSAL #5:
ALLOW FAMILY BUSINESS TO LEASE FARMLAND

BY: MARTHA WALSTON, FISCAL RESEARCH DIVISION

SUMMARY: This bill would allow farmland owned by a business entity to keep its present-use value status when the land is leased to a nonmember of the entity, as long as all members of the business entity are relatives. The land must be leased for agricultural, horticultural, or forestry purposes.

CURRENT LAW: Agricultural land, horticultural land, and forestland must meet certain size, income, and ownership requirements in order to qualify as special classes of property subject to taxation at present-use value rather than fair market value. This property must be individually owned, which means owned by a natural person, a business entity, a trust, a testamentary trust, or tenants in common. Business entity is defined in G.S. 105-277.2 as a corporation, a general partnership, a limited partnership, or a limited liability company. G.S. 105-277.2(4)b also requires that the principal business of the business entity be either agriculture, horticulture, or forestry. In addition, all members of the business entity must be natural persons who meet one or more of the following conditions:

1. The member is actively engaged in the business of the entity.
2. The member is a relative of a member who is actively engaged in the business of the entity.
3. The member is a relative of, and inherited the membership interest from, a decedent who met one or both of the preceding conditions after the land qualified for classification in the hands of the business entity.

In a 1987 Property Tax Commission decision, the Commission was confronted with a factual situation wherein agricultural land, owned by a corporation, was leased by the corporation's shareholders to a non-member. The facts were that the lessee, not the corporation, provided the capital equipment, bore the risks associated with the farming operation, and made the decisions as to the crops to be planted, the equipment needed, and the labor to be hired. The Commission concluded that the corporation was engaged in the business of leasing land and was not in the principal business of and actively engaged in the commercial production of growing crops, plants, or animals. The Commission, therefore, ordered that the county correctly denied present-use value status. Based upon this decision, the Department of Revenue has interpreted the language in G.S. 105-277.2(4)b to deny present-use value status to land owned by a business entity where the members' role consists solely of negotiating a lease of the farmland.

By contrast, the current law does not require that a natural person who owns farmland be actively engaged in the business of agriculture, horticulture, or forestry. This means that a widow who inherits farmland from her husband will not lose the benefit of present-use value tax status if she negotiates a lease for the land to be farmed by another. However, the land still must meet the ownership requirements for a natural person and the size and income requirements for agricultural land, horticultural land, or forestland.

BILL ANALYSIS: The bill amends G.S. 105-277.2(4)b so that land owned by a business entity will not lose its present-use value status if its members lease the land for the purpose of agriculture, horticulture, or forestry and if all members of the business entity are relatives.¹ The bill adds language that the terms "having as its principal business" and "actively engaged in the business of the entity" include the leasing of land for agriculture, horticulture, or forestry as long as all members of the business entity are relatives.

This proposal will allow family businesses to keep their present-use value status if the members do not want to physically participate in farming the land or to make decisions about the farming activity. As a result farmland owned by a limited liability company whose members are a father and his three children, will not lose its present-use value status when the father, who has been physically farming the land, dies and the three children decide to lease the land to a nonmember to handle all farming activity.

EFFECT OF BILL DRAFT ON FOLLOWING SITUATIONS: The Department of Revenue offers the following situations to show the impact of this bill:

1. Husband and wife farm the land - land qualifies.
Husband and wife form LLC and still farm - land qualifies.
Husband dies, wife does not farm but leases land out to be farmed - land qualifies.
2. Husband and wife farm the land - land qualifies.
Husband and wife form LLC and still farm - land qualifies.
Land inherited by children who lease land out to be farmed. - land qualifies.

¹ G.S. 105-277.2(5a) defines "relative as any of the following:

- A spouse or the spouse's lineal ancestor or descendant.
- A lineal ancestor or a lineal descendant.
- A brother or sister, or the lineal descendant of a brother or sister. The term brother or sister includes stepbrother or stepsister.
- An aunt or an uncle
- A spouse of a person listed in one of the categories above.

For the purpose of this subdivision, an adoptive or adopted relative is a relative and the term "spouse" includes a surviving spouse.

3. Husband and wife farm the land – land qualifies.
Family held LLC formed and members all farm - land qualifies.
Membership interests inherited by relatives who now lease out the land to be farmed - land qualifies.
- 4 Three non-relatives form a LLC and farm the land - land qualifies.
The LLC stops farming and starts to lease land out to be farmed - land disqualified.

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: April 18, 2004

TO: Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Allow Family Business to Lease Farmland - 2003-LAz-13[v.6]

FISCAL IMPACT

Yes () No () No Estimate Available (X)

FY 2003-04 FY 2004-05 FY 2005-06 FY 2006-07 FY 2007-08

REVENUES

General Fund

No General Fund Impact

Local Governments

See Assumptions and Methodology

PRINCIPAL DEPARTMENT(S) &

PROGRAM(S) AFFECTED: North Carolina Local Governments.

EFFECTIVE DATE: This act is effective for taxes imposed for taxable years beginning on or after July 1, 2004.

BILL SUMMARY: The bill changes the current present-use value program for property taxes to allow farmland owned by a business entity to keep its present-use value status when

the land is leased to a nonmember, as long as all members of the business entity are relatives.

ASSUMPTIONS AND METHODOLOGY: Under the current present use value program, property can qualify for a lower valuation if it meets a series of size, use, and ownership requirements. According to a 1987 Property Tax Commission decision, if the property is owned by a business entity, members of the business entity or their relatives must be “actively engaged” in the business of farming for the property to continue to qualify for the use value program. (The Commission determined that leasing land in and of itself did not qualify, as the primary business then becomes land leasing and not farming). A similar provision does not exist for properties owned by an individual. This has the net result of disqualifying land from the program if it is owned by a family business, but is leased to a non-relative. If an individual held the same property, the land would still qualify if the property were leased. (In both cases, the leased land must still meet the remaining use and size requirements.). The bill effectively removes this distinction.

Because this is a property tax issue, no General Fund impact is expected. Fiscal Research cannot estimate the impact this change will have on local governments, as we have no data what properties might qualify if the ownership requirements were changed. The bill will result in a loss of revenue to local governments, as it will allow more parcels to qualify for the farm use program.

LEGISLATIVE PROPOSAL #6

ADOPT FLAT FEE FOR DEBT COLLECTION



LEGISLATIVE PROPOSAL #6:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO ADOPT A FLAT COLLECTION ASSISTANCE FEE UNDER THE SETOFF DEBT COLLECTION ACT.

SHORT TITLE: Adopt Flat Fee for Debt Collection.

SPONSORS: Wainwright, G. Allen, Brubaker, Hill Luebke, McGee, Miner,
Wood

BRIEF OVERVIEW: This bill would adopt a flat collection assistance fee of \$5.00 for debts collected by the Department of Revenue under the Setoff Debt Collection Act.

FISCAL IMPACT: This could result in a small increase for the Department of Revenue. The exact amount of that increase is unknown, but it would likely be less than \$100,000.

EFFECTIVE DATE: This act becomes effective for fees assessed on or after October 1, 2004.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page



GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

U

D

BILL DRAFT 2003-SVfz-6 [v.1] (3/5)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
3/5/2004 2:58:19 PM

Short Title: Adopt Flat Fee for Debt Collection.

(Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO ADOPT A FLAT COLLECTION ASSISTANCE FEE UNDER THE
SETOFF DEBT COLLECTION ACT.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105A-13(a) reads as rewritten:

"(a) State Setoff. – To recover the costs incurred by the Department in collecting debts under this Chapter, a collection assistance fee of ~~no more than fifteen~~ five dollars ~~(\$15.00)~~(\$5.00) is imposed on each debt collected through setoff. The Department must collect this fee as part of the debt and retain it. ~~The Department must set the amount of the collection assistance fee based on its actual cost of collection under this Chapter for the immediately preceding year. The collection assistance fee shall not be added to child support debts or collected as part of child support debts. Instead, the Department shall retain from collections under Division II of Article 4 of Chapter 105 of the General Statutes the cost of collecting child support debts under this Chapter.~~"

SECTION 2. This act becomes effective for fees assessed on or after October 1, 2004.

BILL ANALYSIS OF LEGISLATIVE PROPOSAL #6: ADOPT FLAT FEE FOR DEBT COLLECTION

BY: TRINA GRIFFIN, RESEARCH DIVISION

SUMMARY: *This bill would adopt a flat collection assistance fee of \$5.00 for debts collected by the Department of Revenue under the Setoff Debt Collection Act.*

ANALYSIS: This act modifies the Setoff Debt Collection Act, Chapter 105A of the General Statutes. Under that Act, the Department of Revenue sends the income tax refund of an individual who owes money to a State or local agency to that agency in payment of the debt rather than to the individual. The individual's income tax refund is therefore set off against the debt the individual owes to the State or local agency.

Each year, the Department of Revenue determines its costs of running the program and recovers these costs by charging a collection assistance fee as a percentage of each debt collected. The act caps this fee at no more than \$15.00 per debt, though the actual fee ends up being less. The fee is added to the debt and paid by the debtor from the refund.

This bill would amend G.S. 105A-13 by imposing a flat \$5.00 collection assistance fee on each debt collected through setoff.

This change is a recommendation of the Department of Revenue. Every year, the Department must attempt to determine the actual costs of collecting debts under this program. According to the Department, the process is very tedious and quite cumbersome because many different areas of the Department are affected. Thus, the "actual cost" is an estimate at best. The collection assistance fee determined by the Department for the four latest calendar years is as follows:

<u>Calendar Year</u>	<u>Fee</u>
2004	\$4.42
2003	\$4.32
2002	\$4.12
2001	\$4.45

legislation changes that arrangement and instead imposes a flat \$5.00 collection assistance fee. The bill comes to Revenue Laws at the request of the Department.

ASSUMPTIONS AND METHODOLOGY: In 2002 the Department of Revenue assisted state and local agencies in collecting \$22,150,562.04 from 102,426 debtors through setoffs from individual income tax refunds. In 2003, that number moved to \$22,221,190.23 from 101,125 debtors.

Under the statute, the Department of Revenue must determine the actual cost of collection per debt and use that amount to determine the fee charged for collection of the debt the next year. The historic collection fees, based on this methodology, are as follows:

Calendar Year	Fee
2004	\$4.42
2003	\$4.32
2002	\$4.12
2001	\$4.45

All revenues derived from the fees remain with the Department of Revenue.

The Department indicates that calculation of the fee is time consuming and difficult and the process affects several divisions within the Department. As a result, the Department has asked that the fee be set at a flat \$5.00.

Fiscal Research does not have enough information to determine likely fees and number of debt setoffs without this legislation. Potentially the legislation could result in a small revenue increase for the Department, as it is unlikely the actual cost of collection would reach \$5.00 in the next few years. The exact amount of that increase is unknown, although it would likely be less than \$100,000.

SOURCES OF DATA: North Carolina Department of Revenue.

LEGISLATIVE PROPOSAL #7

NOTICE PERIOD FOR SALES AND USE TAX REFUNDS

LEGISLATIVE PROPOSAL #7:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO REQUIRE THAT SELLERS BE PROVIDED WITH NOTICE AND A 60-DAY-PERIOD TO RESPOND TO A REQUEST FOR A REFUND OF OVER-COLLECTED SALES OR USE TAXES BEFORE A PURCHASER MAY BRING A CAUSE OF ACTION AGAINST THE SELLER.

SHORT TITLE: Notice Period for Sales and Use Tax Refunds.

SPONSORS: Luebke, G. Allen, Brubaker, Hill, McGee, Miner, Wainwright,
Wood

BRIEF OVERVIEW: This bill requires a purchaser seeking a refund of over-collected sales or use tax to provide written notice to the seller and to allow the seller 60 days to respond before the purchaser may bring a cause of action against the seller.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This act would be effective when it becomes law.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2003

H

D

BILL DRAFT 2003-SVz-10 [v.5] (4/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

5/10/2004 10:11:18 AM

Short Title: Notice Period for Sales and Use Tax Refunds. (Public)

Sponsors: Representatives Luebke; G. Allen, Wainwright, Miner, Brubaker, Hill, Wood, and McGee.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO REQUIRE THAT SELLERS BE PROVIDED WITH NOTICE AND A 60-DAY-PERIOD TO RESPOND TO A REQUEST FOR A REFUND OF OVER-COLLECTED SALES OR USE TAXES BEFORE A PURCHASER MAY BRING A CAUSE OF ACTION AGAINST THE SELLER.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-164.11 reads as rewritten:

"§ 105-164.11. **Excessive and erroneous collections.**

(a) Remittance of Over-collections to Secretary. – When the tax collected for any period is in excess of the total amount that should have been collected, the total amount collected must be paid over to the Secretary. When tax is collected for any period on exempt or nontaxable sales the tax erroneously collected shall be remitted to the Secretary and no refund shall be made to a taxpayer unless the purchaser has received credit for or has been refunded the amount of tax erroneously charged. This provision shall be construed with other provisions of this Article and given effect so as to result in the payment to the Secretary of the total amount collected as tax if it is in excess of the amount that should have been collected.

(b) Refund Procedures First Remedy. – The first course of remedy available to purchasers seeking a refund of over-collected sales or use taxes from the seller are the customer refund procedures provided in this Chapter or otherwise provided by administrative rule, bulletin, or directive on the law issued by the Secretary.

(c) Cause of Action Against Seller. – A cause of action against the seller for over-collected sales or uses taxes does not accrue until a purchaser has provided

1 written notice to a seller and the seller has had sixty days to respond. The notice to
2 the seller must contain the information necessary to determine the validity of the
3 request.

4 (d) Presumption of Reasonable Business Practice. –In connection with a
5 purchaser's request from the seller of over-collected sales or use taxes, a seller shall
6 be presumed to have a reasonable business practice if, in the collection of sales and
7 use taxes, the seller uses either a provider or a system, including a proprietary
8 system, that is certified by the State and the seller has remitted to the State all taxes
9 collected less any deductions, credits, or collection allowances."

10 **SECTION 2.** This act is effective when it becomes law.

BILL ANALYSIS OF LEGISLATIVE PROPOSAL #7: NOTICE PERIOD FOR SALES AND USE TAX REFUNDS

BY: TRINA GRIFFIN, RESEARCH DIVISION

SUMMARY: This bill requires a purchaser seeking a refund of over-collected sales or use tax to provide written notice to the seller and to allow the seller 60 days to respond before the purchaser may bring a cause of action against the seller. This requirement is necessary to conform to the Streamlined Sales Tax Agreement.

ANALYSIS:

Under the Streamlined Sales Tax Agreement, purchasers seeking a refund of over-collected sales or use taxes must provide the seller with written notice and allow the seller 60 days in which to respond prior to bringing a cause of action against the seller.

Earlier this year, the Department of Revenue adopted this provision as part of a technical bulletin. However, retailers have expressed a preference for the provisions to be in statute.

Therefore, this section of the proposal codifies into statute current Department policy regarding refund procedures for over-collected sales and use tax.

This act would become effective when the act becomes law.

FISCAL ANALYSIS MEMORANDUM

[This fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: May 10, 2004
TO: Revenue Laws
FROM: Linda Struyk Millsaps
Fiscal Research Division
RE: Sales and Use Tax Changes

FISCAL IMPACT

Yes ()	No (X)	No Estimate Available ()		
(Smillions)				
<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>

REVENUES
General Fund

(See Assumptions and Methodology)

**PRINCIPAL DEPARTMENT(S) &
PROGRAM(S) AFFECTED:** North Carolina Department of Revenue.

EFFECTIVE DATE: When it becomes law.

BILL SUMMARY:

The bill requires that sellers be given notice and 60 days to respond to a purchaser request for a refund of over collected sales taxes before purchaser can bring a cause of action against the seller.

ASSUMPTIONS AND METHODOLOGY:

The legislation changes the process through which a purchaser can challenge a potential overpayment of sales tax to a retailer. The Department indicates that this procedural change is needed to comply with the Streamlined Sales Tax Project requirements. Because this portion only makes procedural changes, no fiscal impact is expected by either Fiscal Research or the Department of Revenue.

LEGISLATIVE PROPOSAL #8

REVENUE LAWS TECHNICAL CHANGES

LEGISLATIVE PROPOSAL #8:

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2004 GENERAL ASSEMBLY, 2003 SESSION

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE REVENUE LAWS AND RELATED STATUTES.

SHORT TITLE: Revenue Laws Technical Changes

SPONSORS: Hartsell, Clodfelter, Dalton, Hoyle, Kerr, Webster

BRIEF OVERVIEW: Makes technical and clarifying changes to the revenue laws and related statutes.

FISCAL IMPACT: This bill has an estimated one-time fiscal impact of \$5.4 million in the 2005-2006 fiscal year.

EFFECTIVE DATE: When it becomes law.

A copy of the proposed legislation, bill analysis, and fiscal analysis begin on the next page

GENERAL ASSEMBLY OF NORTH CAROLINA
SESSION 2003

S

D

BILL DRAFT 2003-LCxz-163 [v.25] (11/24)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/12/2004 12:49:24 PM

Short Title: Revenue Laws Technical Changes.

(Public)

Sponsors: Senator.

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL AND CONFORMING CHANGES TO THE
REVENUE LAWS AND RELATED STATUTES.

The General Assembly of North Carolina enacts:

SECTION 1. Section 30C.3(b) of S.L. 2002-126, as amended by Section 37A.4 of S.L. 2003-284, reads as rewritten:

"**SECTION 30C.3.(b)** This section is effective on and after January 1, 2002, and applies to the estates of decedents dying on or after that date. This section is is and Section 37A.5 of S.L. 2003-284 are repealed effective for the estates of decedents dying on or after July 1, 2005."

SECTION 2. The lead-in language of Section 2 of S.L. 2003-360 reads as rewritten:

"**SECTION 2.** The capital improvements projects, and their respective costs, authorized by this act to be constructed and financed as provided in Sections 1, 5, and 6 of this act are as follows:"

SECTION 3.(a) S.L. 2003-405 is reenacted.

SECTION 3.(b) This section is effective on and after August 12, 2003.

SECTION 4.(a) G.S. 105-32.2(b) reads as rewritten:

"(b) Amount. – The amount of the estate tax imposed by this section for estates of decedents dying on or after January 1, 2002, is the maximum credit for state death taxes allowed under section 2011 of the Code without regard to the phase-out and termination of that credit under subdivision (b)(2) and subsection (f) of that section and without regard to the deduction for state death taxes allowed under section 2058 of the Code. If any property in the estate is located in a state other

1 than North Carolina, the amount of tax payable depends on whether the decedent was
2 a resident of this State at death. If the decedent was a resident of this State at death,
3 the amount of tax due under this section is reduced by the lesser of the amount of the
4 death tax paid the other state or an amount computed by multiplying the credit by a
5 fraction, the numerator of which is the gross value of the estate that has a tax situs in
6 another state and the denominator of which is the value of the decedent's gross estate.
7 If the decedent was not a resident of this State at death, the amount of tax due under
8 this section is an amount computed by multiplying the credit by a fraction, the
9 numerator of which is the gross value of real property that is located in North
10 Carolina plus the gross value of any personal property that has a tax situs in North
11 Carolina and the denominator of which is the value of the decedent's gross estate. For
12 purposes of this section, the gross value of property is its gross value as finally
13 determined in the federal estate tax proceedings."

14 **SECTION 4.(b)** This section is repealed effective for the estates of
15 decedents dying on or after July 1, 2005.

16 **SECTION 5.** G.S. 105-113.5 reads as rewritten:

17 **"§ 105-113.5. Tax on cigarettes.**

18 A tax is levied on the sale or possession for sale in this State, by a distributor, of
19 all cigarettes at the rate of two and one-half mills per individual cigarette.

20 ~~This tax does not apply to any of the following:~~

- 21 ~~(1) Sample cigarettes distributed without charge in packages containing~~
22 ~~five or fewer cigarettes.~~
23 ~~(2) Cigarettes in a package of cigarettes given without charge by the~~
24 ~~manufacturer of the cigarettes to an employee of the manufacturer~~
25 ~~who works in a factory where cigarettes are made, if the cigarettes~~
26 ~~are not taxed by the federal government."~~

27 **SECTION 6.** G.S. 105-113.68(a)(2) is repealed.

28 **SECTION 7.** G.S. 105-113.83(b) reads as rewritten:

29 "(b) Beer and Wine. – The excise taxes on malt beverages and wine levied
30 under G.S. 105-113.80(a) and (b), respectively, are payable to the Secretary by the
31 resident wholesaler or importer who first handles the beverages in this State. The
32 excise taxes ~~on wine~~ levied under G.S. 105-113.80(b) on wine shipped directly to
33 consumers pursuant to G.S. 18B-1001.1 must be paid by the wine shipper permittee.
34 The taxes on malt beverages and wine shall be paid only once on the same beverages.
35 The tax shall be paid on or before the 15th day of the month following the month in
36 which the beverage is first sold or otherwise disposed of in this State by the
37 wholesaler, importer, or wine shipper permittee. When excise taxes are paid on wine
38 or malt beverages, the wholesaler, importer, or wine shipper permittee shall submit to
39 the Secretary verified reports on forms provided by the Secretary detailing sales
40 records for the month for which the taxes are paid. The report shall indicate the

1 amount of excise tax due, contain the information required by the Secretary, and
2 indicate separately any transactions to which the excise tax does not apply."

3 **SECTION 8.** G.S. 105-113.108(a) reads as rewritten:

4 "(a) Revenue Stamps. – The Secretary shall issue stamps to affix to
5 unauthorized substances to indicate payment of the tax required by this Article.
6 Dealers shall report the taxes payable under this Article at the time and on the ~~form~~
7 return prescribed by the Secretary. ~~Dealers~~ Notwithstanding any other provision of
8 law, dealers are not required to give their name, address, social security number, or
9 other identifying information on the ~~form~~ return and the return is not required to be
10 verified by oath or affirmation. Upon payment of the tax, the Secretary shall issue
11 stamps in an amount equal to the amount of the tax paid. Taxes may be paid and
12 stamps may be issued either by mail or in person."

13 **SECTION 9.** G.S. 105-129.2 is amended by adding a new subdivision to

14 read:

15 "**§ 105-129.2. Definitions.**

16 The following definitions apply in this Article:

17 . . .

18 (12a) Interstate air courier. – Defined in G.S. 105-164.3."

19 **SECTION 10.** 105-129.4(b2) reads as rewritten:

20 "(b2) Health Insurance. – A taxpayer is eligible for a credit for creating jobs or
21 for worker training under this Article if the taxpayer provides health insurance for the
22 positions for which the credit is claimed when the jobs are created and each year it
23 claims an installment or carryforward of the credit. A taxpayer is eligible for the
24 other credits under this Article if the taxpayer provides health insurance for all of the
25 full-time positions at the location with respect to which the credit is claimed when the
26 taxpayer engages in the activity that qualifies for the credit and each year it claims an
27 installment or carryforward of the credit. For the purposes of this subsection, a
28 taxpayer provides health insurance if it pays at least fifty percent (50%) of the
29 premiums for health care coverage that equals or exceeds the minimum provisions of
30 the basic health care plan of coverage recommended by the Small Employer Carrier
31 Committee pursuant to G.S. 58-50-125.

32 Each year that a taxpayer claims a credit or an installment or carryforward of a
33 credit allowed under this Article, the taxpayer must provide with the tax return the
34 taxpayer's certification that the taxpayer continues to provide health insurance for the
35 jobs for which the credit was claimed or the full-time jobs at the location with respect
36 to which the credit was claimed. If the taxpayer ceases to provide health insurance
37 for the jobs during a taxable year, the credit expires and the taxpayer may not take
38 any remaining installment or carryforward of the credit."

39 **SECTION 11.** G.S. 105-129.4(b6) reads as rewritten:

40 "(b6) Overdue Tax Debts. – A taxpayer is not eligible for a credit allowed under
41 this Article if, at the time the taxpayer claims the credit or an installment or

1 carryforward of the credit, the taxpayer has received a notice of an overdue tax debt
2 and that overdue tax debt has not been satisfied or otherwise resolved."

3 **SECTION 12.** G.S. 105-129.6(b) reads as rewritten:

4 "(b) Reports. – The Department of Revenue shall publish by ~~March-April~~ 1 of
5 each year the following information itemized by credit and by taxpayer for the
6 12-month period ending the preceding December 31:

- 7 (1) The number of claims for each credit allowed in this Article.
- 8 (2) The number and enterprise tier area of new jobs with respect to
9 which credits were generated and to which credits were claimed.
- 10 (3) The cost and enterprise tier area of machinery and equipment with
11 respect to which credits were generated and to which credits were
12 claimed.
- 13 (4) The number of new jobs created by businesses located in
14 development zones, and the percentage of jobs at those locations
15 that were filled by residents of the zones.
- 16 (5) The amount and enterprise tier area of worker training expenditures
17 with respect to which credits were generated and to which credits
18 were claimed.
- 19 (6) The amount and enterprise tier area of new research and
20 development expenditures with respect to which credits were
21 generated and to which credits were claimed.
- 22 (7) The cost and enterprise tier area of real property investment with
23 respect to which credits were generated and to which credits were
24 claimed."

25 **SECTION 13.** G.S. 105-129.9(d) reads as rewritten:

26 "(d) Expiration. – As used in this subsection, the term 'disposed of' means
27 disposed of, taken out of service, or moved out of State.

28 If, in one of the seven years in which the installment of a credit accrues, the
29 machinery and equipment with respect to which the credit was claimed are disposed
30 of, ~~taken out of service, or moved out of State,~~ the credit expires and the taxpayer
31 may not take any remaining installment of the credit for that machinery and
32 equipment unless the cost of that machinery and equipment is offset in the same
33 taxable year by the taxpayer's new investment in eligible machinery and equipment
34 placed in service in the same enterprise tier, as provided in this subsection. If, during
35 the taxable year the taxpayer disposed of the machinery and equipment for which
36 installments remain, there has been a net reduction in the cost of all the taxpayer's
37 eligible machinery and equipment that are in service in the same enterprise tier as the
38 machinery and equipment that were disposed of, and the amount of this reduction is
39 greater than twenty percent (20%) of the cost of the machinery and equipment that
40 were disposed of, then the taxpayer forfeits the remaining installments of the credit
41 for the machinery and equipment that were disposed of. If the amount of the net

1 reduction is equal to twenty percent (20%) or less of the cost of the machinery and
2 equipment that were disposed of, or if there is no net reduction, then the taxpayer
3 does not forfeit the remaining installments of the expired credit. In determining the
4 amount of any net reduction during the taxable year, the cost of machinery and
5 equipment the taxpayer placed in service during the taxable year and for which the
6 taxpayer claims a credit under Article 3B of this Chapter may not be included in the
7 cost of all the taxpayer's eligible machinery and equipment that are in service. If in a
8 single taxable year machinery and equipment with respect to two or more credits in
9 the same tier are disposed of, the net reduction in the cost of all the taxpayer's eligible
10 machinery and equipment that are in service in the same tier is compared to the total
11 cost of all the machinery and equipment for which credits expired in order to
12 determine whether the remaining installments of the credits are forfeited.

13 The expiration of a credit does not prevent the taxpayer from taking the portion of
14 an installment that accrued in a previous year and was carried forward to the extent
15 permitted under G.S. 105-129.5.

16 If, in one of the seven years in which the installment of a credit accrues, the
17 machinery and equipment with respect to which the credit was claimed are moved to
18 an area in a higher-numbered enterprise tier, or are moved from a development zone
19 to an area that is not a development zone, the remaining installments of the credit are
20 allowed only to the extent they would have been allowed if the machinery and
21 equipment had been placed in service initially in the area to which they were moved."

22 **SECTION 14.** G.S. 105-129.35(c)(4) reads as rewritten:

23 "(4) State Historic Preservation Officer. – Defined in G.S.
24 ~~105-129.6.~~105-129.36."

25 **SECTION 15.** G.S. 105-130.4(a)(6) reads as rewritten:

26 "(a) As used in this section, unless the context otherwise requires:

27 . . .
28 (6) 'Public utility' means any corporation that is subject to control of
29 one of more of the following entities: the North Carolina Utilities
30 Commission, the Federal Communications Commission, the
31 Interstate Commerce Commission, the Federal ~~Power~~Energy
32 Regulatory Commission, or the Federal Aviation Agency; and that
33 owns or operates for public use any plant, equipment, property,
34 franchise, or license for the transmission of communications, the
35 transportation of goods or persons, or the production, storage,
36 transmission, sale, delivery or furnishing of electricity, water,
37 steam, oil, oil products, or gas. The term also includes a motor
38 carrier of property whose principal business activity is transporting
39 property by motor vehicle for hire over the public highways of this
40 State."

41 **SECTION 16.(a)** G.S. 105-130.46 reads as rewritten:

1 "§ 105-130.46. Credit for manufacturing cigarettes for exportation while
2 increasing employment and utilizing State Ports.

3 (a) Purpose. – The credit authorized by this section is intended to enhance the
4 economy of this State by encouraging qualifying cigarette manufacturers to increase
5 employment in this State with the purpose of expanding this State's economy, the use
6 of the North Carolina State Ports, and the use of other State goods and services,
7 including tobacco.

8 (b) Definitions. – The following definitions apply in this section:

- 9 (1) Employment level. – The total number of full-time jobs and
10 part-time jobs converted into full-time equivalences.
- 11 (2) Exportation. – The shipment of cigarettes manufactured in the
12 United States to a foreign country sufficient to relieve the cigarettes
13 in the shipment of the federal excise tax on cigarettes.
- 14 (3) Full-time job. – A position that requires at least 1,600 hours of work
15 per year and is intended to be held by one employee during the
16 entire year.
- 17 (4) Successor in business. – A corporation that through amalgamation,
18 merger, acquisition, consolidation, or other legal succession
19 becomes invested with the rights and assumes the burdens of the
20 predecessor corporation and continues the cigarette exportation
21 business.

22 (c) Employment Level. – In order to be eligible for a full credit allowed under
23 this section, the corporation must maintain an employment level in this State that
24 exceeds the corporation's employment level in this State at the end of the 2004
25 calendar year by at least 800 full-time jobs. In the case of a successor in business, the
26 corporation must maintain an employment level in this State that exceeds all its
27 predecessor corporations' combined employment levels in this State at the end of the
28 2004 calendar year by at least 800 full-time jobs. A job is located in this State if more
29 than fifty percent (50%) of the employee's duties are performed in this State.

30 (d) Credit. – A corporation that satisfies the employment level requirement
31 under subsection ~~(b)~~(c) of this section, is engaged in the business of manufacturing
32 cigarettes for exportation, and exports cigarettes and other tobacco products through
33 the North Carolina State Ports during the taxable year is allowed a credit as provided
34 in this section. The amount of credit allowed under this section is equal to forty cents
35 (40¢) per one thousand cigarettes exported. The amount of credit earned during the
36 taxable year may not exceed ten million dollars (\$10,000,000).

37 (e) Reduction of Credit. – A corporation that has previously satisfied the
38 qualification requirements of this section but that fails to satisfy the employment
39 level requirement in a succeeding year may still claim a partial credit for the year in
40 which the employment level requirement is not satisfied. The partial credit allowed is
41 equal to the credit that would otherwise be allowed under subsection ~~(e)~~(d) of this

1 section multiplied by a fraction. The numerator of the fraction is the number of
2 full-time jobs by which the corporation's employment level in this State exceeds the
3 corporation's employment level in this State at the end of the 2004 calendar year. The
4 denominator of the fraction is 800. In the case of a successor in business, the
5 numerator of the fraction is the number of full-time jobs by which the corporation's
6 employment level in this State exceeds all its predecessor corporations' combined
7 employment levels in this State at the end of the 2004 calendar year.

8 (f) Allocation. – The credit allowed by this section may be taken against the
9 income taxes levied under this Part or the franchise taxes levied under Article 3 of
10 this Chapter. When the taxpayer claims a credit under this section, the taxpayer must
11 elect the percentage of the credit to be applied against the taxes levied under this Part
12 with any remaining percentage to be applied against the taxes levied under Article 3
13 of this Chapter. This election is binding for the year in which it is made and for any
14 carryforwards. A taxpayer may elect a different allocation for each year in which the
15 taxpayer qualifies for a credit.

16 (g) Ceiling. – The total amount of credit that may be taken in a taxable year
17 under this section may not exceed the lesser of the amount of credit which may be
18 earned for that year under subsection ~~(e)~~(d) of this section or fifty percent (50%)
19 of the amount of tax against which the credit is taken for the taxable year reduced by the
20 sum of all other credits allowable, except tax payments made by or on behalf of the
21 taxpayer. This limitation applies to the cumulative amount of the credit allowed in
22 any tax year, including carryforwards claimed by the taxpayer under this section or
23 G.S. 105-130.45 for previous tax years.

24 (h) Carryforward. – Any unused portion of a credit allowed in this section may
25 be carried forward for the next succeeding 10 years. All carryforwards of a credit
26 must be taken against the tax against which the credit was originally claimed. A
27 successor in business may take the carryforwards of a predecessor corporation as if
28 they were carryforwards of a credit allowed to the successor in business.

29 (i) Documentation of Credit. – A corporation that claims the credit under this
30 section must include the following with its tax return:

- 31 (1) A statement of the exportation volume on which the credit is based.
- 32 (2) A list of the corporation's export volumes shown on its monthly
33 reports to the Alcohol and Tobacco Tax and Trade Bureau of the
34 United States Treasury for the months in the tax year for which the
35 credit is claimed.
- 36 (3) Any other information required by the Department of Revenue.

37 (j) No Double Credit. – A taxpayer may not claim this credit and the credit
38 allowed under G.S. 105-130.45 for the same activity.

39 (k) Reports. – Any corporation that takes a credit under this section must
40 submit an annual report by May 1 of each year to the Senate Finance Committee, the
41 House of Representatives Finance Committee, the Senate Appropriations Committee,

1 the House of Representatives Appropriations Committee, and the Fiscal Research
2 Division of the General Assembly. The report must state the amount of credit earned
3 by the corporation during the previous year, the amount of credit including
4 carryforwards claimed by the corporation during the previous year, and the
5 percentage of domestic leaf content in cigarettes produced by the corporation during
6 the previous year. The first reports required under this section are due by May 1,
7 2006."

8 **SECTION 16.(b)** This section is effective for taxable years beginning on
9 or after January 1, 2006, and expires for exports occurring on or after January 1,
10 2018.

11 **SECTION 17.** G.S. 105-160.3(b)(6) is repealed.

12 **SECTION 18.** G.S. 105-164.3(28) reads as rewritten:

13 "(28) Prepared food. – Food that meets at least one of the conditions of
14 this subdivision. Prepared food does not include food the retailer
15 sliced, repackaged, or pasteurized but did not otherwise
16 ~~process, heat, mix, or sell with eating utensils.~~

- 17 a. It is sold in a heated state or it is heated by the retailer.
18 b. It consists of two or more foods mixed or combined by the
19 retailer for sale as a single item. This sub-subdivision does
20 not include foods containing raw eggs, fish, meat, or poultry
21 that require cooking by the consumer as recommended by the
22 Food and Drug Administration to prevent food borne
23 illnesses.
24 c. It is sold with eating utensils provided by the retailer, such as
25 plates, knives, forks, spoons, glasses, cups, napkins, and
26 straws."

27 **SECTION 19.** G.S. 105-164.3(37) reads as rewritten:

28 "(37) Sales price. – The total amount or consideration for which personal
29 property or services are sold, leased, or rented. The consideration
30 may be in the form of cash, credit, property, or services. The sales
31 price must be valued in money, regardless of whether it is received
32 in money.

- 33 a. The term includes all of the following:
34 1. The retailer's cost of the property sold.
35 2. The cost of materials used, labor or service costs,
36 interest, losses, all costs of transportation to the
37 retailer, all taxes imposed on the retailer, and any
38 other expense of the retailer.
39 3. Charges by the retailer for any services necessary to
40 complete the sale.
41 4. Delivery charges.

5. Installation charges.
6. The value of exempt personal property given to the consumer when taxable and exempt personal property are bundled together and sold by the retailer as a single product or piece of merchandise.

7. Credit for trade-in.

b. The term does not include any of the following:

1. Discounts, including cash, term, or coupons, that are not reimbursed by a third party, are allowed by the retailer, and are taken by a consumer on a sale.
2. Interest, financing, and carrying charges from credit extended on the sale, if the amount is separately stated on the invoice, bill of sale, or a similar document given to the consumer.
3. Any taxes imposed directly on the consumer that are separately stated on the invoice, bill of sale, or similar document given to the consumer."

SECTION 20. G.S. 105-164.4B(3) reads as rewritten:

"(3) Delivery address unknown. – When a seller of a product does not know the address where a product is received, the sale is sourced to the first address or location listed in this subdivision that is known to the seller:

- a. The business or home address of the purchaser.
- b. The billing address of the purchaser or, if the product is a prepaid telephone calling service that authorizes the purchase of mobile telecommunications service, the location associated with the mobile telephone number.
- c. The billing address of the purchaser address from which tangible personal property was shipped or from which a service was provided."

SECTION 21.(a) G.S. 105-164.14(e) reads as rewritten:

"(e) State Agencies. – **(Effective July 1, 2004 and applicable to sales made on or after that date)** The State is allowed quarterly refunds of local sales and use taxes paid indirectly by the State agency on building materials, supplies, fixtures, and equipment that become a part of or annexed to a building or structure that is owned or leased by the State agency and is being erected, altered, or repaired for use by the State agency. ~~services and of~~

A person who pays local sales and use taxes on building materials or other tangible personal property for a State building project shall give the State agency for whose project the property was purchased a signed statement containing all of the following information:

- 1 (1) The date the property was purchased.
- 2 (2) The type of property purchased.
- 3 (3) The project for which the property was used.
- 4 (4) If the property was purchased in this State, the county in which it
- 5 was purchased.
- 6 (5) If the property was not purchased in this State, the county in which
- 7 the property was used.
- 8 (6) The amount of sales and use taxes paid.

9 If the property was purchased in this State, the person shall attach a copy of the
10 sales receipt to the statement. A State agency to whom a statement is submitted shall
11 verify the accuracy of the statement.

12 Within 15 days after the end of each calendar quarter, every State agency shall
13 file with the Secretary a written application for a refund of taxes to which this
14 subsection applies paid by the agency during the quarter. The application shall
15 contain all information required by the Secretary. The Secretary shall credit the local
16 sales and use tax refunds directly to the General Fund."

17 **SECTION 21.(b)** This section becomes effective July 1, 2004.

18 **SECTION 22.** G.S. 105-164.29A reads as rewritten:

19 "**§ 105-164.29A. State government exemption process.**

20 (a) Application. – To be eligible for the exemption provided in G.S.
21 ~~105-164.13(51),105-164.13(52)~~, a State agency must obtain from the Department a
22 sales tax exemption number. The application for exemption must be in the form
23 required by the Secretary, be signed by the State agency's head, and contain any
24 information required by the Secretary. The Secretary must assign a sales tax
25 exemption number to a State agency that submits a proper application.

26 (b) Liability. – A State agency that does not use the items purchased with its
27 exemption number must pay the tax that should have been paid on the items
28 purchased, plus interest calculated from the date the tax would otherwise have been
29 paid."

30 **SECTION 23.** 105-259(b)(7) reads as rewritten:

31 "(b) Disclosure Prohibited. – An officer, an employee, or an agent of the State
32 who has access to tax information in the course of service to or employment by the
33 State may not disclose the information to any other person unless the disclosure is
34 made for one of the following purposes:

35 ...

- 36 (7) To exchange information with the Division of the State Highway
37 Patrol of the Department of Crime Control and Public ~~Safety~~Safety,
38 the Division of Motor Vehicles of the Department of
39 Transportation, or the International Fuel Tax Association, Inc.,
40 when the information is needed to fulfill a duty imposed on the
41 Department of ~~Revenue~~Revenue, the Division of the State

1 Highway Patrol of the Department of Crime Control and Public
2 Safety, or the Division of Motor Vehicles of the Department of
3 Transportation Safety."

4 **SECTION 24.** G.S. 105-449.47(a1) reads as rewritten:

5 "(a1) Registration and Identification Marker. – When the Secretary registers a
6 motor carrier, the Secretary must issue at least one identification marker for each
7 motor vehicle operated by the motor carrier. A motor carrier must keep records of
8 identification markers issued to it and must be able to account for all identification
9 markers it receives from the Secretary. Registrations and identification markers
10 issued by the Secretary are for a calendar year. ~~The Secretary may renew a~~
11 ~~registration or an identification marker without issuing a new registration or~~
12 ~~identification marker.~~ All identification markers issued by the Secretary remain the
13 property of the State. The Secretary may withhold or revoke a registration or an
14 identification marker when a motor carrier fails to comply with this Article, former
15 Article 36 or 36A of this Subchapter, or Article 36C or 36D of this Subchapter.

16 A motor carrier must carry a copy of its registration in each motor vehicle
17 operated by the motor carrier when the vehicle is in this State. A motor vehicle must
18 clearly display an identification marker at all times. The identification marker must
19 be affixed to the vehicle for which it was issued in the place and manner designated
20 by the authority that issued it."

21 **SECTION 25.** G.S. 105-449.52(a) reads as rewritten:

22 "(a) Penalty. – A motor carrier who does any of the following is subject to a
23 civil penalty:

- 24 (1) Operates in this State or causes to be operated in this State a motor
25 vehicle that ~~does not~~either fails to carry the registration card
26 required by this Article or ~~does not~~fails to display an identification
27 marker in accordance with this Article. The amount of the penalty is
28 one hundred dollars (\$100.00).
- 29 (2) Is unable to account for identification markers the Secretary issues
30 the motor carrier, as required by G.S. 105-449.47. The amount of
31 the penalty is one hundred dollars (\$100.00) for each identification
32 marker the carrier is unable to account for.
- 33 (3) Displays an identification marker on a motor vehicle operated by a
34 motor carrier that was not issued to the carrier by the Secretary
35 under G.S. 105-449.47. The amount of the penalty is one thousand
36 dollars (\$1,000) for each identification marker unlawfully obtained.
37 Both the licensed motor carrier to whom the Secretary issued the
38 identification marker and the motor carrier displaying the
39 unlawfully obtained identification marker are jointly and severally
40 liable for the penalty under this subdivision.

1 A penalty imposed under this section is payable to the Department of Revenue
2 Revenue, the Department of Crime Control and Public Safety, or the Division of
3 Motor Vehicles. When a motor vehicle is found to be operating without a registration
4 card or an identification marker or with an identification marker the Secretary did not
5 issue for the vehicle, the motor vehicle may not be driven for a purpose other than to
6 park the motor vehicle until the penalty imposed under this section is paid unless the
7 officer that imposes the penalty determines that operation of the motor vehicle will
8 not jeopardize collection of the penalty."

9 SECTION 26. G.S. 105-449.54 reads as rewritten:

10 "§ 105-449.54. Commissioner of Motor Vehicles made process agent of
11 nonresident motor carriers.

12 The acceptance by ~~By operating a motor vehicle on the highways of this State, a~~
13 nonresident motor carrier ~~consents to the appointment of of the rights and privileges~~
14 ~~conferred by the laws now or hereafter in force in this State permitting the operation~~
15 ~~of motor vehicles, as evidenced by the operation of a motor vehicle by such~~
16 ~~nonresident, either personally or through an agent or employee, on the public~~
17 ~~highways of this State, or the operation by such nonresident, either personally or~~
18 ~~through an agent or employee, of a motor vehicle on the public highways of this State~~
19 ~~other than as so permitted or regulated, shall be deemed equivalent to the~~
20 ~~appointment by such nonresident motor carrier of the Commissioner of Motor~~
21 ~~Vehicles as its attorney in fact and process agent for Vehicles, or his successor in~~
22 ~~office, to be his true and lawful attorney and the attorney of his executor or~~
23 ~~administrator, upon whom may be served all summonses or other lawful process or~~
24 ~~notice in any action, assessment proceeding assessment, or other proceeding against~~
25 ~~him or his executor or administrator, arising out of or by reason of any provisions of~~
26 ~~this Article relating to such vehicle or relating to the liability for tax with respect to~~
27 ~~operation of such vehicle on the highways of this State. Said acceptance or operation~~
28 ~~shall be a signification by such nonresident motor carrier of his agreement that any~~
29 ~~such process against or notice to him or his executor or administrator shall be of the~~
30 ~~same legal force and validity as if served on him personally, or on his executor or~~
31 ~~administrator. All of the provisions of G.S. 1-105 following the first paragraph~~
32 ~~thereof shall be applicable with respect to the service of process or notice pursuant to~~
33 ~~this section under this Chapter."~~

34 SECTION 27. G.S. 105-449.60(7) reads as rewritten:

35 "§ 105-449.60. Definitions.

36 The following definitions apply in this Article:

- 37 ...
- 38 (7) Diesel fuel. – Any liquid, other than gasoline, that is suitable for use
39 as a fuel in a diesel-powered highway vehicle. The term includes
40 kerosene and biodiesel. ~~biodiesel, fuel oil, heating oil, high sulfur~~

1 dyed diesel fuel, and kerosene. The term does not include jet fuel
2 sold to a buyer who is certified to purchase jet fuel under the Code."

3 **SECTION 28.** The lead-in language of G.S. 105-449.72(a) reads as
4 rewritten:

5 "(a) Initial Bond. – An applicant for a license as a refiner, a terminal operator, a
6 supplier, an importer, a blender, a permissive supplier, or a distributor must file with
7 the Secretary a bond or an irrevocable letter of credit. A bond or irrevocable letter of
8 credit must be conditioned upon compliance with the requirements of this Article, be
9 payable to the State, and be in the form required by the Secretary. The amount of the
10 bond or irrevocable letter of credit is determined as follows:"

11 **SECTION 29.** G.S. 105-449.74 reads as rewritten:

12 "**105-449.74. Issuance of license.**

13 Upon approval of an application, the Secretary must issue a license to the
14 ~~applicant as well as a duplicate copy of the license for each place of business of the~~
15 applicant. A supplier's license must indicate the category of the supplier. A license
16 holder must maintain and display a copy of the license issued under this Part in a
17 conspicuous place at each place of business of the license holder. A license is not
18 transferable and remains in effect until surrendered or cancelled."

19 **SECTION 30.** G.S. 105-449.81(3a) reads as rewritten:

20 "An excise tax at the motor fuel rate is imposed on motor fuel that is:

21 . . .

22 (3a) Fuel ~~grade ethanol alcohol or biodiesel, if it meets either that meets~~
23 any of the following descriptions:

- 24 a. Is removed from a terminal or another storage and
25 distribution facility, unless the removed fuel is received by a
26 supplier for subsequent sale.
27 b. Is imported to this State outside the terminal transfer system
28 by a means other than a marine vessel, a transport truck, or a
29 railroad tank car."

30 **SECTION 31.** G.S. 105-449.123 reads as rewritten:

31 "**§ 105-449.123. Marking requirements for dyed diesel-fuel storage facilities.**

32 (a) Requirements. – A person who is a retailer of dyed ~~diesel-motor fuel~~ or
33 who stores both dyed and undyed ~~diesel-motor fuel~~ for use by that person or another
34 person must mark the storage facility for the dyed ~~diesel-motor fuel~~ as follows in a
35 manner that clearly indicates the fuel is not to be used to operate a highway vehicle.
36 The storage facility must be marked "Dyed Diesel, Nontaxable Use Only, Penalty
37 For Taxable Use" or "Dyed Kerosene, Nontaxable Use Only, Penalty for Taxable
38 Use" or a similar phrase that clearly indicates the fuel is not to be used to operate a
39 highway vehicle.

40 (1) The storage tank of the storage facility must be marked if the
41 storage tank is visible.

- (2) The fillcap or spill containment box of the storage facility must be marked.
- (3) The dispensing device that serves the storage facility must be marked.
- (4) The retail pump or dispensing device at any level of the distribution system must comply with the marking requirements.

(b) Exception. – The marking requirements of this section do not apply to a storage facility that contains fuel used only for one of the purposes listed in G.S. 105-449.105A(a)(1) and is installed in a manner that makes use of the fuel for any other purpose improbable."

SECTION 32. G.S. 105-469 reads as rewritten:

"§ 105-469. Secretary to collect and administer local sales and use tax.

(a) The Secretary shall collect and administer a tax levied by a county pursuant to this Article. As directed by G.S. 105-164.13B, taxes levied by a county on food are administered as if they were levied by the State under Article 5 of this Chapter. The Secretary must, on a monthly basis, distribute local taxes levied on food to the taxing counties as follows:

- (1) The Secretary must allocate one-half of the net proceeds on a per capita basis according to the most recent annual population estimates certified to the Secretary by the State Budget Officer. The Secretary must then adjust the amount allocated to each county as provided in G.S. 105-486(b).
- (2) The Secretary must allocate the remaining net proceeds proportionately to each taxing county based upon the amount of sales tax on food collected in the taxing county in the 1997-1998 fiscal year under Article 39 of this Chapter or under Chapter 1096 of the 1967 Session Laws relative to the total amount of sales tax on food collected in all taxing counties in the 1997-1998 fiscal year under Article 39 of this ~~Chapter~~, Chapter and under Chapter 1096 of the 1967 Session Laws.

(b) The Secretary shall require retailers who collect use tax on sales to North Carolina residents to ascertain the county of residence of each buyer and provide that information to the Secretary along with any other information necessary for the Secretary to allocate the use tax proceeds to the correct taxing county."

SECTION 33. G.S. 119-15.1 reads as rewritten:

"§ 119-15.1. List of persons who must have a license.

(a) License. – A person may not engage in business in this State as any of the following unless the person has a license issued by the Secretary authorizing the person to engage in business:

- (1) A kerosene supplier.
- (2) A kerosene distributor.

1 (3) A kerosene terminal operator.

2 (b) Exception. – A kerosene supplier license is not required if the supplier is
3 licensed as a supplier under Part 2 of Article 36C of Chapter 105 of the General
4 Statutes. A kerosene distributor is required to have a kerosene distributor license only
5 if the distributor imports kerosene. Other kerosene distributors may elect to have a
6 kerosene license. A kerosene terminal operator license is not required if the ~~supplier~~
7 terminal operator is licensed as a ~~supplier-terminal operator~~ under Part 2 of Article
8 36C of Chapter 105 of the General Statutes."

9 **SECTION 34.** G.S. 119-19 reads as rewritten:

10 **"§ 119-19. Authority of Secretary to cancel a license.**

11 The Secretary of Revenue may cancel a license issued under ~~G.S. 119-16.2~~this
12 Article upon the written request of the license holder. The Secretary may summarily
13 cancel a license issued under ~~G.S. 119-16.2 or this Article or under Article 36C or~~
14 ~~36D~~ of Chapter 105 of the General Statutes when the Secretary finds that the license
15 holder is incurring liability for the tax imposed by this Article after failing to pay a
16 tax when due under this Article. The Secretary may cancel the license of a license
17 holder who files a false report under this Article or fails to file a report required under
18 this Article after holding a hearing on whether the license should be cancelled.

19 The Secretary must send a person whose license is summarily cancelled a notice
20 of the cancellation and must give the person an opportunity to have a hearing on the
21 cancellation within 10 days after the cancellation. The Secretary must give a person
22 whose license may be cancelled after a hearing at least 10 days' written notice of the
23 date, time, and place of the hearing. A notice of a summary license cancellation and a
24 notice of hearing must be sent by registered mail to the last known address of the
25 license holder.

26 When the Secretary cancels a license and the license holder has paid all taxes and
27 penalties due under this Article, the Secretary must either return to the license holder
28 the bond filed by the license holder or notify the person liable on the bond and the
29 license holder that the person is released from liability on the bond."

30 **SECTION 35.** G.S. 120-70.108(a) reads as rewritten:

31 "(a) The Revenue Laws Study Committee shall establish a Property Tax
32 Subcommittee consisting of ~~six-up to eight~~ members. The Senate cochair of the
33 Committee shall designate ~~three-up to four~~ members appointed by the President Pro
34 Tempore of the Senate to serve on the Subcommittee and shall name one of those
35 members a cochair of the Subcommittee. The House cochair of the Committee shall
36 designate ~~three-up to four~~ members appointed by the Speaker of the House of
37 Representatives to serve on the Subcommittee and shall name one of those members
38 a cochair of the Subcommittee. The Subcommittee shall meet upon the call of the
39 Subcommittee cochairs."

40 **SECTION 36.(a)** G.S. 153A-155(d) reads as rewritten:

1 "(d) Administration. – The taxing county shall administer a room occupancy
2 tax it levies. A room occupancy tax is due and payable to the county finance officer
3 in monthly installments on or before the 15th day of the month following the month
4 in which the tax accrues. Every person, firm, corporation, or association liable for the
5 tax shall, on or before the ~~15th-20th~~ day of each month, prepare and render a return
6 on a form prescribed by the taxing county. The return shall state the total gross
7 receipts derived in the preceding month from rentals upon which the tax is levied. A
8 room occupancy tax return filed with the county finance officer is not a public record
9 and may not be disclosed except in accordance with G.S. 153A-148.1 or G.S.
10 160A-208.1."

11 **SECTION 36.(b)** G.S. 160A-215(d) reads as rewritten:

12 "(d) Administration. – The taxing city shall administer a room occupancy tax it
13 levies. A room occupancy tax is due and payable to the city finance officer in
14 monthly installments on or before the ~~fifteenth-20th~~ day of the month following the
15 month in which the tax accrues. Every person, firm, corporation, or association liable
16 for the tax shall, on or before the fifteenth day of each month, prepare and render a
17 return on a form prescribed by the taxing city. The return shall state the total gross
18 receipts derived in the preceding month from rentals upon which the tax is levied. A
19 room occupancy tax return filed with the city finance officer is not a public record
20 and may not be disclosed except in accordance with G.S. 153A-148.1 or G.S.
21 160A-208.1."

22 **SECTION 36.(c)** This section becomes effective October 1, 2004.

23 **SECTION 37.** The title of Article 16 of Chapter 153A of the General
24 Statutes reads as rewritten:

25 "Article 16.

26 County Service Districts; County Research and Production Service ~~Districts~~;
27 Districts; County Economic Development and Training Districts."

28 **SECTION 38.** G.S. 153A-317.11 reads as rewritten:

29 "**§ 153A-317.11. Purpose for which ~~districts may be created and nature of~~**
30 **districts.**

31 The board of commissioners of any county may define a county economic
32 development and training district, as provided in this Part, to finance, provide, and
33 maintain for the district a skills training center in cooperation with its community
34 college branch in or for the county to prepare residents of the county to perform
35 manufacturing, research and development, and related service and support jobs in the
36 pharmaceutical, biotech, life sciences, chemical, telecommunications, and electronics
37 industries, and allied, ancillary, and subordinate industries, to provide within the
38 district any of the education, training, and related services, facilities, or functions that
39 a county or a city is authorized by general law to provide, finance, or maintain, and to
40 promote economic development in the county. The skills training center and related
41 services shall be financed, provided, or maintained in the district either in addition to

1 or to a greater extent than training facilities and services are financed, provided, or
2 maintained in the entire county. A district created under this Part is a special tax area
3 under Section 2(4) of Article V of the North Carolina Constitution."

4 **SECTION 39.** G.S. 153A-317.17 reads as rewritten:

5 "**§ 153A-317.17. Taxes authorized; rate limitation.**

6 A county may levy property taxes within an economic development and training
7 district, in addition to those levied throughout the county, ~~in order to finance,~~
8 ~~provide, or maintain for the district a skills training center provided therein for the~~
9 purposes listed in G.S. 153A-317.11 within the district in addition to or to a greater
10 extent than ~~worker training facilities the same purposes~~ provided for the entire
11 county. In addition, a county may allocate to a district any other revenues whose use
12 is not otherwise restricted by law. The proceeds of taxes within a district may be
13 expended only to pay annual debt service on up to one million two hundred thousand
14 dollars (\$1,200,000) of the capital costs of a skills training center provided for the
15 district and any other services or facilities provided by a county in response to a
16 recommendation of an advisory committee.

17 Property subject to taxation in a newly established district or in an area annexed
18 to an existing district is subject to taxation by the county as of the preceding January
19 1.

20 Such additional property taxes may not be levied within any district established
21 pursuant to this Article in excess of a rate of eight cents (8¢) on each one hundred
22 dollars (\$100.00) value of property subject to taxation."

23 **SECTION 40.** Except as otherwise provided in this act, this act is
24 effective when it becomes law.
25

BILL ANALYSIS OF LEGISLATIVE PROPOSAL #8: REVENUE LAWS TECHNICAL CHANGES

BY: MARTHA H. HARRIS, BILL DRAFTING DIVISION

SUMMARY: This draft bill makes the following technical and clarifying changes to the revenue laws and related statutes.

Section	Explanation
1	Clarifies that estate tax changes have uniform sunset date.
2	Supplies a missing cross-reference in UNC self-liquidating bond legislation.
3	Reenacts the 2003 session law relating to ESC surtax delay, in order to correct a technical omission.
4	Clarifies that calculation of State estate tax without regard to federal phase-out and termination of federal credit for state death taxes includes disregarding the federal deduction that replaces the federal credit January 1, 2005.
5	Deletes obsolete provisions.
6	Deletes definition of term no longer used in statutes.
7	Corrects grammatical issue.
8	Updates terminology in controlled substance tax law and clarifies provision complying with Fifth Amendment protection against self-incrimination.
9	Adds cross-reference to defined term.
10	Provides that Bill Lee Act health insurance requirement begins when jobs are created or when qualifying investment is made and continues when credit, installment, or carryforward is claimed. Current law refers only to when installment or carryforward is claimed. This change conforms to the current practice of the Department.
11	Clarifies that Bill Lee Act tax debt requirement begins when credit is claimed and continues when installment or carryforward is claimed. Current law refers only to when installment or carryforward is claimed.
12	Delays report deadline by one month in order to allow time for quality of report to be improved.
13	Clarifies that loss of the Bill Lee machinery and equipment tax credit because property is disposed of is the same if the property is taken out of service or moved out of state.

14	Corrects incorrect cross-reference
15	Updates terminology. In 1977, the Federal Energy Regulatory Commission replaced the Federal Power Commission established in 1920. It is responsible for issuing licenses for the development of water and electrical power and prohibiting operators from restricting output or restraining trade in electrical energy.
16	Corrects cross-references in new tobacco export credit.
17	Deletes cross-reference to repealed statute.
18	Clarifies the prepared food definition exception for food that is sliced, repackaged, or pasteurized by the retailer.
19	Restores provision inadvertently deleted in earlier legislation.
20	Corrects erroneous language.
21	Removes extraneous language that resulted from redlining conflicts between two laws enacted in 2003.
22	Corrects cross-reference.
23	Restores reference to DMV that was inadvertently deleted from secrecy provision by 2003 legislation.
24	Removes administration option that is not used and is not allowed by the International Fuel Tax Agreement, which North Carolina has followed since 1992.
25	Clarifies when penalty applies and expands who the penalty is paid to, in order to reflect recent reorganization of the Division of Motor Vehicles.
26	Modernizes language.
27	Adds additional examples of fuels included in definition of diesel fuel under current law. This definition applies in the fuel tax and inspection tax statutes.
28	Extends to letters of credit the condition requirements that apply to bonds.
29	Provides that licensee rather than Department will make extra copies of license when there is more than one place of business.
30	Clarifies that biodiesel and all fuel alcohols are treated the same as fuel grade ethanol. This change conforms to the current practice of the Department.
31	Corrects incorrect terminology.
32	Adds missing reference to Mecklenburg one-cent sales tax.
33	Corrects incorrect terminology.
34	Conforms cross-references to reflect statutes repealed and added in 2003.
35	Provides that the property tax subcommittee of the Revenue Laws Study Committee may consist of up to eight members.

36	Conforms the date for filing a local occupancy tax return to the current law date for filing a monthly sales tax return.
37	Conforms title of Article to reflect addition of Part 3 in 2003.
38	Clarifies that county economic development and training districts are special tax areas authorized by Section 2(4) of Article V of the N.C. Constitution.
39	Conforms purposes for which economic development and training district taxes may be levied to match the purposes for which the districts may be created.
40	Section 3 is effective on and after August 12, 2003. Section 15 is effective for same period that cigarette export credit is in effect. Section 19 becomes effective July 1, 2004. Section 32 becomes effective October 1, 2004. The remainder of the act is effective when it becomes law.

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: May 6, 2004

TO: Revenue Laws Study Committee

FROM: Dave Crotts
Fiscal Research Division

RE: Revenue Laws Technical Changes (Estate Tax Provisions)

FISCAL IMPACT

	Yes (x)	No ()	No Estimate Available ()		
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>

REVENUES

State General Fund

\$5.4

PRINCIPAL DEPARTMENT AFFECTED: The tax is collected by the Department of Revenue. The enactment of the legislation is not expected to affect the budget requirements of the Department.

EFFECTIVE DATE: Deaths occurring on or after January 1, 2005.

ISSUE BACKGROUND: The federal Economic Growth and Tax Reconciliation Act of 2001 provided for the phase-out between 2002 and 2005 of the credit allowed under the federal estate tax for state death taxes. North Carolina, like most states, has an estate tax ("pickup tax") that is based on the amount of the federal credit. Without further changes by the General Assembly, the repeal of the federal credit will have automatically repeal the North Carolina estate tax.

As part of the 2002 budget package, amended during the 2003 session, the North Carolina estate tax was partially decoupled from the federal estate tax until July 1, 2005. Thus the North Carolina estate tax continues to be levied without regard to the phase-out of the federal credit. However, under the "partial conformity" solution adopted by the General Assembly in 2002 and 2003, the North Carolina tax is calculated using other provisions of federal estate tax law in effect on the date of the decedent's death. For example, the federal "unified credit" used to calculate the State estate tax, which effectively sets the threshold for taxability of an estate, is the credit in effect as of the decedent's death. Under the federal Act, the amount effectively exempted under the unified credit was increased from \$700,000 to \$1 million in 2002, and then phased up over a period of years to \$3.5 million in 2009. The partial conformity solution in current state law adjusts for the federal exemption increase so that estates do not have to file a North Carolina return if no federal return is required.

By remaining coupled to the federal estate tax base, the N. C. estate tax will incorporate a provision of federal law effective beginning in 2005 that will allow a deduction for State death taxes paid in lieu of the previously allowed credit for State death taxes paid. Allowing the deduction of State death taxes for purposes of determining the State death tax base will result in a circular calculation because the tax being calculated results in a deduction from the tax base, which then alters the calculation of the tax owed. When the federal provision allowing a deduction for State death taxes takes effect, a series of calculations will be required to calculate the North Carolina estate tax.

BILL SUMMARY: The effect of the proposed bill is to create an addition to the federal taxable estate for N.C. estate tax purposes that is equal to the amount of the federal deduction for State death taxes paid.

ASSUMPTIONS AND METHODOLOGY: The estates affected by the enactment of these provisions are those for deaths occurring between January 1, 2005 and June 30, 2005. The reason is that under current law, North Carolina will lose its estate tax base on July 1, 2005. Thus there would no impact of the proposal after that date. In addition, estates are not required to pay the tax until nine months after a death. This means that the reduction in General Fund revenue will take place during the period October 1, 2005 - March 31, 2006.

The estimated impact was based mostly on a refinement of some numbers from a similar proposal in Maryland. The Maryland estimates had to be adjusted for the fact that Maryland still has a regular inheritance tax (though spouses and lineal ancestors are exempt) and the fact that North Carolina is a larger state.

The Maryland numbers indicate that the impact of the identical proposal will be 10.8% of baseline "death tax" collections in that state. We adjusted this ratio for the fact that the estate tax portion of their death tax is smaller due to the fact that a regular tax continues in place. The ratio selected for our analysis is 9.0%.

The North Carolina tax base is running around \$120 million per year. Applying 9% to this estimate yields a 12-month cost of \$10.8 million.

APPENDIX A

AUTHORIZING LEGISLATION ARTICLE 12L OF CHAPTER 120 OF THE GENERAL STATUTES

ARTICLE 12L

Revenue Laws Study Committee

§ 120-70.105. **Creation and membership of the Revenue Laws Study Committee.**

(a) Membership. -- The Revenue Laws Study Committee is established. The Committee consists of 16 members as follows:

- (1) Eight members appointed by the President Pro Tempore of the Senate; the persons appointed may be members of the Senate or public members.
- (2) Eight members appointed by the Speaker of the House of Representatives; the persons appointed may be members of the House of Representatives or public members.

(b) Terms. -- Terms on the Committee are for two years and begin on January 15 of each odd-numbered year, except the terms of the initial members, which begin on appointment. Legislative members may complete a term of service on the Committee even if they do not seek reelection or are not reelected to the General Assembly, but resignation or removal from service in the General Assembly constitutes resignation or removal from service on the Committee.

A member continues to serve until a successor is appointed. A vacancy shall be filled within 30 days by the officer who made the original appointment. (1997-483, s. 14.1; 1998-98, s. 39.)

§ 120-70.106. **Purpose and powers of Committee.**

(a) The Revenue Laws Study Committee may:

- (1) Study the revenue laws of North Carolina and the administration of those laws.
- (2) Review the State's revenue laws to determine which laws need clarification, technical amendment, repeal, or other change to make the laws concise, intelligible, easy to administer, and equitable.
- (3) Call upon the Department of Revenue to cooperate with it in the study of the revenue laws.
- (4) Report to the General Assembly at the beginning of each regular session concerning its determinations of needed changes in the State's revenue laws.

These powers, which are enumerated by way of illustration, shall be liberally construed to provide for the maximum review by the Committee of all revenue law matters in this State.

(b) The Committee may make interim reports to the General Assembly on matters for which it may report to a regular session of the General Assembly. A report to the General Assembly may contain any legislation needed to implement a recommendation of the Committee. When a recommendation of the Committee, if enacted, would result in an increase or decrease in State revenues, the report of the Committee must include an estimate of the amount of the increase or decrease. (1997-483, s. 14.1.)

§ 120-70.107. **Organization of Committee.**

(a) The President Pro Tempore of the Senate and the Speaker of the House of Representatives shall each designate a cochair of the Revenue Laws Study Committee. The Committee shall meet upon the joint call of the cochairs.

(b) A quorum of the Committee is nine members. No action may be taken except by a majority vote at a meeting at which a quorum is present. While in the discharge of its official duties, the Committee has the powers of a joint committee under G.S. 120-19 and G.S. 120-19.1 through G.S. 120-19.4.

(c) The Committee shall be funded by the Legislative Services Commission from appropriations made to the General Assembly for that purpose. Members of the Committee receive subsistence and travel expenses as provided in G.S. 120-3.1 and G.S. 138-5. The Committee may contract for consultants or hire employees in accordance with G.S. 120-32.02. Upon approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional staff to assist the Committee in its work. Upon the direction of the Legislative Services Commission, the Supervisors of Clerks of the Senate and of the House of Representatives shall assign clerical staff to the Committee. The expenses for clerical employees shall be borne by the Committee. (1997-483, s. 14.1.)

APPENDIX B

DISPOSITION OF COMMITTEE'S
RECOMMENDATIONS
TO THE
2003 SESSION
OF THE
GENERAL ASSEMBLY

SHORT TITLE	SENATE SPONSORS	HOUSE SPONSORS	BILL #	FINAL STATUS*
IRC Update		McComas	H320	Enacted SL 2003-25
Revenue Laws Technical Changes	Hartsell		S97	Enacted* SL 2003-416
Adopt Streamlined Sales Tax Changes		Luebke	H1521	Original bill not enacted. The provisions were put into HB 397, which was enacted, SL 2003-284 (see Sec. 45.2)
State Govt. Sales Tax Exempt/Sch Coop Refund	Kerr		S100	Enacted SL 2003-431
Revenue Administrative Changes	Kerr		S236	Enacted* SL 2003-349


* Bills were modified prior to enactment.

APPENDIX C

STATE BUDGET OUTLOOK

BUDGET OUTLOOK

Fiscal Research Division
January 13, 2004



State Budget for FY2003-04

FY2003-04

- General Fund \$14.77 b
- Highway Fund \$2.13 b
- Other \$2.5 B
- Federal \$8.46 B
- Total Budget \$27.89 b

FY2003-04 Budget Outlook


- Given the caution we all share about the current revenue outlook for FY2003-04, the Office of State Budget and Management continues to withhold approximately 2% of the agency allotments.
- 2% = \$295 m, if applied 100% to all agencies and departments.

FY2003-04: Budgetary Risks

- ABC bonus payouts that exceeded budget by \$44 m will substantially reduce reversions in the public school budget.
- Medicaid continues to be the most volatile component of the State budget.
 - \$1.98 b General Fund
 - \$7.03 b Total Budget
- FY2003-04 – Medicaid budgeted growth rate – 10.8%
- Growth rate for the first half of fiscal year 9.9%

FY2003-04: Budgetary Risks (Continued)

- For the month of December 2003, Medicaid's year-over-year increase was 16.53%.
- Historically, Medicaid growth in the second half of a fiscal year is greater than in the first half.
- We will follow the Medicaid budget very closely in the coming months.



State Budget for FY2004-05

FY2004-05

- General Fund \$15.5 b
- Highway Fund \$2.45 b
- Other \$2.59 b
- Federal \$8.90 b
- Total Budget \$29.46

FY2004-05: Potential Additional Funding Requirements

Continuation budget for FY2004-05 balanced, but high priority commitments remain unfunded.

These include:

- Higher Ed enrollment increases (\$75 m)
- Employee/teacher pay raise (2% = \$180-\$270m) (\$90 m for each 1%)
- Teacher performance initiative (ABC's-\$145 m)
- Repairs/Renovations (\$150 million)
- Rainy Day Fund (\$100 m)
- Water Resources Development Projects (\$30 m)

FY2004-05: Potential Additional Funding Requirements

- Retirement system contribution and repayments
- Debt service on new prisons
- Provider inflation rates in Medicaid
- Gubernatorial or legislative initiatives

APPENDIX D

STATE REVENUE OUTLOOK

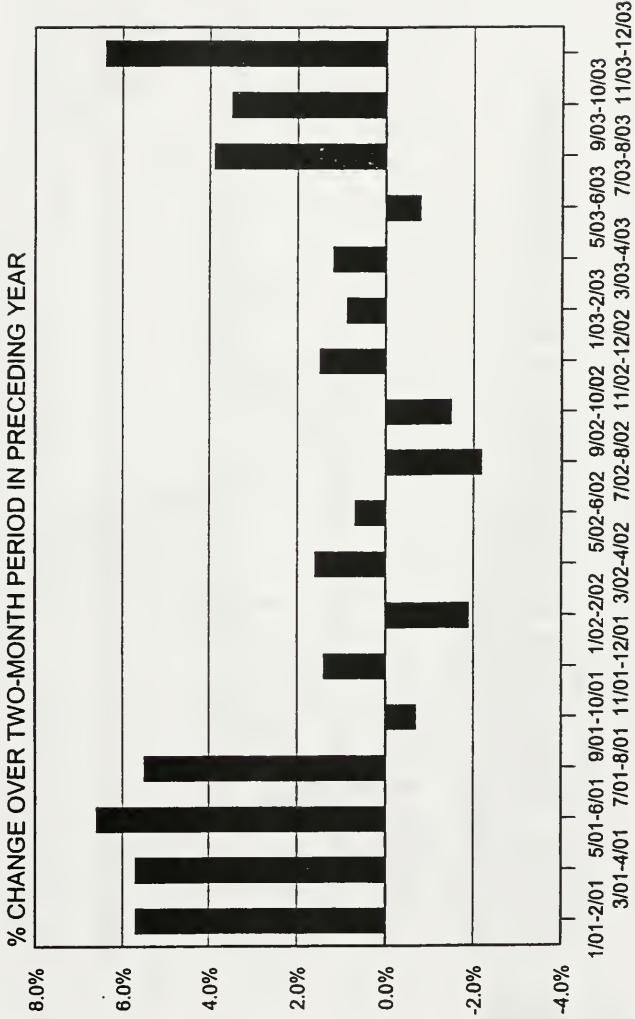
STATE REVENUE OUTLOOK

Fiscal Research Division
January 8, 2004

State Revenues Are Reflecting the National Economic Recovery

- Year-to-date receipts through December are \$25.8 million ahead of \$7.0 billion target (.3%).
- This compares to \$41.4 million shortfall as of 9/30.
- The \$67.2 million turnaround during last three months is tied to economy-based taxes.
 - Withholding taxes were up strongly during the last two months (see page 3).
 - Sales tax collections continue to rise even without federal rebate checks (see page 4).

Withholding Tax Receipts from Large Employers

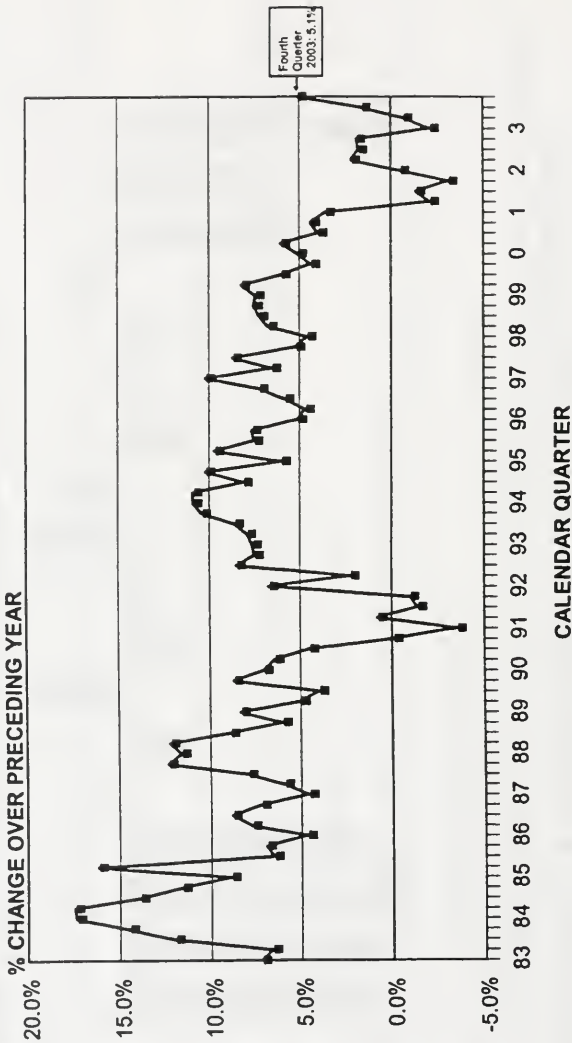


Notes: Two month periods are used to smooth out monthly volatility.




Gross State and Local Sales Tax Collections

Source: U.S. Department of Commerce, Bureau of Economic Analysis



NOTE: Data has been adjusted for tax law changes.



Economic Outlook Brightest in Three Years

- Current recovery similar to 1991-93 “fits and starts” cycle.
- 1991-93 recovery stalled three times before the exploding in mid-1993.
- The 2001-02 and 2002-03 recoveries were sidetracked by external events:
 - September 11 terrorist attacks
 - Anthrax scare
 - Financial scandals
 - Build up to Iraq invasion
 - SARS concerns

Economic Outlook Brightest in Three Years (Continued)

- Recovery is now sustainable due to following factors:
 - Monetary policy (lowest interest rates in four decades)
 - Federal tax cuts (three packages in two years)
 - Explosive federal spending
 - Passage of time (excess inventory is worked off)
 - Strong Federal Reserve signals about delaying interest rate hikes

The Improved Revenue Situation Does Not Automatically Translate into an Improved 2004-05 Revenue Base

- A continued acceleration of revenue growth rates is needed to meet budget target for 2003-04.
- Carry forward losses of investors could affect April income tax returns.
- Tentative revenue growth rate of 5.5% for FY 05 not likely to be raised.



North Carolina General Assembly Legislative Services Office

George R. Hall, Legislative Services Officer
Legislative Services Office
16 W. Jones Street Room 2129
Raleigh, NC 27601-1030 Tel. (919) 733-7044

Goldman, Director
ative Division
es Street Room 9
IC 27601-1030
-7500

Gerry F. Cohen, Director
Bill Drafting Division
300 N. Salisbury St. Rm 401
Raleigh, NC 27603-5925
(919) 733-6660

James D. Johnson, Director
Fiscal Research Division
300 N. Salisbury St. Rm 619
Raleigh, NC 27603-5925
(919) 733-4910

Dennis W. McCarty, Director
Information Systems Division
300 N. Salisbury St. Rm 400
Raleigh, NC 27603-5925
(919) 733-6834

Terrence D. Sullivan, Director
Research Division
300 N. Salisbury St. Rm 545
Raleigh, NC 27603-5925
(919) 733-2578

MEMORANDUM

TO: Appropriations and Finance Chairs

FROM: Dave Crotts
Fiscal Research Division

DATE: January 8, 2004

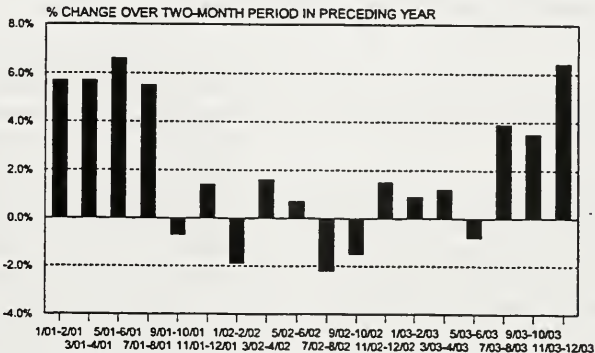
SUBJECT: Revenue Update

How are revenues holding up?

A review of preliminary General Fund revenue collection data for December indicates that for the first six months of 2003-04, net General Fund revenues are running \$25.8 million ahead of the \$7.0 billion target for the period. This is a difference of .3%. More importantly, during the last three months, we have moved from a \$41.4 million **shortfall** to the \$25.8 million **surplus**, a turnaround of \$67.2 million.

The improvement continues to be fueled primarily by the taxes that are closely related to current economic conditions. For example, withholding taxes remitted by the largest employers (84% of withholding dollars) rose at a 6.4% rate for November and December combined. This compares to 3.7% for July-October and a flat situation for 2001-02 and 2002-03. For the full six months, total withholding from all employers is up 4.2%. In short, the employment situation has improved dramatically in recent months.

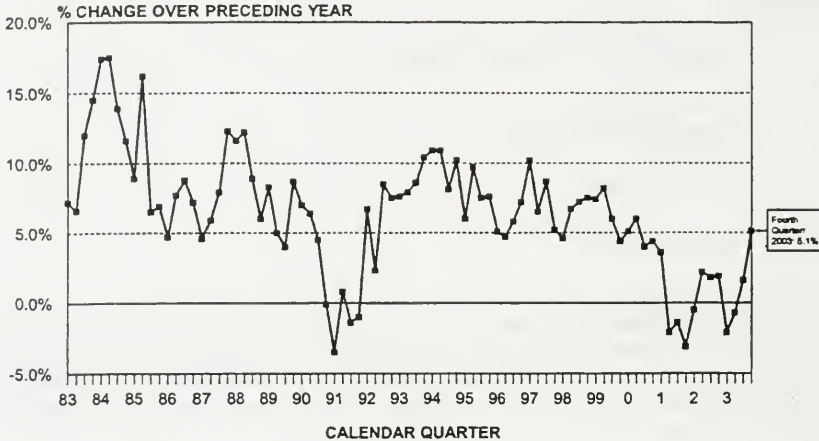
WITHHOLDING TAX RECEIPTS FROM LARGE EMPLOYERS



Notes: Two month periods are used to smooth out monthly volatility.

For the sales tax, we experienced 6.3% growth in December after a 4.8% rise in November and 4.0% in October. This compares to a gain of 1.6% for July-September and a 1.4% decline for January-June 2003. While the federal tax rebates mailed out in July and August were clearly the trigger, the continued acceleration reflects the bounce-back in stock prices since March and the improving job market.

GROSS STATE AND LOCAL SALES TAX COLLECTIONS



NOTE: Data has been adjusted for tax law changes.

Corporate income tax receipts, comprised primarily of estimated tax payments for the third and fourth quarters of the 2003 tax year, are running \$6.5 million ahead of schedule.

Discussions with our contacts in other states and a review of budget news around the country indicate that most states are experiencing the type of turnaround we are seeing in North Carolina.

It might be helpful to look at the key revenue sources in growth terms:

**Key Revenue Growth Rates*
July - December, 2003**

<u>Source</u>	<u>Budgeted Growth</u>	<u>Actual Growth</u>
Withholding Taxes	4.3%	4.2%
Sales Tax	4.7%	5.7%
Other	.9%	2.7%
Total	3.2%	3.5%

*Adjusted for tax law changes.

Should we be concerned about the rest of the year?

There are a number of reasons to be cautious about the next few months. First, the revenue growth rates need to continue to increase if we are to meet the budget target. The reason is that the monthly targets are based on an assumed economic recovery that accelerates as the year progresses. Thus, the revenue growth target for the second half of the year is 3.8%, versus 3.2% for July-December.

A second issue is that during the last two fiscal years, the recovery was sidetracked by outside events. In 2001-02 these external shocks included the events of September 11 and the anthrax scare. During 2002-03, the build-up to the Iraqi invasion, SARS, and financial abuses (Enron, etc.) shook confidence and short-circuited the recovery from 9/11. Hopefully, we will avoid a major shock this year.

Another concern has to do with carryover losses from the stock market crash. A couple of states that track this data using income tax returns indicate that the backlog of losses is the highest since the 1973-1974 bear market. That market decline led to a drop in net capital gains reported on returns for the next few years as taxpayers used the losses to offset their gains, as well as deducting \$3,000 of losses against "ordinary income". The issue making state revenue forecasters across the country nervous this year is that unused losses from the 2001 and 2002 tax years can be carried forward to 2003 and subsequent years. If this amount is unusually large, it could lead to a modest negative "April surprise".

A final issue is the fact that many of the North Carolina jobs lost to overseas locations will not be replaced. This will keep a lid on employment growth and may keep the State from assuming its usual role of leading the nation out of the recession. A related issue is that many laid-off manufacturing employees in North Carolina have been forced to accept lower paying jobs in other sectors, at least temporarily. This depresses the taxable wage base.

Is the current recovery sustainable?

The most important lesson of the last couple of years has been how outside events can derail a recovery. Most analysts believe that a new shock would not have as much impact as prior events because the current recovery has a built-in momentum. This sustainability is due to the following factors:

1. Federal Reserve monetary policy has led to the lowest short-term interest rates in four decades.
2. The explosion in federal spending, especially in defense-related activities, will continue to be stimulative in the short-run, even if the long-term consequences of the burgeoning federal deficit are not favorable.
3. Three major federal tax-cut packages adopted during the last 31 months will continue to push up the disposable income of consumers. In addition, the recent increase in capital spending is due largely to the 50% bonus depreciation provision adopted this summer and more favorable small business expensing rules. You might recall that the key distinguishing feature of the 2001-02 recession was the sharp drop in spending on capital equipment following the stock market crash. Finally, the new treatment of dividends has been a major plus for stock prices.

4. The continuing stock market recovery is lifting consumer confidence and providing the resources for additional spending through the "wealth effect".
5. The simple passage of time has allowed businesses to work off excess inventories and capital equipment accumulated during the economic boom of the late-1990s.

An additional comforting factor is the fact that members of the Federal Reserve have been unusually candid in their comments that interest rates will not be raised until they feel that the recovery is sustainable. This means that short-term rates (treasury bills, certificates of deposit) will not go up until the middle of this year.

These factors work in combination. For example, the rebate checks mailed out last summer led to an increase in consumer spending. This depleted inventories, causing manufacturers to ramp up production. Favorable interest rates and the new depreciation rules provided additional incentives for producers to hire back workers and invest in capital equipment to meet demand. Finally, improving corporate profits pushed up stock prices and this has provided additional resources for consumers.

In North Carolina, the disappearance of manufacturing jobs has been so dramatic that continued job losses in this sector do not have the same impact on overall economic growth as in past years. This means that the success of the recovery depends on what happens to employment in services, especially healthcare, retail trade, construction, finance, government, and other nonmanufacturing activities. These sectors now comprise 85% of the employment base in North Carolina.

What are the economic indicators showing?

In the last few monthly reports we have noted the wide variety of economic measures that have turned upward. This trend continues. Below are some recent data:

1. In December, the level of the "new orders" portion of the well-respected survey of the nation's purchasing managers was the highest since July 1950 and the increase from November was the largest in two decades.
2. Unemployment claims continue to decline at a rapid rate, both nationally and in North Carolina.
3. Stock prices have risen another 7% since our December 4 report and are now up about 40% from the March 2003 lows.
4. A proprietary survey of weekly business activity compiled by a Wall Street advisory service is at the highest level since December 15, 2000.
5. Capital spending plans continue to show improvement.
6. Holiday retail sales for many merchants were the strongest since 1999.
7. Industrial commodity prices continue to rise, reflecting stronger demand.

8. Junk bond yields have fallen from 14% to 7.5% during the last year, lowering the spread between junk and regular bonds. The reason is that bondholders see less business risk. It is noteworthy that the current rate is even lower than during the boom period of the late 1990s.
9. Overseas economies are sharing in the recovery.
10. The commercial real estate market continues to recover.
11. Major layoff announcements have been almost nonexistent during the last couple of weeks.

Do national economic growth reports automatically translate into North Carolina revenues?

It is tempting to try to convert news reports on the national economy into state revenues. In recent years, this has not worked. For one thing, media reports of economic growth ("gross domestic product") measure "real growth," a measure that excludes inflation. A good example is the forecast made a couple of days ago at a conference sponsored by the N.C. Bankers' Association and the Citizens for Business and Industry. In his presentation, Dr. Harry Davis of Appalachian State University indicated that the overall economic growth for North Carolina during the 2004 calendar year would be 3.5%, versus the national rate of 4.5%. These measures do not include inflation, which would add a couple of percentage points and bring total growth in line with the tentative revenue growth forecast of 5.5% for the 2004-05 budget.

Another illustration is the late-October news report indicating that the nation's real economic growth for the third quarter was 8.2% (annualized rate), or about 10% if we include inflation. This is the most impressive showing in many years. A question posed by many observers at the time is why we did not see a similar explosion in state tax collections. The reason is that the broad-based measure of national economic growth includes productivity growth that is due in large part to technological change. State revenue systems assess a tax on the wages of employees, but not the productivity enhancements that add to the overall output of the economy. This is why the reported national economic growth during 2002 and 2003 was positive even though state revenues were flat or declining for some quarters.

Summary

After struggling to recover from the 2000 stock market crash, the nation's economy is finally showing signs that a broad-based sustainable turnaround similar to the experience of 1983 and 1993 is occurring. What is different this time is that there is a stronger tailwind of fiscal and monetary stimulus from Washington and that the Federal Reserve is sending consistent signals that it will delay raising interest rates. The latter issue is very important because premature rate hikes during the last two recoveries led to a slowdown less than two years after the recovery had begun.

The national experience has led to a sharp turnaround in state revenues in recent months, especially in withholding and sales tax receipts. The result is that revenue growth through December is slightly ahead of the budget forecast.

There are very good reasons why it is premature to start thinking in terms of a budget surplus. For one thing, carryforward losses from the market crash may hamper April income tax collections. In addition, it is not likely that the tentative 5.5% economic growth basis for the 2004-05 budget adopted last summer will be upgraded. Finally, even if the 2004-05 tentative budget adopted last summer is balanced, it does not provide funding for typical legislative

commitments such as pay raises for teachers and state employees, the ABC's initiative, higher education enrollment increases, repairs/renovations of state facilities, and a partial restoration of the rainy-day fund. These "commitments" typically amount to \$500-\$800 million.

APPENDIX E

DEPARTMENT OF REVENUE REPORT ON THE COLLECTION OF TAX DEBT



North Carolina Department of Revenue

Michael F. Easley
Governor

January 13, 2004

E. Norris Tolson
Secretary

Report on Collection of Tax Debt

To: The Honorable Marc Basnight
President Pro Tempore

The Honorable James B. Black
Speaker of the House

The Honorable Richard Morgan
Speaker of the House

From: E. Norris Tolson
Secretary of Revenue

General Statute 105-243.1(f) requires the Department to submit a quarterly report to the North Carolina General Assembly on the Department's progress regarding the collection of tax debt. The report must detail the amount and age of tax debt in three categories: tax debt collected by collection agencies, tax debt collected as a result of the 20% collection assistance fee notice, and all other collections of tax by the Department. The report must list itemized collections by tax type, include a long-term collection plan, a timeline for implementing each step of the plan, a summary of steps taken since the last report and their results, and any other data requested by the Commission or the Committee.

Long Term Collection Plan

The Department was requested by the General Assembly to collect \$50 million in the 2003-2004 annual budget. To achieve this goal, several initiatives are being employed.

- **Hire 44 New Collection Division Employees**— For the six-month period ending December 31, 2003, these employees have collected a total of \$19 million. Since July 1, 2001, these employees have collected over \$72 million.
- **Civil Enforcement Team**— For the six-month period ending December 31, 2003, the team collected \$832,000. This brings the total collections from this effort to \$15.1 million. The team's current membership includes nine revenue officers.
- **Enhance Bankruptcy Collections**— This Unit collected \$2.75 million for the six-month period ending December 31, 2003. This brings the total collections since July 1, 2001 to \$13.5 million.
- **Offer-In-Compromise Program**— The Department has expanded use of the Offer-In-Compromise program as a part of Project Collect. During the six-month period ending December 31, 2003, we collected over \$918,000. Since July 1, 2001, the Department has reviewed 1394 offers and accepted 530. This resulted in \$4.1 million in collections against a total liability of \$16.8 million.

- **Federal Offset Initiative**— During the six-month period ending December 31, 2003, this initiative has resulted in state tax debt collections of just over \$1 million. The cumulative total of this initiative since July 1, 2001 is \$9.8 million.

New revenue generated from all "Project Collect Tax" initiatives for six-month period ending December 31, 2003 totaled **\$87,368,909**. Since July 1, 2001, this initiative has generated **\$274,881,809** in new revenue.

Additional Collection Initiatives

In an effort to continue the success of Project Collect Tax, the Department is focused on the following areas as a part of the Department's collection strategy:

- **Organizational Focus**— We continue to divert lower yield cases to collection agencies and lower dollar cases to the TACC (call center) and away from highly trained field collectors. This strategy enables us to boost collection totals through the efficient allocation of resources and by allowing cases to be worked more quickly while they are most collectable (less than 120 days old). Under this plan, the right collection resources are applied to the right case at the right time.
- **Increased Use of Special Procedures**—We are expanding our use of all of our collection tools, including a more strategic use of jeopardy assessments, transferee liabilities, and successor liability. DOR is developing policies and procedures to allow the Department to conduct its own levies, thereby reducing our reliance on local sheriffs' offices. The General Assembly provided this authority to the Department in 1991 but it has not been implemented. Procedures for the Department to use in conducting its own levies have been drafted and are being reviewed by the Department's senior staff and the Revenue Section of the Attorney General's Office. Implementation of the pilot program for conducting levies is expected during the second quarter of the current fiscal year.
- **Performance Measures**— The Collection Division continues to track performance of the collection program through the various performance measures. Collections are tracked at the division, office and individual collector level. The data from this tracking effort is used to devise better, more efficient strategies for collection of taxes and to allocate resources in an effective manner.
- **Better Information Exchange**— A great deal of effort is being focused on improving collaboration and sharing best practices between the five DOR divisions with primary responsibility for collection of delinquent taxes and tax compliance: Collection, Examination, Taxpayer Assistance, Motor Fuels and Unauthorized Substances.
- **Reduce Accounts Receivable for Accounts Billed Prior to July 1, 2001**

Accounts Receivable—July 1, 2001	\$359 Million
Total Reductions *	<u>\$248 Million</u>
Balance as of 12/31/03 Accounts Receivable	\$111 Million

* Estimate based on aging report data available.

Exhibit 1 – Tax Debt Collections July 1, 2003 –December 31, 2003

Age of Assessments	Collection Agencies	20% Fee Warning Letters	Other DOR Collection Efforts	Totals
0-30 days	\$ -	\$ -	\$ 4,720,748.35	\$ 4,720,748.35
31-60 days	\$ -	\$ 35.00	\$ 10,364,451.55	\$ 10,364,486.55
61-90 days	\$ -	\$ 710,694.47	\$ 6,889,430.53	\$ 7,600,125.00
91-120 days	\$ -	\$ 2,498,101.23	\$ 3,718,213.91	\$ 6,216,315.14
121-180 days	\$ 45,272.72	\$ 2,667,865.32	\$ 5,393,016.44	\$ 8,106,154.48
181-365 days	\$ 615,988.15	\$ 1,377,519.69	\$ 9,463,952.59	\$ 11,457,460.43
366-730 days	\$ 652,134.37	\$ 706,224.46	\$ 8,558,065.33	\$ 9,916,424.16
Older than 730 days	\$ 888,437.17	\$ 368,398.07	\$ 4,366,011.43	\$ 5,622,846.67
Totals	\$ 2,201,832.41	\$ 8,328,838.24	\$ 53,473,890.13	\$ 64,004,560.78

Miscellaneous delinquent tax collections

Grand Total - Tax Debt and Non-Filer Collections (July 2003-December 2003)

Total PCT Tax Debt and Non-Filer Collections from July 2001-December 2003

	\$ 100,870,507.00
	\$ 164,875,067.78
Total	\$ 696,504,119.66

Exhibit 2 – Project Collect Tax Collections By Tax Type
October 1, 2003 – December 31, 2003

Tax Type	October 2003			November 2003			December 2003			Total
Individual Income *	\$	8,127,018	\$	10,404,569	\$	7,218,640	\$	25,750,227		
Sales & Use	\$	2,045,959	\$	2,253,456	\$	1,554,628	\$	5,854,043		
Corporate	\$	1,581,836	\$	28,681	\$	51,805	\$	1,662,322		
Franchise	\$	247,102	\$	790,623	\$	111,769	\$	1,149,494		
Motor Fuels	\$	41,438	\$	43,620	\$	51,854	\$	136,912		
Other **	\$	418,841	\$	695,728	\$	711,920	\$	1,826,489		
TOTAL	\$	12,462,194	\$	14,216,677	\$	9,700,616	\$	36,379,487		

* Individual Income includes debts owed by businesses for employee withholding taxes held but not paid.

** The category "Other" includes License and Excise Taxes, Insurance Premium Tax, Unauthorized Substances Tax, and Estate/Gift Taxes.

***Deducted from the Project Collect Tax total is \$1,701,859 collected from Project Compliance

APPENDIX F

MEMOS BY MARTHA WALSTON AND TRINA GRIFFIN, STAFF ATTORNEYS TO THE REVENUE LAWS STUDY COMMITTEE, REGARDING RECENT COURT CASES INVOLVING TAXATION ISSUES

- *N.C. School Boards Association v. Moore*
- *A&F Trademark, Inc. v. State of North Carolina*
- *DIRECTV, Inc. and EchoStar Satellite Corp. v. State of NC*
- *Coley v. State of North Carolina*

MEMORANDUM

TO: Interested Parties
FROM: Finance Team
RE: Fines and Forfeitures Decision
DATE: October 1, 2003 (revised January 9, 2004)

On Tuesday, September 16, 2003, the N. C. Court of Appeals issued an opinion reversing much of the Wake County Superior Court's December 14, 2001 ruling in which the superior court had ordered that payments collected by certain State agencies and licensing boards be distributed to the public schools in lieu of allowing the agencies and boards to retain these payments for other purposes. The result of this opinion is that the Department of Revenue and the University System will not have to pay out monetary sums totaling more than \$511 million.¹

The matter arose in December 1998, when the Plaintiff North Carolina School Boards Association and the individual Boards of Education for Wake, Durham, Johnston, Buncombe, Edgecombe, and Lenoir counties sued defendant State departments, agencies, institutions, and licensing boards seeking a determination that various monetary payments collected by these defendants should go to the school systems in the counties where the payments are collected and that the school boards should decide how to spend the money. Plaintiffs based their position on Article IX, Section 7 of the North Carolina Constitution, which provides in part, "[T]he clear proceeds of all penalties and forfeitures and of all fines collected in the several counties for any breach of the penal laws of the State, shall belong to and remain in the several counties, and shall be faithfully appropriated and used exclusively for maintaining free public schools." Defendants' position is that none of the challenged payments falls within the purview of Article IX, Section 7, because these payments are remedial rather than punitive in nature, and that defendants may therefore retain and use the payments for purposes other than maintaining free public schools.

The case came before the Court of Appeals after the Wake County Superior Court entered summary judgment in plaintiffs' favor on grounds that all of the monetary payments at issue

¹ This assumes that the opinion is affirmed on appeal to the North Carolina Supreme Court. No estimates are available for the moneys collected by the licensing boards. The monetary sum of \$511 million includes payments collected by the Department of Revenue beginning in fiscal year 1995-96 to the present and payments collected by the University System for fiscal years 1999-2000 and 2000-2001.

were subject to Article IX, Section 7 of the State Constitution and belong to the public schools. The Court of Appeals reversed most of the findings in the superior court's order of summary judgment.

The Court of Appeals, in reversing most of the findings of the superior court, held that the following monetary payments may go to the State agencies collecting the payments and may be used for purposes other than the public schools. The Court concluded that the following payments are remedial rather than punitive in nature and, therefore, are not governed by Article IX, Section 7 of the State Constitution.

- Penalties collected by the Department of Revenue as an additional tax under G.S. 105-236 and other provisions of the NC Revenue Act for failure to comply with the tax code. These payments total on average about \$50 million annually in fiscal years 1995-1996 through 1998-1999 and are deposited into the General Fund.
- Payments collected by the Department of Revenue from persons dealing in unauthorized substances pursuant to Article 2D of Chapter 105 of the General Statutes. These payments total about \$6 million annually in fiscal years 1995-1996 through 1998-1999. The State or local law enforcement agency that conducted the investigation leading to the assessment of the tax on unauthorized substances received 75% of these collections.
- Payments collected by the Employment Security Commission from employers for overdue contributions to the Unemployment Insurance Fund, late filing of wage reports, and tendering a worthless check pursuant to G.S. 96-10(g) and (h).
- Payments collected by the boards of trustees of the Consolidated University of North Carolina campuses for violation of ordinances regulating traffic, parking, and vehicle registration pursuant to G.S. 116-44.4(h). In fiscal year 1999-2000, UNC-CH collected over \$1.6 million while NCSU collected about \$800,000. These moneys are used for parking, traffic, and transportation purposes including as a pledge to secure revenue bonds for parking facilities.
- Payments collected by the boards of trustees of the Consolidated University of North Carolina campuses for loss, damage, or late return of materials borrowed from University libraries pursuant to G.S. 116-33. In a recent year, NCSU collected nearly \$160,000. These payments are used to offset the cost of maintaining the institutions' library collections.
- Payments collected by the Plumbing and Heating Board, the Electrical Board, the Cosmetic Board and the State Bar for licensees' failure to timely comply with licensing requirements. In a recent three-year period these payments ranged from approximately \$18,000 collected on average annually by the State Bar to \$45,000 collected annually by the Board of Cosmetic Art Examiners. Generally, these payments are retained by the collecting agency and used for operating expenses.

- Payments collected by State agencies as fines or civil penalties assessed against a public school or local school administrative unit, including the \$11,000 paid to the Department of Environment and Natural Resources (DENR) by the Edgecombe County Board of Education in April, 1997, may remain with the collecting State agency, where they may be used for purposes other than maintaining public schools.² Local school administrative units paid at least \$500,000 to DENR during a recent five-year period.

The Court of Appeals held that the following payments are punitive in nature and must go to the public schools pursuant to Article IX, Section 7 of the North Carolina Constitution.

- Payments collected by the Department of Transportation from owners of vehicles that exceed axle-weight limits pursuant to G.S. 20-118(e). These payments average \$7 million annually and are credited to the State Highway Fund.
- Payments collected by the Department of Transportation from vehicle owners who allow their motor vehicle insurance to lapse and from insurers who fail to give notice on insurance termination to the DOT pursuant to G.S. 20-309.
- Payments made in support of a supplemental environmental project, in lieu of paying a civil penalty.³

Additional holdings by the Court of Appeals

- The Civil Penalty and Forfeiture Fund (Civil Penalty Fund) and the State School Technology Fund enacted by the General Assembly do NOT violate the plain language of Article IX, Section 7 of the NC Constitution. The Court emphasized that the Constitution only requires generally that revenue collected from civil penalties be used exclusively to support the public schools but does not specify how this is to be accomplished. The Court concluded "that the statutory scheme's creation of the Civil Penalty Fund, its mandate that all funds accruing thereto be transferred to the School Technology Fund for allocation to local school units based on student population, and its requirement that these funds be used to implement local school technology plans are consistent with the intent and purpose of Article IX, Section 7." The Court rejected the plaintiffs' argument that the language in Article IX, Section 7 required that the payments be made to a specific city and/or county school board.

² The Court did not base this result on whether the payment was punitive or remedial in nature but on the public policy that a wrongdoer should not be allowed to enrich himself as a result of his own misconduct.

³ This includes \$50,125 paid by the City of Kinston to Lenoir Community College on March 31, 1998 in support of a supplemental environmental project. A SEP has been defined as part of a settlement to an enforcement action and as providing opportunities for environmental benefit as a result of negotiated settlements.

- The trial court correctly applied the three-year statute of limitations to plaintiffs' claims. This means plaintiffs' claims apply to payments collected within three years preceding the filing of their complaint in December 1998. Defendants argued that a one-year statute of limitation should apply.

Dissenting opinion

One of the appellate judges, in the three-judge panel hearing the case, dissented from the majority opinion on the following grounds:

- The payments collected by DOT pursuant to G.S. 20-118(e) are not punitive in nature and therefore, do not belong to the public schools. These payments were intended to compensate the State for the deterioration of its highways due to operation of overweight vehicles and go to the State Highway Fund instead of the public schools.
- The \$11,000 penalty assessed against the Edgecombe County School Board for environmental violations should go to the public schools. However, in determining how to distribute this money among the eligible school systems from the Civil Penalty Fund, the average daily attendance of Edgecombe County public schools should not be included in the calculation and Edgecombe county School Board should not receive any of the money.

Both parties have appealed to the North Carolina Supreme Court. A hearing date has not been scheduled. The State has appealed the following portions of the majority opinion:

- **That the payments to the Department of Transportation are punitive in nature and must go to the public schools.**
- **That the payments made in support of a supplemental environmental project, in lieu of paying a civil penalty, are punitive in nature and must go to the public schools.**

Note that pursuant to G.S. 7A-30, the parties have a right to a direct appeal to the North Carolina Supreme Court on the substantial constitutional questions raised in the opinion and on the issues raised in the dissenting opinion.

A&F Trademark, Inc., et al.

versus

E. Norris Tolson, Secretary of Revenue, State of North Carolina and his Successors

(Summary prepared by Finance Team January 12, 2004)

In 2001, the General Assembly created a new statute in the Corporate Income Tax Act addressing trademark payments between related members. It states that royalties received for the use of trademarks in this State are income derived from doing business in this State and thus are subject to North Carolina income tax⁴. Prior to this act, some corporations argued that an out-of-state investment company's receipt of royalty income from the use of trademarks in this State did not subject the investment company to North Carolina income tax on the royalties. In this case, the Tax Review Board⁵ confirmed, on May 2, 2002, the final decision of the Secretary of Revenue, entered on September 19, 2000, that the taxpayers were doing business in this State and as such were subject to North Carolina corporate income and franchise tax. On May 22, 2003, the Wake County Superior Court affirmed the Tax Review Board's administrative decision in its entirety and further found that the decision is:

1. not in violation of constitutional provisions;
2. not in excess of the statutory authority or jurisdiction of the agency;
3. made upon lawful procedure;
4. not affected by error of law;
5. supported by substantial evidence in view of the entire record as submitted;
6. not arbitrary, capricious or an abuse of discretion; and
7. not prejudicial to the substantial rights of the taxpayers.

The taxpayers have appealed to the North Carolina Court of Appeals.⁶ Oral argument before the Court of Appeals has not been scheduled.

In this case, the taxpayers are nine wholly-owned subsidiaries⁷ of the Limited Stores, Inc. The Limited also owns 100% of eight retail companies⁸ who have retail subsidiaries doing business in more than 130 locations in North Carolina. These retail subsidiaries pay North Carolina corporate income and franchise taxes. The taxpayers were incorporated in Delaware to hold the trademarks owned by the Limited and the related retail companies. The taxpayers do not own or lease any real property or tangible personal property in any state except Delaware. The taxpayers have no employees in any state. They received the trademarks they own in separate I.R.C. Section 351 tax-free exchanges with the related retail companies. In these exchanges, the related retail companies transferred the trademarks to the taxpayers for little or no consideration. The taxpayers then entered

⁴ S.L. 2001-327.

⁵ The Tax Review Board is composed of the following members: the State Treasurer, the chair of the Utilities Commission, a member appointed by the Governor, and the Secretary of Revenue. The appointed member is Noel Allen.

⁶ No. COA03-1203

⁷ A&F Trademark, Inc.; Caciqueco, Inc.; Expressco, Inc.; Lanco, Inc.; Lernco, Inc.; Limco Investments, Inc.; Limtoo, Inc.; Structureco, Inc.; V. Secret Stores, Inc.

⁸ Lane Bryant, Inc.; Lerner, Inc.; Victoria's Secret, Inc.; Cacique, Inc.; Abercrombie & Fitch, Inc.; Limited Too, Inc.; Express, Inc. and Structure, Inc.

into licensing agreements with the corresponding related retail companies. The licensing agreements authorized the related retail companies to continue to use the trademarks they had previously owned in exchange for royalty payments to the taxpayers. The royalty payments are based on a percentage of the retail companies' gross sales. The Limited and the related retail companies deducted these royalty payments from their income for North Carolina tax purposes. Taxpayers then loaned these royalty payments back to the related companies for use in their retail operations. Taxpayers charged the retail companies a market rate of interest, which generated further income tax deductions for the related retail companies. The taxpayers did not pay any income tax to any state on any of the income received from the related retail companies. For the year at issue (1994), taxpayers recorded \$301,067,619 in royalty income and \$122,031,344 in interest income from the related retail companies. This accounted for 100% of taxpayers' income.

North Carolina imposes a franchise tax on every corporation doing business in this State. For franchise tax purposes, "doing business" is defined as each and every act, power, or privileges granted by the laws of this State. North Carolina also imposes a corporate income tax on every C corporation doing business in this State. Although the term "doing business" is not defined by statute for corporate income tax purposes, the Secretary of Revenue has promulgated an administrative rule defining the term. The rule defines the term to mean "the operation of any business enterprise or activity in North Carolina for economic gain, including, but not limited to, ...the owning, renting, or operating of business or income-producing property in North Carolina including but not limited to trademarks and tradenames."⁹

In this case, the Tax Review Board found that the taxpayers own valuable intangible property in the form of trademarks, tradenames, and service marks and the goodwill associated with the marks. This property is business or income-producing property. Under applicable principles of law, intangible property has acquired a business situs where it is used. Applying principles of trademark law, the taxpayers' property cannot exist apart from an established business in which it is used. The property is used extensively in North Carolina in connection with established businesses. The taxpayers have also purposefully licensed their property for use in this State and earn significant royalty income from the licensing agreements.

Based upon these findings, the Tax Review Board found that the taxpayers own business or income-producing property in North Carolina, the taxpayers license business or income-producing property in North Carolina, and the taxpayers operate business or income-producing property in North Carolina. Therefore, the Tax Review Board determined that the record supported the Secretary's determination that the taxpayers were "doing business" under the applicable State statutes and administrative rules.

The taxpayers also argued that physical presence in a state is a constitutional prerequisite for taxation and that since they are not physically present in the State they cannot be taxed by North Carolina. The Tax Review Board determined that it did not have the authority or jurisdiction to rule upon the constitutionality of a statute.

⁹ 17 NCAC 5C.0102.

DIRECTV and EchoStar Satellite Corp. v. State of North Carolina

Prior to 2002, cable TV services were subject to a local franchise tax of 5%, but satellite TV services were not. In 2001, the General Assembly equalized the tax treatment of satellite TV and cable TV by establishing a 5% State sales tax on the gross receipts derived from satellite TV services, so that both services are subject to a 5% tax on their gross receipts. (The equalization of the taxation of cable TV and satellite TV was part of the Governor's recommended tax loophole closings.) The sales tax became effective January 1, 2002.

On September 30, 2003 DirecTV and EchoStar Satellite Corporation, which are the nation's largest providers of satellite TV services, filed a lawsuit in Wake County Superior Court against the State. The satellite providers claim that they are subject to discriminatory taxation because their customers pay a 5% sales tax for satellite TV services while cable subscribers do not pay sales tax. Thus, they argue that the local cable providers are being given an unfair competitive edge. The challenges are largely based on the constitutionality of the taxing policy under the Commerce Clause of the U.S. Constitution, which prohibits state taxes that discriminate against interstate commerce. Similar lawsuits were also filed in Ohio and Tennessee earlier in the year. (Cable operators pay a franchise fee in exchange for rights and privileges that they receive from local authorities. Among other things, these fees compensate a community for benefits including cable's use of the local rights-of-way and to offset government costs. The satellite carriers do not receive any such benefits from the local authorities and are not subject to those fees.)

The complaint and answer have been filed in this case. The plaintiffs are seeking a refund of \$30 million in sales taxes.

Coley v. State of North Carolina

In 2001, the General Assembly created a fourth tax bracket with a tax rate of 8.25% on taxable income over \$200,000 for married couples filing jointly, over \$160,000 for heads of household, over \$120,000 for unmarried individuals, and over \$100,000 for married individuals filing separately. The change was estimated to affect approximately 2% of North Carolina taxpayers. The new tax bracket was initially scheduled to be in effect only for the 2001, 2002, 2003 tax years. In 2003, the General Assembly extended the sunset from January 1, 2004 to January 1, 2006.

A lawsuit has been filed challenging the 8.25% income tax bracket as having unconstitutional retroactive application. The plaintiffs argue that because the budget act, which imposed the new rate, was passed mid-year (July 1, 2001), yet the new rate was effective for the entire tax year, beginning in January, that the provision violates Article I, Sec. 16 of the State Constitution. That section of the State Constitution states "No law taxing retrospectively sales, purchases, or other acts previously done shall be enacted."

The Department has estimated approx. \$62 million in taxes were paid at that rate for the entire year. Presumably, if the court were to find that only those taxes paid for the time period preceding the act's ratification were unconstitutional, then the potential liability for the State would be approximately \$30 million.

The complaint has been filed and the State has filed a motion to dismiss. A hearing is scheduled for this month on the motion.

APPENDIX G

TESTIMONY TO THE REVENUE LAWS STUDY
COMMITTEE BY WILLIAM SCHWEKE
REGARDING WAGE AND BENEFIT
PERFORMANCE STANDARDS FOR BUSINESS
INCENTIVES

WAGE AND BENEFIT PERFORMANCE STANDARDS FOR BUSINESS INCENTIVES

Testimony to NC House Revenue Law Committee

March 16, 2004

By William Schweke, Corporation for Enterprise Development

Background

The Corporation for Enterprise Development (CFED) has mixed feelings about business incentives. On one hand, they can make the difference in attracting a facility in some cases. But they are, in the majority of cases, a windfall for the business. Furthermore, there is an “arms race” mentality that encourages policymakers to match any development incentive a competitor offers, regardless of its utility and effectiveness. This is fueled by a host of governments who are constantly striving to strike first in offering a particular inducement. This also results in the situation that any business subsidy advantage that a jurisdiction possesses is very short-lived and that the price of the incentive competition only goes up, up, up.

In a nutshell, if improperly used, incentives can:

- Waste scarce public dollars on projects without creating net new jobs, nationwide.
- Subsidize shareholders for actions their companies would have made anyway.
- Cost more than the public benefits that they create.
- Foster unfair competition by helping some firms and industries and not others.
- Create opportunities for cronyism and abuse.
- Divert policymakers’ attention from more effective ways of creating jobs and improving the business climate.

But providing development incentives will continue to be an important part of economic development practice. States and localities, therefore, should set them in a broader policy context which:

- Bases competition mainly on the quality of public services.
- Focuses on the balance, fairness, and stability of the tax structure not just tax competitiveness.
- Limits business incentives to strategic uses.
- Strengthens accountability and disclosure.
- Picks the most appropriate incentive.
- Links incentives with employment training and placement programs.

One critical tool that policymakers can use to get a higher return on their incentive dollars are job creation performance standards.

It is important for NC policymakers to sort out the state’s policy guidelines, regarding incentive-based performance standards. The new JDIG program has no explicit quality job benchmarks and one of the recent Joint Select Committee on Economic Growth and Development hearings surfaced some concerns about the wage standards in other NC incentive programs as being too high in some

counties for landing projects. This testimony discusses these issues and suggests a way forward, regarding appropriate wage and benefit performance standards.

The Lay of the Land

The latest survey by Good Jobs First demonstrates that

The number of economic development subsidies with job quality standards is continuing to rise sharply, and that standards are becoming an everyday tool for effectively targeting development subsidies to businesses that create high-quality jobs. There are now at least 116 state programs with standards and 49 standards that apply to local subsidies, often covering multiple programs. Altogether, that amounts to 165 job quality precedents . . . At least 43 states, 41 cities, and 5 counties – a total of 89 jurisdictions – now attach job quality standards to at least one development subsidy . . . Standards are being attached to every type of subsidy program, including tax credits, training programs, industrial revenue bonds, loan programs, enterprise zones and tax increment financing. Wage standards continue to be the most common requirement . . . Standards that mandate employer-provided healthcare benefits are also on the rise. . . The vast majority of development officials interviewed agree that job quality standards do not adversely affect business climates. Only 16 of the 119 officials interviewed had heard complaints that job quality standards negatively affect development efforts. (*The Policy Shift to Good Jobs* – November 2003)

In some respects, this is probably the tip of an iceberg. These programs are “statutory” incentives.

But some incentives are provided in a more ad hoc, customized, negotiating manner. Here the incentives for a specific project might include some statutory programs, along with other “discretionary deal sweeteners.” The latter incentives can work, but the whole process is even more fraught with perils – most especially the possibilities for corruption and the danger of offering too much (the so-called winner’s curse).

But CFED would argue that offers of discretionary incentives should still be guided by criteria that embody the “ideal” deal. The state or local government should have its own “bottom-line.” The firm, after all, has its “tipping point” where the subsidies and other business conditions meet its threshold. Government also has its “bottom-line.”

It should be noted that the firm and the jurisdiction possess both mutual and differing interests – the company wants to maximize its profits and get the government to cover as much of the risks and costs of investment as possible, while the public sector’s goals are more diffuse and varied – but they basically involve such returns as private investment in lagging regions, new jobs, a higher standard of living for its citizens, increased productivity and innovation, greater synergy with existing firms and business climate assets, and adequate tax revenues.

Yet, the firm and the government also need each other. Businesses rely on a modern public service infrastructure, property security, a good quality of life, a well-educated workforce, predictable and professional regulation, a can-do attitude within the public sector, and a stable, appropriate business climate, while the government depends on the tax revenues, employment, and physical development that the firm provides.

The likelihood of a successfully used business attraction subsidy is increased if economic development policymakers use a conservative fiscal impact and/or cost-benefit model to appraise all public offers in negotiated deals and any new legislative proposals for a new incentive. And if the incentive package or new incentive alternative flunks this test, policymakers must discard these options. (Often times, no deals are good deals.)

But it is critical to have a set of clear benchmarks as well. The firm and the government are not on equal footing. The company is the more empowered party, because of the jurisdictional competition for the honor of hosting its new facility and because only the firm knows what business climate features (e.g., wage costs, skill needs, tax burdens, market size and access, higher education institutions, etc.) and financial hurdles must be met. Moreover, they only know what other jurisdictions are offering.

So, what should be the goals and milestones that guide incentive policies and practices?

These benchmarks should include quality of job standards for four reasons. First, extremely cost-sensitive, lower-wage firms that produce basic commodities are likely to relocate abroad in the near future. So, why should NC use scarce public monies to go after them? Secondly, a state government's prime imperative is to raise the citizenry's standard of living and this means that higher wage jobs, high performance workplaces, and cutting edge technologies or services are what the doctor orders. (Ideally, America's state policymakers should be creating the most profitable environment for firms, not necessarily the cheapest.) Third, all things being equal, a higher wage firm will more likely pass a fiscal impact test and generate more revenues than the jurisdiction lost via foregone revenue and spent due to the inevitable increase in public sector requirements (e.g., K-12 schools, infrastructure, etc.) Fourth, NC has a high number of working poor households. They need access to better jobs and a career path in today's economy.

In Search of the Ideal Deal

A good place-based economic development outcome is more likely if:

- Any performance standards are clear and upfront (no surprises for the firm);
- There are legally binding provisions in the law or contract between firm and government that specify concrete public benefits, such as: creating a certain number of jobs, meeting a wage or benefit standard, complying with environmental or design standards, complying with local hiring guidelines, and meeting these public benchmarks and maintaining operations within a particular time period;
- Incentive payments from the public sector are triggered by the employer meeting certain agreed upon milestones;
- Enforcement and oversight mechanisms are specified by disclosure, audits, and real penalties for non-compliance (e.g., recisions, clawbacks, debarment, etc.); and
- The facility locates in a community that is slow growing with a high rate of joblessness.

The Issue of NC's Wage and Benefit Standards

The state of North Carolina already has helpful wage and benefit standards for its development incentive programs. There is some variation between programs, but the basic picture is as follows.

Depending on the program, eligible firms must pay:

- Greater than the county average weekly manufacturing wage; or
- 110% of the state average weekly manufacturing wage; or
- 110% of the average wage for all insured employers in the state.

Companies must pay at least 50% of employees' health benefits.

Tier 1 and tier 2 counties are not under these standards for the Lee Act.

There is some griping from economic development professionals at the county or town level that the wage standards create some problems with some prospects. (Any standard, above a certain threshold, will inevitably discourage some prospects. One cannot escape the trade-offs that characterize almost all public policies.) They feel that they are losing some chances to land projects in their county which would advance the citizenry's standard of living and tighten local labor markets.

How should we respond to these concerns?

First, by waiving the performance standards for the most troubled economies (Tiers 1 and 2), NC policymakers have already taken an action that helps those places that are in most need of jobs – any jobs.

Second, an industry-based standard might be the way to deal with this problem. The state could use the existing eligible industry list in the Lee Act and require that firms that take NC subsidies must pay, in Tiers 3, 4, and 5, 110 percent of the average hourly wage for that industry in that county. (This would be for non-management employees.) If there is no other industry like this in the county, the state would require that firms eligible for NC business incentives must pay 110% of the average hourly wage in the county.

Given the incredible importance of health benefits and the rising costs of insurance premiums, the state should stick with its current health insurance requirements: For full time employees, firms must provide 50% of health premiums or exceed the minimum provisions of the basic health care plan of coverage recommended by the Small Employer Carrier Committee.

The state could also follow precedents elsewhere, which require incentive recipients to pay higher wages if they do not provide health benefits. The average amount allotted for topping up wages in this situation is \$1.50 per hour. This might be another good amendment to existing incentive laws.

APPENDIX H

WIRELESS 911 BOARD EXECUTIVE SUMMARY

Wireless 9-1-1 Fund

THE WIRELESS 911 BOARD EXECUTIVE SUMMARY CY 2002-2003





North Carolina WIRELESS 911 BOARD

George Bakolia, Chair

Carolyn H. Carter, Vice Chair

Wireless 911 Board Executive Summary February 10, 2004

Presented by Richard Taylor, Executive Director

Background

On September 25, 1998, the 1998 Session of the General Assembly of North Carolina approved Senate Bill 1242, G.S. 62A, Enhanced 911 Wireless Fund. The objectives of the Act include providing for a Enhanced Wireless 911 System for the use of wireless telephone customers. The Act provides for a service charge of \$.80 per month on each commercial mobile radio service (CMRS) connection. These funds are disbursed as provided by statute to CMRS providers and public safety answering points (PSAPs) in North Carolina.

The Board is staffed by an Executive Director and an accountant within the Office of Information Technology Services. The Board consists of 13 members and meets bi-monthly, or as required, to identify, discuss and act upon those issues concerning the Enhanced Wireless 911 Fund.

Financial Data

Total revenue collected by CMRS providers in CY 2002:	\$ 35,649,090.91
Total revenue collected by CMRS providers in CY 2003:	36,214,909.45
Total funds disbursed to PSAPs in CY 2002:	\$ 13,283,619.80
Total funds disbursed to PSAPs in CY 2003:	14,557,861.38

Total funds reimbursed to CMRS providers in CY 2002: \$ 12,045,284.33
Total funds reimbursed to CMRS providers in CY 2003: 22,089,124.99

Total funds expenditure for administration in CY 2002: \$ 155,244.34
Total funds expenditure for administration in CY 2003: 250,318.90

The fund balance as of December 31, 2003, including interest, was:
\$ 51,170,841.80

Wireless Phase II deployment, the technology that provides for the latitude / longitude of the caller, began on a large scale in the last quarter of 2003. Initial invoices for partial Phase II deployment were received prior to December 31, 2003, and indicate preliminary costs estimates provided by three of the 12 carriers in North Carolina will meet or exceed the estimated costs of \$47,000,000 over a three year period for Phase II alone.

In April 2002, the Office of State Budget and Management, under the authority of Governor Easley, transferred \$ 2,500,000 from the Enhanced Wireless 911 Fund to assist the State in its budget crisis. These funds were paid from the CMRS provider portion of the fund balance.

In July 2003, the General Assembly, through S.L. 2003-416, voted to transfer \$ 33,000,000 in FY 2003/04 and \$ 25,000,000 in FY 2004/05 from the Enhanced Wireless 911 Fund to assist the State in its budget crisis. As of December 31, 2003, the funds scheduled for transfer on April 30, 2004 for FY 2003/04 have not been transferred.

Wireless 911 Deployment Data

As of December 31, 2003, 125 PSAPs, representing 99 counties and the Eastern Band of the Cherokee Indians were receiving funds from the Enhanced Wireless 911 Fund. Yancey County is the only county not receiving funds due to the lack of enhanced wireline 911 capabilities. For Phase I deployment, the 12 wireless carriers operating in North Carolina report 87% total deployment statewide.

The Federal Communications Commission require carriers to deploy Wireless Phase II in those counties that have made a formal request for the service. For Phase II deployment, 63 counties have requested Wireless Phase II from the CMRS providers. The wireless carriers have fulfilled 88% of those requests. The remaining 12% will be completed by May 2004.

The Enhanced Wireless 911 Board staff is working closely with the remaining 36 counties to prepare them to receive and utilize the phase II data elements. Part of that work includes an educational program prepared specifically for the Telecommunicators responsible for answering wireless 911 calls. As of

December 31, 2003, 725 Telecommunicators representing 85 PSAPs, representing 57 counties, have received this wireless 911 training at no cost to the individual PSAPs. All costs for this program have come from the Administrative Fund of the Wireless 911 Board.

In the year ending December 31, 2003, Sprint & BellSouth reported that 38% of all 911 calls entering their networks were from wireless devices in North Carolina.

National Comparisons & Implications

Based on information from the US Department of Transportation in conjunction with the National Emergency Number Association (NENA), only 65% of counties nationwide have some form of Wireless Phase I. Only 18.5% of those counties have some form of Wireless Phase II.

Wireless cost recovery mechanisms are in place in 45 states, for PSAPs, ranging from \$.20 to \$ 1.50.

The United States Congress is currently working on legislation that will provide additional funding for PSAPs through a grant program. The House version, HR 2898 has passed in the full House and has been sent to the Senate. The key focus of these grant monies in both the House and Senate version, will only go to PSAPs in states where the 911 funds have not been used for purposes other than 911 deployment.

At the Federal Communications Commission E-911 Initiative on October 29, 2003, North Carolina was singled out by Congressman Upton, R-Michigan, in his opening comments, for using 911 funds for purposes other than 911 and would not be allowed to receive future federal grant monies designated for 911.

Additional Information

On July 10, 2003, the North Carolina legislature enacted into law S.L.2003-341, "An Act To Extend The Surcharge For The Telecommunications Relay Service To Include Wireless Communications". This provision allows for the collection of a surcharge to help fund the Telecommunications Relay Service (TRS) in North Carolina. The Telecommunications Relay Service provides to deaf and hard of hearing individuals the ability to communicate, via telephone, with the hearing community, and, allows for the hearing community to communicate with the deaf and hard of hearing.

Based on NCGS 62-157.(i), the surcharge imposed on wireless devices shall be the same as the surcharge imposed on wireline phones as established by the North Carolina Utilities Commission. That current rate is \$.11 per line.

In addition, the statute allows for each carrier to retain 1% of the total TRS collections for their administrative costs. The balance of the collection is to be forwarded monthly to the North Carolina Wireless 911 Board for disbursement to the Department of Health and Human Resources. The Wireless 911 Board does not retain any fee for the collection or disbursement of the TRS surcharge.

The new ruling went into effect January 1, 2004. As of December 31, 2003, no fees have been collected or disbursed to the North Carolina Telecommunications Relay Service.

Wireless 911 Board Members

As of December 31, 2003, the North Carolina Wireless 911 Board has three vacancies in the total thirteen positions authorized. Two of the positions, appointed by the President Pro Tem, represent the Police Chiefs and the National Emergency Number Association (NENA). The third vacancy is appointed by the Speaker of the House, and represents the Sheriffs of North Carolina.

Agency Represented	Name
National Emergency Number Association <i>appointed by the President Pro Tem</i>	Vacant
NC Association of County Commissioners <i>appointed by the Governor</i>	Richard B. Self Manager, Franklin County
League of Municipalities <i>appointed by the Governor</i>	Carolyn H. Carter Retired Asst City Manager, Raleigh
NC Licensed LEC Provider <i>appointed by the President Pro Tem</i>	Belinda Gurkins E-911 Area Manager, Sprint
Office of Information Technology Services <i>designated by Statute</i>	George Bakolia Chief Information Officer, State of North Carolina
NC Licensed CMRS Provider <i>appointed by the President Pro Tem</i>	Leigh Horner Nextel Communications
NC Licensed CMRS Provider <i>appointed by Speaker of the House</i>	David Keever Alltel Communications
Chief of Police <i>appointed by the President Pro Tem</i>	VACANT

Sheriff	VACANT
<i>appointed by Speaker of the House</i>	
NC Licensed CMRS Provider	Toby Turner
<i>appointed by the Speaker Pro Tem</i>	Sprint PCS
Association of Public Safety Communications Officials	Frank T. Thomason
<i>appointed by Speaker of the House</i>	Telecommunications Director, Rowan County
NC Licensed CMRS Provider	Pamela M. Tope
<i>appointed by Speaker of the House</i>	Verizon Wireless
NC Licensed CMRS Provider	Don Van Liew
<i>appointed by Speaker of the House</i>	Manager of Network Technical Operations Cingular Communications

APPENDIX I

**MEMO FROM LINDA MILLSAPS, FISCAL
ANALYST TO THE REVENUE LAWS STUDY
COMMITTEE, REGARDING VOICE-OVER
INTERNET PROTOCOL**

Memorandum

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps
Fiscal Research

DATE: March 15, 2004

SUBJ.: Voice over Internet Protocol (VoIP) - the "Pac-Man of
Protocols"

In recent months there has been a great deal of activity related to a relatively new area of technology - Voice over Internet Protocol. The growth of this technology has the potential to have significant revenue implications for the State and our municipalities. I hope you find this information of use.

What is VoIP?

According to the Federal Communications Commission, Voice over Internet Protocol (VoIP) is a technology that allows you to make telephone calls using a broadband Internet connection instead of a regular (or analog) phone line. As such, it allows you to make telephone calls using a computer network, over a data network like the Internet. VoIP converts the voice signal from your telephone into a digital signal that travels over the Internet then converts it back at the other end so you can speak to anyone with a regular phone number.

How popular is VoIP?

Currently VoIP is a relatively new technology, with limited rollouts in North Carolina. However, it should be noted that Vonage, Bell South, and Time-Warner Cable are currently offering this technology in the State. AT&T has made a national announcement of their intention to offer VoIP services in the near future. Circuit City and Radio Shack have also announced that they plan to make this technology available through their stores.

Is VoIP likely to become more popular?

The possibility of VoIP becoming a central part of our nation's telecommunications infrastructure is extremely high. According to an August 2003 Business Week analysis, productivity increasing technologies like VoIP could yield \$140 billion in annual savings in the next five years to businesses in six industries alone. On the residential front, VoIP service providers, including those offering service in North Carolina, are advertising \$39.95 a month for unlimited local and long distance calling, including such popular features as call waiting and call-forwarding. As a point of reference, in Japan, where the technology has been available for a longer period, VoIP serves as the phone lines for 10-15% of that nation's calling network.

What is the tax status of VoIP?

The Department of Revenue believes that if state and federal law are left unchanged, "it is our opinion that all VoIP telecommunications services are subject to sales tax in North Carolina." At this point Fiscal Research is aware of two companies - Time Warner and Bell South - that are either collecting telecommunications taxes on these calling services, or intend to collect those taxes once the service is rolled out in the state. In other states, Vonage has filed suit when asked to collect and pay telecommunications taxes, as they maintain that their product is not a telephone service, but is instead an information service. Under federal law, information services are not subject to state regulation or taxation. (Because of confidentiality statutes the North Carolina Department of Revenue cannot comment on the activities of specific taxpayers).

What are the revenue implications of VoIP?

It appears that the advent of VoIP will reduce the amount of telecommunication tax revenue available to the State and municipalities. Currently the State collects about \$310-\$360 million in telecommunications taxes annually, with approximately \$50-\$60 million of that amount going to municipalities under a tax sharing program. If VoIP were found to be an information service, the State and our municipalities

would potentially lose all the revenue associated with VoIP services. However, even if VoIP were found to be a telecommunications service that could be taxed by the states and local governments, the cost savings associated with using VoIP would likely reduce the taxable base.

What is the current status of the VoIP issue?

Currently there are activities on three fronts that may affect the taxability of VoIP services. On the congressional front H.R. 49 and S.B. 150 have the potential to erode the state and local tax base related to VoIP. Known as the Internet Tax Freedom Act, these bills include language that could be interpreted as barring the states from taxing VoIP by defining it as an information service. There is also a legal challenge to the taxation of VoIP. In Minnesota, the United States District Court ruled in *Vonage v. Minnesota Public Utilities Commission* (MPUC) that “Vonage is an information service provider”. The court also noted “In its role as an interpreter of legislative intent, the Court applies federal law demonstrating Congress’ desire that information services such as those provided by Vonage must not be regulated by state law enforced by the MPUC”. The case is under appeal. Most significant, however, is likely to be Federal Communication Commission (FCC) activity. In 1998 the FCC made some initial rulings that seemed to suggest that phone-to-phone VoIP would be considered telecommunications. However, in 2003 the FCC started a massive rulemaking process to consider the regulatory status of VoIP. On March 10, 2004, the FCC published a 97-page notice of proposed rulemaking for IP-Enabled Services. Most industry watchers believe it will be the Federal Communications Commission that ultimately makes the decision on the taxability of VoIP.

APPENDIX J

**PC WORLD ARTICLE: *SENATE WEIGHS RULES FOR
INTERNET PHONES***

TECHNOLOGY ADVICE YOU CAN TRUST

PC WORLD

Topics > [Internet & Networking](#) > [Web Telephony & Conferencing](#) >

Senate Weighs Rules for Internet Phones

Opponents say exempting Voice over IP from taxes could hurt states' budgets.

Grant Gross, IDG News Service
Tuesday, February 24, 2004

WASHINGTON -- A U.S. senator, a state public utilities commissioner, and a telephone company executive have asked the Federal Communications Commission and Congress to slow down their rush toward declaring Voice over Internet Protocol service essentially free from government regulation.

Most members of the Senate Commerce, Science and Transportation Committee called for the "light touch" approach to regulating VoIP advocated by FCC Chairman Michael Powell during a hearing Tuesday. However, Senator Lamar Alexander (R-Tennessee) said efforts to exempt VoIP from telecommunications taxes will take money away from state and local governments.

Playing Favorites?

State and local governments across the U.S. currently collect about \$20 billion yearly in telecommunications taxes and fees. If Congress exempts VoIP from those taxes, the states' income will shrink as more telecommunications carriers and consumers switch to VoIP, Alexander said. Exempting VoIP from state taxes would be an "unfunded mandate" from Congress, something the Republican majorities in Congress pledged to avoid, Alexander added.

Some committee members suggested VoIP will draw investment and expand broadband services, because most VoIP service is offered over broadband. But Alexander questioned why Congress should give broadband and VoIP special treatment.

"There's no justification...for Congress deciding to give telecommunications companies such a bonanza, then turn around and send the bill to governors and to mayors," Alexander said.

Earlier in February, [the FCC began](#) a rule-making process to determine the appropriate level of regulation for VoIP. Powell suggested the emerging voice service should be treated more like unregulated Internet service than heavily regulated telephone service.

Alexander also criticized congressional efforts to [extend a temporary ban](#) on taxes unique to the Internet, including Internet access taxes. The Internet Tax Non-Discrimination Act, a version of which passed the House in September, would make permanent the Internet tax ban that expired in November. But Alexander and other opponents say the bill's definition of "Internet access" could be interpreted to include VoIP as exempt from taxes.

If Congress wants to encourage broadband adoption, it should instead follow the lead of Texas and give broadband customers a sales tax exemption on the first \$25 of their monthly bill, Alexander said. The sales tax exemption might cost \$2 billion a year, while he says exempting VoIP from taxes could eventually cost states and local governments more than \$10 billion yearly.

Other Proposals

Committee member George Allen, a Virginia Republican and cosponsor of the Internet Tax Non-Discrimination Act, responded to Alexander's testimony by saying he will introduce an amendment that clearly states VoIP services are not exempt from taxes. But other senators questioned

Advertisement

Microsoft

9:52 a.m. GREAT MOMENTS AT WORK 2:10 p.m.

You hammer out the FY04 IT budget request with time to spare.

4:24 p.m.

The new Microsoft Office System helps you focus on what's important.

Microsoft Office Get your Evaluation Kit

if VoIP should be subject to state and local taxes.

Opening VoIP to state and local taxes could mean VoIP calls get taxed dozens of times as they travel through taxing jurisdictions, and could discourage investment in VoIP services, said committee member Ron Wyden (D-Oregon).

Committee member John Sununu (R-New Hampshire) said he will introduce legislation that creates federal jurisdiction for VoIP regulation, not state or local jurisdiction. Sununu's legislation will also exempt VoIP from state and local taxes, as Internet access was exempt under the tax moratorium that expired in November.

VoIP traffic should be treated the same as other IP traffic, such as e-mail, Sununu argued. "If we try to regulate or legislate, discriminating on the type of data that is being sent over a broadband network...then I think we are headed down the wrong path," he added. "We don't want to be in the position of looking at data and trying to determine, 'Is this an e-mail message, is this an instant message, is this voice traffic...are these photographs?' and then trying to regulate or tax based on what type of data is being sent."

Competitive Issues

But others argued VoIP providers shouldn't get special exemptions from taxes and regulations that other telecommunications carriers must deal with. Most VoIP calls end up on traditional phone networks built by telephone carriers, and VoIP carriers should have to pay access fees for the use of those lines and pay into the Universal Service Fund, which helps bring telephone service to rural and poor areas, said Glen F. Post III, chairman and chief executive officer of telephone service carrier CenturyTel of Monroe, Louisiana.

Post argued that VoIP should face the same regulations as traditional telephone services because it's essentially the same service over a different network.

"Certain petitions now before the FCC would lead us to believe that inserting the words 'Voice over IP' or 'Internet' into description of voice service magically changes the nature of that service," Post said. An AT&T petition to have the FCC declare traditional telephone calls partially carried over IP networks free from many regulations is "alarming," Post added.

If states can't tax VoIP, they could eventually lose \$13 billion yearly, said Stan Wise, a commissioner with the Georgia Public Service Commission and president of the National Association of Regulatory Utility Commissioners. States don't want to lose the taxes and fees they're currently collecting, he said.

States can also make sure VoIP providers offer services such as 911 and ensure fair competition between voice providers, including access fee payments, Wise added. "My job is to facilitate competition in the state," he said. "It is our job to protect the consumer."

But most senators said consumers will benefit if VoIP service can grow without regulation.

"IP telephony is an important innovation which can give consumers something they deserve by driving down the cost of phone service," said committee member Maria Cantwell (D-Washington). "This is about innovation of a technology, and we need to preserve its nascent stage so that more competition can happen."

Related Topics: [Internet Legal Issues](#), [Proposed Laws](#)

APPENDIX K

**PRESENTATION BY THE DEPARTMENT OF REVENUE ON
THE PRESENT-USE VALUE PROGRAM**

Present-Use Value Program

N.C. Department of Revenue

Present-use value is defined as:

The value of land in its current use as agricultural land, horticultural land, or forestland, based solely on its ability to produce income and assuming an average level of management.

Present-use value defined - (continued)

A rate of nine percent (9%) shall be used to capitalize the expected net income of forestland. The capitalization rate for agricultural land and horticultural land is to be determined by the Use-Value Advisory Board as provided in G.S. 105-277.7.

Requirements that must be met

- Size
- Income
- Sound Management
- Ownership

Size Requirements

-Land that is actively engaged in the commercial production.

10 acres—Agricultural

5 acres—Horticultural

20 acres—Forestry

Income Requirement

AGRICULTURAL AND HORTICULTURAL

-Land must have produced an average gross income of at least \$1,000 for the three years prior to making application.

FORESTLAND

-No income requirement

GROSS INCOME

-Income from the sale of products produced from the land

-Income received under a governmental soil conservation or land retirement program

-GROSS income requirement not net income.

Sound Management defined as:

A program of production designed to obtain the greatest net return from the land consistent with its conservation and long-term improvement.

Sound Management-Agricultural and Horticultural

- (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.

Sound Management-Agricultural and Horticultural (continued)

- (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.

Sound Management-Forestland

If the owner of forestland demonstrates that the forestland complies with a written sound forest management plan for the production and sale of forest products, then the forestland is operated under a sound management program.

Ownership Requirements

- Natural person
- Trust
- Testamentary Trust
- Business Entity

If owned by a natural person, one of the following must be true:

1. It is the owner's place of residence.
2. It has been owned by the current owner or a relative of the current owner for the four years preceding Jan. 1 of the year that benefit is sought.
3. At time of transfer, it qualified in the hands of the business entity or trust and the transferee is a member of the business entity or a beneficiary of the trust.

Business Entity

- A corporation, a general partnership, a limited partnership, or a limited liability company.

A qualifying business entity:

-Principal business must be agricultural, horticultural, or forestry and.

Whose members are all natural persons who meet one or more of the following conditions:

1. The member is actively engaged in the business of the entity.
2. The member is a relative of a member who is actively engaged in the business of the entity.
3. The member is a relative of, and inherited the membership interest from, a decedent who met one or both of the preceding conditions after the land qualified for classification in the hands of the business entity.

Exception to the ownership requirements:

1. The land was appraised at its present use value or was eligible for appraisal at its present use value at the time title to the land passed to the new owner.
2. At the time title to the land passed to the new owner, the new owner acquires the land for the purposes of and continues to use the land for the purposes it was classified under subsection (a) of this section while under previous ownership.

Exception to the ownership requirements:

(continued)

3. The new owner has timely filed an application as required by G.S. 105-277.4(a) and has certified that the new owner accepts liability for the deferred taxes and intends to use the present use of the land.

Application requirement.

G.S. 105-277.4(a)

Why Require Applications?

- Taxpayers have the burden to prove that they qualify.
- Voluntary program
 - Rules
 - Consequences

Applications Must Be Filed:

- During the regular listing period, or
- Within 30 days of a notice of change in value, or
- Within 60 days of the date of the property's transfer.

APPENDIX L

**STATEMENT OF THE CONSERVATION TRUST FOR NORTH
CAROLINA AND THE NORTH CAROLINA LAND TRUST
COUNCIL TO THE PROPERTY TAX SUBCOMMITTEE**

**Statement of the Conservation Trust for North Carolina and
The North Carolina Land Trust Council to the
Property Tax Subcommittee of the Revenue Laws Committee of the
North Carolina General Assembly
March 3, 2004**

The Conservation Trust for North Carolina and the 23-member North Carolina Land Trust Council respectfully request that the Property Tax Subcommittee consider the following suggestions in its deliberations about how property tax laws in North Carolina impact private landowners and land trusts working to voluntarily conserve land for future generations.

The Conservation Trust for North Carolina is a statewide land trust that protects land along the Blue Ridge Parkway and provides an array of services to the members of the North Carolina Land Trust Council, a network that includes 22 local and regional North Carolina-based land trusts and the Conservation Trust. The Conservation Trust administers the state's Farmland Preservation program and provides legislative representation for the Council. The Land Trust Council organizations represent more than 10,000 members and have permanently protected over 150,000 acres statewide in more than 750 locations. We consider ourselves partners with the state in its effort to protect one million acres through the One North Carolina Naturally initiative.

In preparation for the Subcommittee meeting, the NC Land Trust Council's Government Affairs Committee developed the following goals and recommendations, which have been endorsed by Council. We look forward to discussing these issues further with the Subcommittee and working with other stakeholders to build consensus on how best to revise state property tax laws to promote land conservation consistent with other state initiatives such as the Million Acre Initiative, One North Carolina Naturally and the Ecosystem Enhancement Program.

Policy Goals

The land trust community's goals for revisions to state property tax law include:

1. Removing disincentives to and creating new incentives for voluntary land conservation.
2. Providing private landowners and land trusts with more cost effective options and greater certainty when working to protect important natural resources.
3. Providing consistent interpretation of property tax law regarding conservation properties.
4. Ensuring property tax laws do not work at cross-purposes with other state land conservation initiatives.

Recommendations for Subcommittee Consideration

1. **Review the current implementation of the Hartsell Amendment (S 1161/NCGS 105-277.3(d1)) and clarify as needed.**

Current Status: Landowners enrolled in the present use value (PUV) tax program interested in managing their property for long term conservation purposes, such as protection of wildlife habitat or water quality, may lose their PUV status if they place a permanent conservation easement on their property. Under the current interpretation of the Hartsell amendment by the Department of Revenue, landowners that place an easement on their

property, but no longer farm or conduct forestry operations, may be removed from the program unless 100 percent of the value of the easement is donated.

Recommendation: Existing law should be clarified to provide that lands currently enrolled in the PUV program be allowed to remain in the program when placed under a conservation easement, regardless if the easement is donated or purchased. The General Assembly also should consider amending the existing statute to no longer require the property be eligible for the NC Conservation Tax Credit to continue in the PUV program.

Benefits: Under this scenario, the landowner would no longer have to pay deferred roll back taxes and would keep the land enrolled in the PUV program. Allowing landowners who sell or donate the value of a conservation easement on their land to remain in the PUV program and to manage their land for nonagricultural or non-forestry purposes, will provide other important public benefits, such as protection of wildlife and water quality, and will remove significant potential financial penalties (i.e., roll back taxes/increased property taxes) and legal uncertainties for landowners considering conservation easements.

2. Consider establishing a separate property tax classification for wildlife lands and lands being managed long-term for conservation purposes.

Current Status: No such classification exists at this time in North Carolina.

Recommendation: This could be accomplished through the creation of a new PUV classification and related assessment schedule and/or the establishment of a new property tax classification for lands that meet predetermined management and conservation criteria, such as being placed under a conservation easement. S. 884, introduced last year by Sen. Hartsell, included this concept, but did not require the property to be under an easement to qualify.

Benefits: This change would provide an incentive in the form of reduced property taxes for landowners who want to voluntarily conserve their land and would not rely on meeting the production-based requirements in the existing PUV program for the property tax reduction.

3. Allow property tax exemptions for nonprofits that own land they are managing long-term for conservation purposes.

Current Status: NCGS 105-275(12) provides this exemption only when the property is being "...exclusively held and used... for scientific or educational purposes."

Recommendation: The land trust community would like to see additional conservation-related criteria under which land trusts that own property fee-simple would qualify for a property tax exemption. If the property does not meet at least one of the criteria it would be assessed and taxed at the fair market value. Section 2 of H. 887, introduced by Reps. Gordon Allen and Joe Hackney, would provide this exemption for lands owned by nonprofits that were managing those lands "...as a protected natural area...for conservation purposes in perpetuity."

Benefits: This change would significantly reduce costs for land trusts planning to convey land to state or federal agencies for permanent protection or to manage the property for long-term conservation purposes.

- 4. Exempt landowners that sell land currently enrolled in the PUV program from paying deferred taxes if they sell the land to a state agency or nonprofit conservation organization at or below market value for long term conservation.**

Current Status: NCGS 105-277.4(d)(2)(3) exempts landowners that donate land enrolled in the PUV program to state agencies or nonprofit conservation organizations from deferred tax payments, but not when the landowner receives compensation for the property regardless if they sell at or below fair market value. S 884 proposed only doing this when the land was sold below market value, but there might be problems documenting that approach.

Recommendation: Consider amending the existing statute to exempt landowners selling land currently enrolled in the PUV program to conservation organizations or state agencies from paying deferred taxes, regardless if the property is sold at or below market value.

Benefits: This change would reduce transaction costs and provide a monetary incentive to landowners to sell land to state agencies and nonprofits for conservation purposes, which would not be available if the landowner sells the land for development.

We applaud the General Assembly for recognizing the important and complex issues outlined in the Subcommittee's charge. The Conservation Trust and the NC Land Trust Council look forward to working with the Subcommittee and other stakeholders to forge a consensus on these issues, while maintaining revenue neutrality for local governments to the extent possible.

We hope the General Assembly will consider clarifying the Hartsell Amendment during the 2004 Short Session and look forward to working with the Subcommittee to explore the development of a comprehensive property tax structure for conservation lands. We also can provide examples of how current property tax laws are negatively impacting conservation efforts in North Carolina if the Subcommittee would be interested in reviewing those.

APPENDIX M

**SOUTHERN ENVIRONMENTAL LAW CENTER AND
ENVIRONMENTAL DEFENSE COMMENTS TO THE
PROPERTY TAX SUBCOMMITTEE**

Southern Environmental Law Center and Environmental Defense

Comments to the
Property Tax Subcommittee of the Revenue Laws Committee of the
North Carolina General Assembly

March 17, 2004

For three decades, North Carolina has provided favorable tax treatment to certain agricultural, horticultural and forestland owners through the Present-Use Value Tax (PUVT) program. Property tax on lands enrolled in the program is assessed not on the basis of fair market value, but on the land's current use, which is often much lower. In recent sessions, the General Assembly has shown an increased interest in making the PUVT program compatible with other state programs and policies aimed at conserving lands. For example, in 2002, legislation removed the tax penalties for landowners who chose to place conservation easements on their enrolled forest and farmlands. That legislation also directed that this Subcommittee study "the feasibility of allowing lands managed for conservation and the preservation of water quality, wildlife habitats, and other conservation purposes to be taxed at their present-use value. (G.S. 120-70.108(b)(4)). A bill currently pending in the Senate (S. 884) would add wildlife land as a fourth class of land eligible for enrollment in the PUVT program.

By lowering taxes for targeted landowners, the PUVT program and other state tax policies can serve important public purposes. Though the statute does not contain explicit purposes for the PUVT program, the implicit purposes include maintaining North Carolina's traditional landscapes of farms and forests that historically have been managed for production of crops and timber. *Our groups believe that the 30-year old PUVT program should be revised and updated to reflect a broader range of legitimate management options, consistent with our state's modern day commitment to conservation and wildlife.*

Specifically we recommend that the subcommittee develop proposed revisions to the program that would accomplish the following objectives:

1. Provide landowners with more choices for managing their farms and forests by removing disincentives to manage enrolled lands for wildlife and other conservation benefits.
2. Ensure that property tax laws enhance conservation and do not work at cross-purposes with other conservation initiatives.
3. Require sound management of all enrolled lands, whether managed for production or conservation.
4. Make the PUVT program more effective in combating sprawl by providing additional incentives to keep eligible lands enrolled in the program.
5. Achieve PUVT program reforms in revenue-neutral manner, i.e., ensure that county revenues do not decline as a result of program changes.

To accomplish these objectives, we request that you consider the following recommendations:

Allow currently enrolled lands to be managed for wildlife and other conservation benefits

Issue: Currently, lands enrolled in the PUVT program must be managed for timber production, crop production, or the production of horticultural products. Surveys show that a majority of today's non-industrial forest landowners do not consider timber production as their number one priority. Nonetheless, landowners who decide to manage some or all of their lands for wildlife habitat or other conservation uses are kicked out of the program, lose the preferential tax treatment and have to pay rollback taxes and penalties. (Among those managing for wildlife or conservation, only landowners who *donate* qualifying conservation easements on enrolled lands are allowed to remain in the program after limiting or ceasing production.) Other state and federal programs, e.g., One NC Naturally, the NC Conservation Tax Credit Program, the Clean Water Management Trust Fund, and the federal Environmental Quality Incentives Program, encourage landowners to conserve lands. By contrast, our out-of-date PUVT program serves as a strong disincentive to those landowners who would prefer to conserve a portion of their farm or forests lands.

Recommendation: Amend the statute to establish a fourth class of lands for the PUVT program: *wildlife and conservation lands*. Allow landowners who otherwise qualify to manage some or all of their lands for wildlife or other conservation purposes. Lands dedicated to conservation would qualify for enrollment if managed pursuant to a qualified sound management program (see below), regardless of whether they are subject to a conservation easement or not. There are multiple mechanisms for making this amendment revenue-neutral, from extending the rollback provisions (see below), to initially restricting eligibility to landowners already enrolled in the program. (Other states have similarly included conservation and wildlife lands in their use value tax programs. We are preparing a summary of use-value programs in other states and will provide that to the subcommittee as soon as it is complete.)

Conservation Easements and Bargain Sales

Issue: In 2002, the General Assembly amended the statute to enable enrolled lands that are placed under certain conservation easements to remain eligible for PUVT benefits. The Department of Revenue has narrowly interpreted the law as providing continued PUVT eligibility only for lands subject to conservation easements that were entirely donated, not those for which any compensation was received, e.g., from the Clean Water management Trust Fund.

Recommendation: The law should be further amended explicitly to provide the same continued PUVT eligibility for lands subject to conservation easements, regardless of whether the conservation easement was donated or sold. Absent this proposed amendment, landowners who receive even partial compensation, e.g., from the Clean Water Management Trust Fund or a land trust, for placing conservation easements on their property will not be entitled to continued PUVT eligibility. (The law should also clarify that lands sold to the state or qualifying conservation organizations for conservation purposes are not subject to rollback payments.)

Require that enrolled lands be well managed

Issue: In return for receiving favorable tax treatment, landowners should be expected to manage enrolled lands in a sound manner, consistent with prevailing best management practices (BMPs). The existing statute appropriately requires all PUVT lands to be under a 'sound management program.'

Recommendation: The statute should be amended to require the same of conservation lands. The statute should specify that a management plan for conservation lands must be consistent with standards to be established by the Wildlife Resources Commission or the Department of Environment and Natural Resources.

Require that forest lands be managed according to accepted best management practices

Issue: Management plans have always been required for forestland. In 2002 the law was changed to require that the plan be in writing, but does not explicitly require that forest lands be managed according to widely accepted best management practices BMPs. Among other things, BMPs are an important tool in preventing sediment and other water pollution from farms and forests.

Recommendation: To provide consistent guidance for the preparation and implementation of such plans, and to ensure that forest management is environmentally sound, the law should be further amended to require that management plans for forest lands include the use of BMPs for water quality as adopted by the Department of Environment and Natural Resources.

Extend "rollback" provisions to discourage landowners from developing enrolled lands

Issue: The PUVT provides an important benefit to all North Carolinians, not just the landowners, by subsidizing farm and forest land ownership. For the program to meet its goal, it is important that it not be abused as a tax shelter by landowners holding land for development. The current statute addresses this by requiring that landowners who withdraw land from the program pay three years of deferred taxes, plus interest.

Recommendation: To focus the tax benefits on landowners who intend to keep their lands in farms, forests or conservation/wildlife management for a more meaningful time period, the law should be amended to extend from 3 years to 10 years the liability for rollback taxes. This amendment would also significantly increase revenues to counties in which farm and forest land is being converted to other uses.

APPENDIX N

**MEMO FROM LINDA MILLSAPS, FISCAL ANALYST TO THE
REVENUE LAWS STUDY COMMITTEE, REGARDING STATE-
OWNED CONSERVATION PROPERTY**

Memorandum

TO: Property Tax Subcommittee
Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research

DATE: April 27, 2004

SUBJ.: State Owned Conservation Property – Study Update

Pursuant to language in the 2003 budget bill and at the request of the Property Tax Subcommittee of Revenue Laws, Fiscal Research has attempted to determine the value and associated property tax loss from “the acquisition of land by the State and non-profit organizations using money from the Clean Water Management Trust Fund and other State funds for conservation purposes” (HB 397, Section 11.7(a)). This is intended as a status report on that effort.

Methodology

Earlier this spring Fiscal Research asked the Department of Environment and Natural Resources (DENR) to produce a report concerning the acquisition of conservation land by the state, pursuant to this language in the budget bill. DENR, in turn, requested that the State Property Office generate such a list. 1995 was set as the start date for the study as that is the date that the Clean Water Management Trust started acquiring property for conservation purposes. Once the data was received from DENR, Fiscal Research parceled out the list and sent a spreadsheet, via e-mail and fax, to each county involved with a request to return the following information:

1. Was the property taxable before it was acquired by the state?
2. What value do they currently place on the property?
3. What tax rate would apply to the property if it were taxable?

To date, 16 counties have responded with the requested information. Several others have contacted Fiscal Research requesting more data from the State Property Office to assist in their parcel identification process. State Property has agreed to send GIS maps to via e-mail to those counties who are able to receive and process this information and have requested additional information.

Tentative Findings

According to the State Property Office, since 1995 the state has acquired 193,696 acres for conservation purposes. This is approximately 14 square miles in total, and involves 454 land purchases or donations in 59 counties. The total purchase price for these properties is \$198,285,088. While purchases occurred statewide, of the heavily urbanized counties only Wake County had any conservation purchase by the state since 1995. Using the purchase price as a proxy for value (until all the assessor surveys are returned), and applying the 2002-03 property tax rate for rurally located property, suggests total potential lost local tax revenue of \$1.4 million statewide. It should be noted, however, that this estimate is likely low as the purchase price may not represent the full assessed value. In addition, the property may have appreciated since the initial state purchase.

APPENDIX O

PRESENTATIONS AND PROPOSALS REGARDING MONETARY COMPENSATION FOR OUTDOOR ADVERTISING

- March 3 letter from Tony Adams (NCOAA) to Andy Romanet (NCLM)
- March 16 presentation to Revenue Laws Study Committee by Tony Adams
- March 29 letter from Andy Romanet to Tony Adams

North Carolina Outdoor Advertising Association
5 West Hargett Street,
Suite 310
Raleigh, North Carolina 27601
(919) 821-3211 (919) 834-4891 Fax

March 3, 2004

Mr. Andrew Romanet
General Counsel
NC League of Municipalities
Albert Coates Local Government Center
215 N. Dawson Street,
Raleigh, NC 27602

Dear Andy,

As you know, it has been our preference from the beginning of our discussions with the NCLM that we work to achieve a mutually acceptable process in which, if no agreement was reached through mediation, jurisdiction over the matter of the amount of monetary compensation would be in the Superior Court in the district where the cause of action arose.

We believe a determination of the amount of compensation by a court of competent jurisdiction would be the fairest method for both sides since a local government and an outdoor advertising company would both be allowed to enter evidence for an objective court to consider. In our estimation, the applicable portions of the draft committee substitute developed last summer by Senators Dalton, Kerr, Clodfelter, Thomas and Reeves is much fairer to all parties than a specific figure or amount written into the bill would be.

However, since the NCLM insists that an absolute amount of monetary compensation be agreed upon, herein is detailed, as you recently requested, the NC Outdoor Advertising Association (NCOAA)'s written proposal for determining the amount of monetary compensation to be paid for the removal of off-premises outdoor advertising pursuant to the zoning and police powers of local governments

With regards to the amount of monetary compensation to be paid, the NCOAA proposes that a local government be required to pay monetary compensation in the amount of 6 ½ times the

annual gross revenue (minus advertising agency fees) of any off-premises outdoor advertising that is caused to be removed pursuant to the zoning and police powers of that local government.

NCOAA also proposes that a section be included in the Committee Substitute that prohibits local governments from making approval of a property owner's request for a permit, variance, site plan or other land use contingent on the removal of an existing but non-conforming off-premises outdoor advertising sign.

In addition, this proposal reiterates those sections of HB 429 that, in the spirit of compromise, the NCOAA has previously offered to change or scale back in an attempt to arrive at a reasonable, mutually acceptable Senate Committee Substitute for HB 429. To that end we remind you of the following items previously offered up for compromise by NCOAA:

- Agreement to scale back HB429 to apply only to off-premises outdoor advertising if an agreement is reached on a formula, figure or process to be used in determining the amount of monetary compensation to be paid. As you know, HB 429 passed the House with the support of 102 of its 120 members, and has the support of a strong majority of the Senate, as well as nearly every business association in North Carolina. Some of these allies would prefer that the bill cover all the types of property contained in the language of the bill that passed the House, but they reluctantly have agreed to support a compromise. This is, as you know, a major concession that we are willing to offer the NCLM.
- In lieu of monetary compensation, local governments and outdoor advertising owners could enter into voluntary relocation, reconstruction, or removal agreements, provided that any such terms are mutually agreeable to the local government and the outdoor advertising owners.
- Local governments and owners of outdoor advertising could agree to non-binding mediation as a means of attempting to reach agreement on the amount of monetary compensation to be paid.
- This legislation would not apply to any amortization ordinance in effect on the effective date of the bill's enactment into law.
- The provisions of the bill would not apply to outdoor advertising on non-FAP routes located in the extraterritorial jurisdiction, or the territory acquired through annexation, within three years of the time this legislation becomes law, of a local governmental entity with an amortization ordinance in effect on the effective date of this legislation.
- Monetary payment would not be required when local governments allow the removal and relocation of off-premises outdoor advertising to equally visible and comparable locations for purposes of road widening or other governmental development projects.

Several of the items detailed above are major concessions offered by NCOAA to the NCLM in an attempt to arrive at a mutually agreeable Committee Substitute. We are heartened by and appreciate your e-mail letter dated February 10th that offers the cessation by local governments of the use of

amortization, without equivocation, once we arrive at a mutually agreeable method for determining the amount of monetary compensation.

I look forward to receiving your response to our proposal.

Sincerely,

Tony L. Adams
Executive Director
NC Outdoor Advertising Association

Cc: Sen. John Kerr
Rep. David Miner
Rep. Paul Luebke
Sen. Walter Dalton
Rep. Bill Culpepper
Sen. Dan Clodfelter
Marty McLaughlin
Paul Meyer

Presentation to the NC General Assembly Revenue Laws Study Committee

Subcommittee on Amortization of Outdoor Advertising

March 16, 2004

Amortization of Outdoor Advertising

By Tony L. Adams, Executive Director, NC Outdoor Advertising Association

Mr. Chairman and members of the committee, my name is Tony Adams, and I am the executive director of the North Carolina Outdoor Advertising Association. I'm also here today on behalf of North Carolinians for Property Rights, which is a coalition of 16 of the largest business associations in North Carolina. I want to thank you for inviting me to appear before you today.

The North Carolina Outdoor Advertising Association and the member associations of North Carolinians for Property Rights oppose the use by local governments of the concept known as "amortization" because it is designed to avoid payment of just compensation to property owners for the loss of their property. Under this concept, governments allow private property owners to use their property for a stated period of time, and then require the removal of the property without payment. In the case of outdoor advertising, at the end of a set time period, sign owners are forced to remove signs at their expense without compensation for lost property or business value.

It is our position that the use of amortization is unconstitutional and intrinsically unfair. Through amortization property owners are subjected to slow-motion loss of their property. Just because the loss comes slower does not make it right. In the case of outdoor advertising, the use of amortization by local governments forces a billboard owner who has complied with all existing laws, paid for and obtained a legal permit, and expended large sums of money to construct a sign, to remove his investment, at his own expense, without a return of his investment.

We believe that amortization can never be compensation. Amortization deprives the property owner of full use and income producing potential of the property and in no way compensates the property owner. Protection of private property rights is a founding principle of our republic. The Fifth Amendment to the U.S. Constitution is explicit: "Private property shall not be taken for the public use without just compensation."

Federal law clearly protects property rights by barring amortization of billboards by local governments along all interstate and federal-aid highways. The law unambiguously requires

just compensation be paid for the removal of legally erected outdoor advertising on these highways and roads, where, in North Carolina, over 75% of the state's billboards are located. The U.S. Congress, in fact, has felt so strongly about this principle that a state can be penalized 10% of its federal highway funding if it does not comply with the requirement of just compensation.

Not only is just compensation required everywhere in the United States on interstate and federal-aid highways, but North Carolina is now one of only five states that still allow the use of amortization by local governments for the removal of outdoor advertising on those streets and roads not covered by federal law.

During the 2003 session of the General Assembly Rep. Bill Culpepper introduced HB 429, which would bring North Carolina into the mainstream by requiring local governments to pay just compensation for the removal of lawfully erected outdoor advertising and other legally built buildings and structures. Rep. Culpepper's bill passed the House with the overwhelming support of 102 of the House's 120 members.

Thirty- four Senators co-sponsored Sen. Walter Dalton's companion bill, SB 534. In both the Culpepper and Dalton bills just compensation is required to be monetary compensation. Neither HB429 or SB534 would allow a period of amortization to constitute any portion of just compensation. We are confident that, if allowed a vote on the floor of the Senate, that either Rep. Culpepper's bill or Sen. Dalton's bill would pass with a significant majority.

As you are aware, however, during the 2003 legislative session the North Carolina League of Municipalities opposed both Rep. Culpepper's bill and Sen. Dalton's bill. At the urging of Senate leadership, representatives of our association and the League of Municipalities got together on the last two days of the 2003 session to try and work out a Senate Committee Substitute for HB 429 that would be mutually acceptable to both sides. Those meetings were monitored by several Senators, including some members of this committee.

In those meetings we were able to make progress on several issues, but it became obvious that we could not reconcile all the differences before the end of the 2003 session. We agreed, and the NCLM also agreed, to reconvene negotiations between the 2003 legislative session and the 2004 session and take as much time as necessary to try and work out an acceptable Senate Committee Substitute for HB 429.

On the last day of the 2003 session, in order to ensure that such discussions would in fact continue, the Senate passed, with House concurrence, an amortization moratorium, HB 754, which forbids any local government, on or before December 31, 2004, from enacting any new ordinance amortizing off-premises outdoor advertising or extending or expanding any existing ordinance amortizing off-premises outdoor advertising.

As part of that bill, the Revenue Laws Study Committee was directed to study local government ordinances amortizing off-premises outdoor advertising, and to report any findings, together with any recommended legislation, to the 2004 regular session of the General Assembly.

In our discussions last summer with the League of Municipalities the sentiment was expressed, both by some of the Senators present and by our negotiating team, that a goal of our renewed discussions with the League of Municipalities would be to work out a mutually agreeable Senate Committee Substitute for HB 429 before the Revenue Laws Study Committee met.

Finally, on January 6 the two sides did meet at the League's offices for a negotiating session on that date and on the subsequent date of January 16. During those sessions we offered to compromise on several key items in the bill, including the formula for determining the amount of monetary compensation to be paid, if the League of Municipalities would agree to give up the use of amortization for removal of off-premises outdoor advertising

The League representatives had indicated during our previous discussions at the end of the 2003 session that, if a mutually acceptable formula, process or figure could be reach for determining the amount of monetary compensation to be paid, that they would be willing to give up the use of amortization for the removal of off-premises outdoor advertising through local governmental ordinance. However, during our meetings on January 6 and 16 the League continued to insist that an amortization period be a part of any agreement.

That proposal was unacceptable. Since we first began discussions with the League of Municipalities at the end of the 2003 Legislative session it has been our clear understanding, and I believe also of the Senators who participated, that the purpose of any further negotiations was to arrive at a mutually acceptable method of determining monetary compensation. At no time last July or at any subsequent time until January 6 did the NCLM insist that an amortization period be accepted as part of such a compromise.

Since those two meetings the NCOAA has submitted to the NCLM a formal, written counter-proposal on the method for determining monetary compensation for the removal of off-premises outdoor advertising through local governmental ordinances. The NCLM has agreed to respond to the NCOAA proposal with another written counter-proposal that does not include an amortization provision. The NCOAA is appreciative of and heartened by the NCLM's movement off its position on amortization.

We remain willing to discuss a mutually acceptable compromise on the issue of determining the amount of compensation and other related issues, and we thank the members of this committee for your interest in and assistance on achieving a mutually agreeable Committee Substitute for HB 429.

Thank you again for inviting us to appear before you today.

March 29, 2004

Mr. Tony L. Adams
Executive Director
North Carolina Outdoor Advertising Association
Five West Hargett Street
Raleigh, N.C. 27601

In response to your letter dated March 3, 2004 the following is our offer to settle the matters regarding HB 429.

Our proposal for the determination of monetary compensation is as follows: If the parties cannot agree on relocation or monetary compensation to be paid, the amount of monetary compensation to be paid, for the required removal of off-premises outdoor advertising, shall be determined in superior court. Upon the determination of the monetary compensation to be paid by the court or jury, after consideration of the listed factors and evidence, the judge, if necessary, shall reduce the award to an amount equal to three (3) times the average annual gross revenue from the sign or signs in question based on the average annual gross revenue for the immediately preceding three (3) years. Gross revenue shall not include any placement or agency fees. The amount of gross revenue shall be an issue of fact for the court or jury, with the burden of proving gross revenue to be on the owner of the off-premises outdoor advertising. If the compensation award is less than an amount initially offered by the municipality, the sign owner must pay attorneys fees and costs. Obviously, any amount offered by the municipality would not be admissible in court.

Subject to acceptance by the North Carolina Outdoor Advertising Association of the formula for determining monetary compensation set forth above, NCLM will agree to the following additional items to be contained in a mutually acceptable Senate Committee Substitute for HB 429:

- (1) Local governments would be required to pay monetary compensation when they require the owner of lawfully erected off-premises outdoor advertising to remove it pursuant to the zoning and police power. This provision would not apply to off-premises outdoor advertising that is determined to be detrimental to the health and safety or defined as a nuisance (as contained in the House version of HB 429).
- (2) Local governments can no longer use amortization to require the owner of lawfully erected off-premises outdoor advertising to remove it pursuant to the zoning and police power. This provision shall apply only to off-premises outdoor advertising. Other types of properties addressed in the original House bill would be dropped from consideration.
- (3) Local governments may continue to regulate outdoor advertising within their jurisdiction; and may require the removal of off-premises outdoor advertising that was not lawfully erected without the payment of monetary compensation..

(4) Except as herein provided, no local government may enact or amend an ordinance to require the removal of any non-conforming, lawfully erected off-premises outdoor advertising sign without the payment of monetary compensation, as herein set forth, to the owners of the affected outdoor advertising.

(5) In determining monetary value, the finder of fact may consider, but shall not be limited to, the following factors: (a) the factors listed in G.S. 105-317.1(a); (b) cost of materials and labor in constructing the outdoor advertising; (c) purchase price of rights to erect and maintain the outdoor advertising; (d) income derived from the outdoor advertising; (e) factors such as comparable sales of similar property, zoning restrictions, market activity and lease restrictions; and (f) the listed property tax value and any documents submitted to the taxing authority.

(6) In lieu of the payment of monetary compensation, local governments and outdoor advertising owners may enter into relocation, reconstruction, or removal agreements, including removal over a period of time, provided that any such terms are agreeable to the off-premises outdoor advertising owner and the local government.

(7) Local governments and owners of outdoor advertising may agree to non-binding mediation as a means of attempting to reach agreement on the amount of monetary compensation to be paid.

(8) This legislation shall not apply to any amortization ordinance in effect on the effective date of the bill's enactment into law.

(9) The provisions of this bill shall not apply to outdoor advertising located in the extraterritorial jurisdiction, or the territory acquired through annexation, within three years of the date this legislation becomes law, if the local governmental entity ordinance amortizing outdoor advertising is in effect on the effective date of this legislation. (Note: I believe this provision was requested by Senator Eric Reeves.)

(10) Local governments may take up to three years to pay the required compensation, as long as the ordinance allows the affected property to remain until the compensation is paid.

(11) The superior court in the district where the cause of action arises would have jurisdiction to decide the compensation issues. The right to a trial by jury shall be preserved.

(12) Monetary payment shall not be required when a unit of local governments requests and allows the removal and relocation of off-premises outdoor advertising to equally visible and comparable locations for purposes of road widening or other governmental development projects.

(13) Local governments may amend ordinances to require significant alteration in size or other physical characteristics of the affected off-premises outdoor advertising but shall compensate the owner of the off-premises outdoor advertising only for the actual cost of the alteration.

(14) The legislation shall "sunset" in its entirety on October 1, 2010.

We will strongly oppose any legislation that contains a provision prohibiting local governments from conditioning issuance of a permit, license or other zoning approval on the continued effectiveness of such a permit, license or other zoning approval on removal of legally erected off-premises advertising, without the payment of monetary compensation. We believe that the removal off-premises outdoor advertising in such cases is self-inflicted and triggered by the property owner on whose property the off-premises outdoor advertising is located. It results from the owner's voluntary action in seeking a change in the zoning of the property. If the request is an unreasonable exaction, there are adequate remedies in the current law. In addition, the owner of the off-premises outdoor advertising has the ability to protect itself in its lease agreement in such instances.

In addition, we will strongly oppose any provision that requires a city or county to pay monetary compensation where it requires the removal of off-premises outdoor advertising located on property owned by the city or county (subject to the provisions of the underlying lease).

It is still our hope, as I am sure it is yours, to resolve these issues amicably before the Joint Revenue Laws Study Commission. If an agreement can be reached we expect the North Carolina Advertising Association to agree in writing not to seek or support additional legislation affecting local land use regulation of off-premises advertising before the 2011 legislative session.

Sincerely yours,

Andrew L. Romanet, Jr.

General Counsel



UNC-CH LAW LIBRARY
L00277955Z