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REVENUE LAWS STUDY COMMITTEE

REPORT TO THE 2005 GENERAL ASSEMBLY OF NORTH CAROLINA 2006 SESSION

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

Senator John H. Kerr, III, Cochair *Representative Paul Luebke, Cochair*

May 2, 2006

TO THE MEMBERS OF THE 2006 GENERAL ASSEMBLY:

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

Respectfully Submitted,

Rep. Paul Luebke, Co-Chair

Sen. John Kerr, Co-Chair

2005-2006

REVENUE LAWS STUDY COMMITTEE

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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 2005-2006 are Senator John Kerr and Representative Paul Luebke.

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 consists of eight members, four appointed by the Senate chair of the Revenue Laws Study Committee and four appointed by the House chair of the Committee. The subcommittee may recommend changes in the property tax system to

[1] S.L. 2002-184, s. 8.

the full Committee for its consideration in its final report to the General Assembly. The Property Tax Subcommittee did not meet during the 2005-2006 interim.

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.

COMMITTEE PROCEEDINGS

The Revenue Laws Study Committee met six times after the adjournment of the 2005 Regular Session of the 2005 General Assembly on September 2, 2005. Appendix B contains a copy of the Committee's agenda for each meeting. All of the materials distributed at the meetings may be viewed on the Committee's website: http://www.ncleg.net/committees/. 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 2005 GENERAL ASSEMBLY

The 2005 General Assembly enacted five of the Revenue Laws Study Committee's six legislative proposals in whole or in part. Appendix C lists the Committee's recommendations and the action taken on them in 2005. A document entitled "**2005 Finance Law Changes**" summarizes all of the tax legislation enacted in 2005. It is available in the Legislative Library located in the Legislative Office Building.

VIDEO PROGRAMMING SERVICES

The Current Operations and Capital Improvements Appropriations Act of 2005 directed the Revenue Laws Study Committee to study the equity of taxation of providers of cable service, direct-to-home satellite service, satellite digital audio radio service, video programming service, and data service. The Committee spent a considerable amount of time on this issue.

In December the Committee looked at the State's current tax structure on these services. North Carolina began taxing these services when the technologies enabling the services were separate and distinct technologies and the providers of the services were separate and distinct taxpayers. The Committee found that the State taxes these services based upon who provides the service rather than the service itself. Despite the General Assembly's repeated attempts to provide tax equity among these providers, it is debatable whether that has been accomplished:

- Providers of telecommunications services are subject to a 7% State sales tax on its gross revenues. Eighteen and three one-hundredths percent (18.03%) of the tax revenue collected is distributed to the cities. The amount each city receives is based upon a per capita statutory formula.
- Providers of direct-to-home satellite services are subject to a 7% State sales tax. Federal law prohibits local governments from taxing satellite services. The tax revenue is not shared with the local governments.
- Providers of cable television services are subject to a 7% State sales tax with a credit against the tax equal to the amount of local franchise tax paid. Local governments may impose a franchise tax on cable services up to 5% of gross revenues. The amount of tax cities and counties impose varies, as well as the tax base. Each city and county negotiates a franchise agreement with cable providers. The negotiated franchise agreement defines the term 'gross revenues' upon which the tax rate is imposed.
- Providers of satellite digital audio radio services are subject to a 4.5% State sales tax and a 2.5% local sales tax.

The technology that enables these various services has evolved and converged in recent years so that today the same technology used to provide one service is able to provide the other. As a result, industries that use to be separate and distinct today compete against each other to provide customers telecommunications and video programming services. The method of taxation should not provide one provider of a service with a competitive advantage over another. The Committee expressed a goal to establish a method of taxation that applies equally to the same service, regardless of who provides it.

The Committee devoted its January meeting to the providers of telecommunications and video programming services. The Committee asked the providers to describe what type of services they have traditionally offered, what types of services they currently offer, and what types of services they would like to offer in the future. The Committee also asked the providers about any statutory, regulatory, or tax-related obstacles they had encountered as they expanded the types of services they offer or plan to offer and any suggestions they may have as to how the Committee could achieve its goal of taxing the services provided equally.

North Carolina is not alone in grappling with the issue of how to tax and regulate telecommunications and video programming services. Congress as well as other states is considering legislation on this issue. At this time, at least three states have enacted legislation changing the regulation and taxation of telecommunications and video programming services and at least eight other states have legislation pending on the issue. The Committee Chairs instructed the staff to begin meeting with the parties most affected by the issue and to draft legislation addressing the issue for the Committee to consider.

The Revenue Laws Study Committee staff met separately with representatives of the cable industry, the telephone industry, the cable administrators, and the counties and cities. It also held a series of four meetings with the all the affected parties and solicited comments from the parties on numerous occasions. The staff prepared a survey given to all the local governments in the State to determine their franchise fee collections and other nonmonetary contributions received in accordance with their cable franchise agreements. A summary of the survey results may be found in Appendix D.

The Committee Chairs, with the input of two other committee members, provided guidance to the Committee staff as it drafted a proposal for the Committee to consider. They established the following principles:

- Equal taxation of the same service.
- A tax system that is easy to administer.
- A tax and regulatory system that do not impede competition.
- Equal compensation to cities for the use of their public rights-of-way.
- PEG channels service a public purpose and should be supported.

Based upon those principles, they directed the staff to draft a proposal for the Committee to consider that meets the following goals:

- Applies the principles stated above.
- Contains no tax or fee increase.
- Preserves local government revenue stream.
- Promotes competition in the marketplace.
- Promotes deployment of broadband as a basic communication tool.

Legislative Proposal #1, *Video Service Competition Act*, establishes uniform taxes for video programming services and seeks to promote consumer choice. It establishes equal taxation of the same service by applying the State 7% sales tax to all video programming services, repealing the local authority to impose a local franchise tax, and repealing the sales tax credit allowed to cable companies for local franchise tax paid. It preserves the local government revenue stream by distributing part of the sales tax revenues from telecommunications and video programming services to the counties and cities. The distribution formula is based upon the amount of cable franchise tax revenue received in fiscal year 2005-2006 plus any subscriber fees received that year.

Legislative Proposal #1 promotes competition by providing a State franchise process, in lieu of the current locally negotiated franchise agreements. It seeks to ensure competitive neutrality by allowing cable providers to opt-out of existing local agreements when one or more households in the franchise area may be served by both the existing provider and the holder of a State-issued franchise. The proposal specifically prohibits discrimination in the provision of video programming services and declares a violation of this law to be an unfair or deceptive trade practice. The holder of a State-issued franchise must comply with customer service and emergency alert requirements established by the Federal Communications Commission. The proposal designates the Consumer Protection Division of the Attorney General's Office as the State agency to receive customer complaints regarding video programming services.

Legislative Proposal #1 preserves local regulation of public rights-of-way and provides for PEG channel support and growth. In addition to including the per subscriber revenues in the distribution base to local governments, the proposal provides up to $2 million for supplemental PEG support. The proposal provides that existing

franchise agreements will determine the number, service tier placement, and transmission quality required of PEG channels under a State-issued franchise. In the absence of an existing agreement, the number of PEG channels a county or city may have is determined by the area's population. A local entity may acquire additional PEG channels, with the maximum number of channels set at seven. The proposal also requires cable service providers to provide free basic service to local public buildings.

SALES AND USE TAX

The Revenue Laws Study Committee has spent a considerable amount of time over the past several years on the Streamlined Sales Tax Project, which began in March 2000. The Streamlined Sales Tax Project is an effort by states, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The goal of the Project is to achieve sufficient simplification and uniformity to encourage sellers without nexus in states to voluntarily collect use tax in participating states.

In November 2002, the implementing states approved the Streamlined Sales and Use Tax Agreement. The Agreement contains the uniformity and simplification provisions developed by the Project. In July 2005, the Agreement became effective when 18 states representing 28% of the population of states imposing a sales tax were found to be in compliance with the terms of the Agreement. On October 1, 2005, the Streamlined Sales Tax Governing Board, Inc. came into existence. The Governing Board consists of representatives of the member states. It oversees administration of the Agreement. North Carolina is one of the 13 full member states because the General Assembly, upon the recommendation of the Revenue Laws Study Committee, has enacted the necessary changes to North Carolina's sales tax laws to bring it into compliance with the Agreement. Andy Sabol, the Director of the Sales and Use Tax

Division of the Department of Revenue and North Carolina's representative on the Governing Board, gave the Committee an update on the Project. Appendix D contains a copy of his remarks.

The Committee reviewed and adopted two proposals related to sales and use tax, both of which have their origins in the Streamlined Sales and Use Tax Agreement. The first proposal would treat commercial logging machinery the same as farm machinery under the sales tax law by exempting the machinery and related items from the tax. This issue arose as the result of recent legislation that imposed a new privilege tax on mill machinery. For years, State tax law provided a preferential rate of sales and use tax on mill machinery at a rate of 1%, with an $80 maximum tax per article. While there is no specific reference in the sales tax statutes to machinery used in the forestry and logging business, the Department of Revenue has maintained the position that logging firms that had contracts with wood product manufacturers to cut timber were entitled to the 1% rate, $80 cap based on the preferential rate afforded to manufacturing industries and plants.

In order to conform to the Streamlined Sales Tax Agreement, the General Assembly enacted legislation in 2001, which became effective January 1, 2006, that exempts purchases of mill machinery, including commercial logging equipment, from sales and use tax, and, instead, imposes a privilege tax at the same preferential rate. By changing the nature of the tax from a sales tax to a privilege tax, the industry kept its preferential rate and the State conformed to the Streamlined Sales and Use Tax Agreement. Since the privilege tax is imposed on the purchaser of qualifying property, commercial loggers, who had been paying the 1% tax to their vendors, are now liable for accruing and remitting the tax to the Department of Revenue.

The Committee heard testimony from the North Carolina Forestry Association that these commercial logging operations are more like small farming operations as opposed to large-scale manufacturing industries, and that administering the new privilege tax has proven confusing and burdensome. In response to these concerns, the Committee reviewed and adopted Legislative Proposal #2, *Amend Taxation of Logging Machinery*, which exempts commercial logging items from the 1%/$80 maximum privilege tax, to which they are currently subject and creates a new exemption in the sales and use tax statutes for commercial logging machinery, attachments and repair parts, lubricants, and fuel used to operate commercial logging machinery.

The second proposal, Legislative Proposal #3, *SSTA Sales Tax Defn/Sales Tax Payments*, modifies the definitions used in the sales and use tax law that apply to telecommunications services. The changes are made to adopt the definitions in the Streamlined Sales and Use Tax Agreement. The proposal also replaces the semimonthly payment sales tax schedule with a single monthly payment and a prepayment of the next month's liability due on the same day as the monthly payment. The change is made at the request of several large retailers involved in the Streamlined Sales and Use Tax Project. North Carolina is one of only a few states that require payments twice a month.

The Current Operations and Capital Improvements Appropriations Act of 2005 directed the Revenue Laws Study Committee to study the application of sales and use tax to maintenance agreements. The Senate included a provision in Senate Bill 622, 4th edition, to impose the State and local sales tax on maintenance agreements. The House included a similar provision in House Bill 1630, 4th edition. The budget bill indicated an intent of the General Assembly to apply the sales and use tax in some manner to maintenance agreements beginning July 1, 2006. In anticipation of the General

Assembly's need to understand the fiscal ramifications of an expansion of the sales tax base to maintenance agreements, the Committee asked its staff to develop a fiscal analysis of the proposal. Linda Millsaps, with the Fiscal Research Division, worked with the Retail Merchant's Association, the N. C. Bankers Association, and the North Carolina Citizens for Business and Industry to survey their memberships on the revenue implications of a sales tax on maintenance agreements. She also obtained information such a proposal would have on automobile warranty contracts from the Automobile Dealers' Association. Appendix F contains a summary of the data collected from this survey.

PROPERTY TAX

The Revenue Laws Study Committee reviewed and adopted two proposals relating to property tax. Legislative Proposal #4, *Property Tax Changes*, is a recommendation of the Department of Revenue and makes several clarifying changes to the property tax laws. Legislative Proposal #5, *Amend Delinquent Property Tax Collection*, is a recommendation endorsed by a group of real estate attorneys, county attorneys, and tax collectors.

Legislative Proposal #4, *Property Tax Changes*, makes five clarifying changes recommended by the Department of Revenue. First, it expands the authority to file electronically to include individual personal property. Current law only provides for the electronic filing of business personal property. The proposal would extend the authority to file electronically to personal property such as jet skis, mobile homes, and boats. Second, the proposal makes a clarifying change to S.L.2005-294 (AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM), to reflect the intent of the act's sponsors and supporters. This act created a combined system for registration and taxation of motor

vehicles to become effective July 1, 2009, or upon the earlier creation of a computer system that allows for the combined payment of registration fees and taxes due on motor vehicles. To cover the cost of the computer system, the act increased the first month's interest on delinquent registered motor vehicle taxes from 2% to 5%. The intent was that 60% of the first month's interest would be transferred to an Account in the Treasurer's Office to implement the computer system. The proposal adds language clarifying this intent. Third, the proposal would give a county board of equalization and review the authority to approve a late application for present-use value appraisal of property if the applicant demonstrates good cause for the delay. Current law allows similar approval for late applications for property tax exemptions or exclusions. Fourth, the proposal would authorize a tax collector to receive tax receipts for assessments that have been or are subsequently appealed to the Property Tax Commission and to send the taxpayer an initial tax bill or notice. The tax collector, however, may not collect the tax or enforce a tax lien until the appeal has been finally adjudicated. Fifth, the proposal, would clarify that the list of items credited to the tax collector in the collector's final settlement with the governing body should include the principal amount of taxes for any assessment appealed to the Property Tax Commission. Current law provides that the final settlement must contain the items to be charged against the tax collector and the items to be allowed as credits for the collector for the preceding fiscal year.

Legislative Proposal #5, *Amend Delinquent Property Tax Collection,* would amend the property tax laws by relieving the seller of personal liability for property taxes assessed on real property when the seller transfers the property before the property becomes delinquent or when the seller transfers the real property before it is annexed by the taxing unit and taxes are imposed by the taxing unit. In effect, the remedies of attachment and garnishment would be enforced against the record owner of the real

property on the date the taxes become delinquent instead of the listing owner of the real property. The proposal would also codify the practice of prorating property taxes on a calendar-year basis when real property is sold. This proposal was endorsed by a group of county attorneys, real estate attorneys, and tax collectors.

At the April 19th meeting, the Committee approved a proposal that would broaden the Department's authority to appraise the property of public service companies for property tax purposes by including the property of wireless companies, paging companies, and tower companies within the definition of public service company. Under current law, the Department makes a yearly appraisal of public service company property and allocates the valuations among the local taxing units in which the companies do business. In determining the true value of a company's property, the Department considers market value of the company's capital stock and debt, the book value of the company's system property, and the gross receipts and operation income of the company. Since, wireless companies, paging companies, and tower companies do not come within the statutory definition of public service company, they are appraised by the local taxing unit in which they are located. Many local taxing units do not have the capability to determine the true value of these companies, and the counties requested the Department to take over the appraisal of the wireless companies, paging companies, companies, and tower companies. At the May 2nd meeting, an amended proposal was presented to the Committee which added cable companies to the list of public system company property to be appraised by the Department. The wireless companies and cable companies voiced opposition to the proposal, as earlier introduced and as amended. After considering the opposing remarks made at the May 2nd meeting, the Committee voted to reconsider their earlier approval of this proposal, and voted not to recommend the proposal to the 2006 General Assembly. The Committee noted that the proposal needed further research.

INCOME TAX

The Committee spent considerable time reviewing several proposals related to income tax, specifically corporate income tax.

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 #6, IRC Update, changes the statutory reference to the Code from January 1, 2005, to January 1, 2006, and makes other conforming changes. Between those dates, Congress enacted four major pieces of federal legislation that made changes to the Internal Revenue Code. This federal legislation includes the Energy Tax Incentive Act of 2005 (P.L. 109-58) signed into law on August 8, 2005, the SAFE Transportation Equity Act of 2005 (P.L. 109-59) signed into law on August 10, 2005, the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) signed into law on September 23, 2005, and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135) signed into law on December 21, 2005. The changes made in 2005 primarily affect persons impacted by Hurricanes Katrina, Rita, and Wilma, persons who contributed to relief efforts related to those storms, and person involved with various types of energy production or distribution. The proposal also

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[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."

seeks to conform several other provisions of State tax law to the federal law even though those provisions are dependent upon a reference to the Code.

The Committee considered one individual income tax proposal. Legislative Proposal #7, *Additional Personal Income Tax Filing Option*, is a recommendation of the Department of Revenue and would allow married couples the option of filing a joint return if one spouse is a nonresident with no North Carolina income.

The Committee considered several corporate income tax proposals upon the request of the Department of Revenue. The Committee discussed the corporate tax proposals during its March meeting. It did not receive any opposition to the proposals.

Under current North Carolina law, an individual's pro rata share of S Corporation income attributable to North Carolina is subject to corporate income tax adjustments, while S Corporation income that is not attributable to North Carolina is subject to individual income tax adjustments. Legislative Proposal #8, *S Corp Income Tax Adjustments*, would make an individual's pro rata share of income from an S Corporation subject only to the individual income tax adjustments, rather than being subject to both individual and corporate income tax adjustments. The change in the proposal is more consistent with the tax treatment of an S Corporation generally and would simplify tax form preparation. Consequently, the Department of Revenue believes it may result in a higher degree of compliance with the law.

North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[3] In addition to the general rate, there is a 1.33% rate applied to the gross premiums on insurance policies that provide fire and lightning coverage. The General Assembly enacted the additional statewide fire and lightning tax in 1959. Although the

[3] Workers' compensation policies are taxed at 2.5%. HMO policies are currently taxed at a rate of 1%; however, effective January 1, 2007, these policies will be taxed at the general rate of 1.9%.

statute does not provide that the tax will apply differently to different types of policies, the Department of Revenue has administered the tax this way. Within the past few years, the Department has been informally advised by both the Department of Insurance and the Attorney General's Office that the statute as written does not provide for assessing the tax against only a percentage of a policy's premium. Rather, without a statutory change, it is their opinion that the tax should be applied to 100% of the premiums of any policy that includes fire and lightning coverage. Legislative Proposal #9, *Clarify Additional Gross Premiums Tax*, would codify the current administrative practice of the Department by setting in statute the percentage of an insurance policy's gross premiums to which the additional tax applies and it would provide that the additional tax would apply to all types of policies.

For the last few years, the Department of Revenue has worked with the Revenue Laws Study Committee to eliminate various loopholes in the application of the franchise tax. Since the franchise tax does not apply to limited liability companies, corporations previously were able to avoid paying franchise tax by transferring assets to a wholly-owned LLC. In 2001, the General Assembly attempted to close this loophole by enacting legislation requiring the attribution of assets transferred to an LLC back to the corporation depending on the corporation's percentage of ownership. The General Assembly enacted legislation again in 2002 and 2004 to tighten the law because corporations were circumventing the attribution rules by interposing other entities between the corporation and the LLC, such as partnerships and business trusts. During the 2005 Session, Senate Bill 540 was introduced to close yet another franchise tax loophole. Under current law, an LLC is treated as a division of its parent. The parent company is then considered to own property in this State and therefore has nexus, making it subject to income and franchise tax, and the constructive ownership

rules apply for attributing the LLC's assets to the parent's franchise tax calculation. However, when an LLC elects to be taxed as a C Corporation, nexus is not conferred on the parent and the attributes of the LLC do not flow to the parent. Therefore, companies currently operating in this State as C Corporations can convert to an LLC, make an election to file as a C Corporation, as they always have, and eliminate their North Carolina franchise tax obligations. Senate Bill 540 attempts to close this loophole by applying the franchise tax to limited liability corporations that elect to be taxed as a C Corporation for federal income tax purposes. The bill passed the Senate, but was not considered by the House. The Department of Revenue requested that the Revenue Laws Study Committee revisit this issue and endorse identical legislation for consideration in the short session. Legislative Proposal #10, *Franchise Tax Loophole Closing*, is substantially similar to Senate Bill 540. It would apply the corporate franchise tax to limited liability companies that elect to be taxed as a C Corporation for federal income tax purposes. The bill would also provide LLCs that elect to be taxed as a C Corporation a credit for the difference between annual report fees for corporations and LLCs such that those LLCs are paying the lower corporation annual report fee rate.

North Carolina imposes a franchise tax at the rate of $1.50 per $1,000 of the total amount of a corporation's capital base. A corporation's determination of its capital base for purposes of the franchise tax is not the same as the calculation of its capital base for financial reporting purposes. The calculation of its capital base for franchise tax purposes is determined by statute. The statute refers to book value as 'issued and outstanding capital stock, surplus, and undivided profits.' This is similar to net book value with certain adjustments. The principal adjustment is for contingent or deferred liabilities. The statute, a 1996 Department of Revenue Technical Advice Memorandum, and the standards under General Accepted Accounting Practices differ on how to

account for deferred liabilities. Legislative Proposal #12, *Franchise Tax Base Calculation*, would clarify how to treat deferred tax liabilities for franchise tax purposes.

Royalty income received for the use of trademarks, patents, and copyrights in North Carolina *is* taxable and must be reported to North Carolina by an out-of-state corporation receiving this income. However, there is a reporting option currently available to corporations and their related members for royalty payments received for trademark usage that is not available when those payments are for patent or copyright usage. Legislative Proposal #12, *Expansion of Royalty Reporting Option*, would expand the royalty payment reporting option for corporations and their related members to include payments received for the use of patents and copyrights. This proposal would give corporations and their related members that receive royalty payments derived from patent or copyright usage the ability to select which entity, the parent or the holding company, reports the income, just as that option is currently available to those corporations with regard to trademark royalties.

The Committee spent some time looking at real estate investment trusts (REIT). A REIT is a corporation or trust that uses the pooled capital of many investors to purchase and manage real estate. A REIT is subject to federal and State income tax only on the income that is not distributed to its shareholders. The shareholders pay tax on the dividends they receive. However, some taxpayers have avoided paying tax on the dividends they receive from the REIT by forming a company in another state to receive the distributions from the REIT. The income received by that company is not subject to North Carolina tax. The company may then distribute the income to the parent company in North Carolina, but the parent company would not have to pay tax on the

income because of the federal dividends received deduction[4]. The Committee is concerned about this tax avoidance method, but does not have a proposal at this time.

ELECTRICITY FRANCHISE TAX DISTRIBUTION

Cities receive a portion of the franchise tax on electric power companies. The distribution is based upon the gross receipts derived by the power company from sales within a city. This method of distribution imposes unnecessary burdens on the cities, the power companies, and the Department of Revenue and it results in numerous errors in the distribution. The General Assembly, through Senate Bill 343[5], asked the League of Municipalities to recommend a method of distributing this revenue to the cities on the basis of a formula that uses factors such as population and percentage share of prior distributions rather than service inside constantly changing city boundaries. The League, working with the electric power companies, devised a formula for making this distribution. Appendix F details the recommended distribution formula. The Committee recommends in Legislative Recommendation #14 that the General Assembly consider a committee substitute for Senate Bill 343[6] that embodies the recommendation of the League.

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[4] 26 U.S.C. 243.

[5] SB 343, AN ACT TO DIRECT THE LEAGUE OF MUNICIPALITIES TO DETERMINE A DIFFERENT METHOD FOR DISTRIBUTING THE FRANCHISE TAX ON ELECTRIC POWER COMPANIES IN ORDER TO SIMPLIFY THE DISTRIBUTION, REDUCE THE ADMINISTRATIVE BURDEN ASSOCIATED WITH THE DISTRIBUTION, AND PREVENT ERRORS IN THE DISTRIBUTION.

[6] SB 343, 2nd edition, is in the House Finance Committee.

COMMITTEE RECOMMENDATIONS AND LEGISLATIVE PROPOSALS

The Revenue Laws Study Committee makes the following 14 recommendations to the 2006 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. Video Services Competition Act
2. Amend Taxation of Logging Machinery
3. SSTA Sales Tax Defn/Sales Tax Payments
4. Property Tax Changes
5. Amend Delinquent Property Tax Collection
6. IRC Update
7. Additional Personal Income Tax Filing Option
8. S Corp Income Tax Adjustments
9. Clarify Additional Gross Premiums Tax
10. Franchise Tax Loophole Closing
11. Franchise Tax Base Calculation
12. Expansion of Royalty Reporting Option
13. Electricity Franchise Tax Distribution
14. Revenue Laws Technical and Motor Fuel Tax Changes

LEGISLATIVE PROPOSAL #1

VIDEO SERVICES COMPETITION ACT

LEGISLATIVE PROPOSAL #1

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO PROMOTE CONSUMER CHOICE IN VIDEO SERVICE PROVIDERS AND TO ESTABLISH UNIFORM TAXES FOR VIDEO PROGRAMMING SERVICES.

SHORT TITLE: Video Services Competition Act

SPONSORS: **Clodfelter;** Dalton, Hartsell, Hoyle, Kerr
Carney; Church, Hill, Luebke, McComas, Wainwright, Wilkins

BRIEF OVERVIEW: This bill would promote consumer choice in video service providers and establish uniform taxes for video programming services.

FISCAL IMPACT: This bill would have no impact on the General Fund, and it would have a potential net gain of $3.3 million for local governments.

EFFECTIVE DATE: January 1, 2007.

A copy of the proposed legislation, an executive summary bill analysis, and a fiscal memo begin on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

U D

BILL DRAFT 2005-RBxz-36B [v.7] (03/30)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
5/2/2006 6:42:13 AM

Short Title: Video Service Competition Act. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO PROMOTE CONSUMER CHOICE IN VIDEO SERVICE PROVIDERS AND TO ESTABLISH UNIFORM TAXES FOR VIDEO PROGRAMMING SERVICES.

The General Assembly of North Carolina enacts:

SECTION 1. Chapter 66 of the General Statutes is amended by adding a new Article to read:

"Article 42.

"State Franchise for Cable Television Service.

"**§ 66-350. Definitions.**

The following definitions apply in this Article:

(1) Cable service. – Defined in G.S. 105-164.3.

(2) Cable system. – Defined in 47 U.S.C. 522.

(3) Channel. – A portion of the electromagnetic frequency spectrum that is used in a cable system and is capable of delivering a television channel.

(4) Commission. – The North Carolina Utilities Commission.

(5) Existing agreement. – A local franchise agreement that was awarded under G.S. 153A-137 or G.S. 160A-319 and is in effect on January 1, 2007.

(6) Pass a household. – Make service available to a household, regardless of whether the household subscribes to the service.

(7) PEG channel. – A public, educational, or governmental access channel provided to a county or city.

"**§ 66-351. State franchising authority.**

(a) Authority. – The North Carolina Utilities Commission is designated the exclusive franchising authority in this State for cable service provided over a cable system. This

designation replaces the authorization to counties and cities in former G.S. 153A-137 and G.S. 160A-319 to award a franchise for cable service. This designation is effective January 1, 2007. After this date, a county or city may not award or renew a franchise for cable service.

(b) Award and Scope. – The Commission is considered to have awarded a franchise to a person who files a notice of service under G.S. 66-352. A franchise for cable service authorizes the holder of the franchise to construct and operate a cable system over public rights of way within the area to be served. Chapter 160A of the General Statutes governs the regulation of public rights-of-way by a city.

§ 66-352. Notice and commencement of service.

(a) Notice of Service. – A person who intends to provide cable service over a cable system in an area must file a notice of service with the Commission before providing the service. The notice is effective when it is filed with the Commission. The notice of service must include all of the following:

(1) The applicant's name and principal place of business.

(2) A description and map of the area to be served.

(3) A list of each county and city in which the described service area is located, in whole or in part.

(4) A schedule indicating when service is expected to be offered in part or all of the service area.

(b) Initial Service. – A person who files a notice of service under subsection (a) of this section must begin providing cable service in the service area described in the notice within 120 days after the notice is filed. If cable service does not begin within this period, the notice of service terminates 130 days after it was filed. If cable service begins within this period, the holder of the State-issued franchise must file a report of initial service with the Commission within 10 days after the cable service begins. Cable service begins when it passes one or more households in the described service area. This subsection does not apply to a cable service provider who terminates an existing agreement whose franchise area includes all of the service area described in a notice of service filed by the provider under subsection (a) of this section.

A report of initial service for a service area must include all of the following:

(1) The effective date of a notice of service for that area.

(2) A description and map of the service area.

(3) A statement that cable service has begun in the service area.

(c) Extension. – A person who intends to provide cable service over a cable system in an area that is contiguous with but outside the service area described in a notice of service on file with the Commission must file a notice of service under subsection (a) of this section that includes the proposed area. The initial service requirements in subsection (b) of this section apply to the proposed area. If the map of the area to be served includes any area that is part of the service area of another State-issued franchise, the termination of a notice of service for the proposed area for failure to begin service within the required time does not affect the status of the other State-issued franchise.

(d) Withdrawal. – A person may withdraw a notice of service by filing a notice of withdrawal with the Commission. The notice of withdrawal must be filed at least 90 days before the service is withdrawn.

"**§ 66-353. Annual service report.**

A holder of a State-issued franchise must file an annual service report with the Commission. The report must be filed on or before July 15 of each year. The report must include all of the following:

(1) The effective date of a notice of service for that area.

(2) A description and map of the service area.

(3) The approximate number of households in the service area.

(4) A description and a map of the households passed in the service area as of July 1.

(5) The percentage of households passed in the service area as of July 1.

(6) The percentage of households passed in the service area as of July 1 of any preceding year for which a report was required under this subsection.

(7) A schedule indicating when service is expected to be offered in part or all of the service area, to the extent the schedule differs from one included in the notice of service or in a report previously submitted under this subsection, and an explanation of the reason for the new schedule.

"**§ 66-354. General filing and report requirements.**

A document filed with the Commission under this section must be signed by an officer or general partner of the person submitting the document. Within five days after a person files a document with the Commission under this section, the person must send a copy of the document to any county or city included in the service area described in the document. A document filed under this section is a public record as defined in G.S. 132-1.

A successor in interest to a person who has filed a notice of service is not required to file another notice of service. When a change in ownership occurs, the owner must file a notice of change in ownership with the Commission within 14 days after the change becomes effective.

"**§ 66-355. Effect on existing local franchise agreement.**

(a) Existing Agreement. – This Article does not affect an existing agreement except as follows:

(1) Effective January 1, 2007, gross revenue used to calculate the payment of the franchise tax imposed by G.S. 153A-154 or G.S. 160A-214 does not include gross receipts from cable service subject to sales tax under G.S. 105-164.4. This exclusion does not otherwise affect the calculation of gross revenue and the payment to counties and cities of franchise tax revenue under existing agreements that have not been terminated under subsection (b) of this section.

(2) A cable service provider under an existing agreement may terminate the agreement in accordance with subsection (b) of this section when a

report of initial service filed under G.S. 66-352 indicates that one or more households in the franchise area of the existing agreement are passed by both the cable service provider under the existing agreement and the holder of a State-issued franchise.

(b) Termination. – To terminate an existing agreement, a cable service provider must file a notice of termination with the affected county or city and file a notice of service with the Commission. A termination of an existing agreement becomes effective at the end of a calendar quarter that is at least 30 days after the notice of termination is filed with the affected county or city. A termination of an existing agreement ends the obligations under the agreement as of the effective date of the termination, but does not affect the rights or liabilities of the county or city, a taxpayer, or another person arising under the existing agreement before the effective date of the termination.

"**§ 66-356. Service standards and requirements.**

(a) Discrimination Prohibited. – A person who provides cable service over a cable system may not deny access to the service to any group of potential residential subscribers within the filed service area because of the race or income of the residents. A violation of this subsection is considered an unfair or deceptive act or practice under G.S. 75-1.1.

In determining whether a cable service provider has violated this subsection with respect to a group of potential residential subscribers in a service area, the following factors must be considered:

(1) The length of time since the provider filed the notice of service for the area. If less than a year has elapsed since the notice of service was filed, it is conclusively presumed that a violation has not occurred.

(2) The cost of providing service to the affected group due to distance from facilities, density, or other factors.

(3) Technological impediments to providing service to the affected group.

(4) Inability to obtain access to property required to provide service to the affected group.

(b) FCC Standards. – A person who provides cable service over a cable system must comply with the customer service requirements in 47 C.F.R. § 76.309 and emergency alert requirements established by the Federal Communications Commission. The Consumer Protection Division of the Attorney General's Office is designated as the State agency to receive and respond to customer complaints concerning cable service. The number for the Division must be printed on the customer's bill.

(c) No Build-out. – No build-out requirements apply to a person who provides cable service under a State-issued franchise.

"**§ 66-357. Availability and use of PEG channels.**

(a) Application. – This section applies to a person who provides cable service under a State-issued franchise. It does not apply to a person who provides cable service under an existing agreement.

(b) Local Request. – A county or city must make a written request to a cable service provider for PEG channel capacity. The request must include a statement describing the county's or city's plan to operate and program each channel requested. The cable service

provider must provide the requested PEG channel capacity within 120 days after it receives the written request.

(c) Initial PEG Channels. – If an area is included in both the franchise area of an existing agreement and the service area of a State-issued franchise, the terms of the existing agreement, as of the filing date on the notice of service for the State-issued franchise, determine the required number, service tier placement, and transmission quality of initial PEG channels. The cable service provider must provide the number of PEG channels activated under those terms, giving equivalent service tier placement and transmission quality to those channels. The cable service provider must maintain the same channel designation for a PEG channel unless the service area of the State-issued franchise includes PEG channels that are operated by different counties or cities and those PEG channels have the same channel designation. The expiration of an existing agreement after January 1, 2007, does not affect the requirements in this subsection.

If no existing agreement includes any part of the service area of a State-issued franchise, then the number, service tier placement, and transmission quality of the initial PEG channels a cable service provider must provide depends upon the population of the city in which part or all of the service area is located. If the city's population is at least 50,000, the cable service provider must provide up to three PEG channels on a basic service tier. If the city's population is less than 50,000, a cable service provider must provide up to two PEG channels on a basic service tier. The transmission quality of these PEG channels must be equivalent to those of the closest city covered by an existing agreement.

(d) Additional PEG Channels. – A county or city that does not have seven PEG channels, including the initial PEG channels, is eligible for an additional PEG channel if it meets the programming requirements in this subsection. A county or city that has seven PEG channels is not eligible for an additional channel.

A county or city that meets the programming requirements in this subsection may make a written request under subsection (b) of this section for an additional channel. The additional channel may be provided on any service tier. The transmission quality of the additional channel must be at least equivalent to the transmission quality of the other channels provided.

The PEG channels operated by a county or city must meet the following programming requirements in order for the county or city to obtain an additional channel:

(1) All of the PEG channels must have scheduled programming for at least eighty percent (80%) of the time for at least eight hours a day.

(2) The programming content of each of the PEG channels must not repeat more than fifteen percent (15%) of the programming content on any of the other PEG channels.

(3) No more than fifteen percent (15%) of the programming content on any of the PEG channels may be character-generated programming.

(e) Use of Channels. – If a county or city no longer provides any programming for transmission over a PEG channel it has activated, the channel may be re-programmed at the cable service provider's discretion. A cable service provider must give at least 60

days notice to a county or city before it re-programs a PEG channel that is not used. The cable service provider must restore a previously lost PEG channel within 120 days of the date a county or city certifies to the provider a schedule that demonstrates the channel will be used.

(f) Operation of Channels. – A cable service provider is responsible only for the transmission of a PEG channel. The county or city to which the PEG channel is provided is responsible for the operation and content of the channel. A county or city that provides content to a cable service provider for transmission on a PEG channel is considered to have authorized the provider to transmit the content throughout the provider's service area, regardless of whether part of the service area is outside the boundaries of the county or city.

All programming on a PEG channel must be noncommercial. A cable service provider is not required to transmit content on a PEG channel that is branded with the logo, name, or other identifying marks of another cable service provider.

"**§ 66-358. Transmission of PEG channels.**

(a) Service. – When a cable service provider operating under a State-issued franchise begins providing cable service in an area, the service must include the transmission of PEG channels by one of the following methods:

(1) Interconnection of its cable system on reasonable and competitively neutral terms with any other cable system operated in its franchise or service area. Interconnection may be accomplished by direct cable, microwave link, satellite, or other method of connection.

(2) Transmission of the signal from each PEG channel programmer's origination site.

(b) Signal. – All PEG channel programming must meet the minimum recognized technical standards for the format used. If a PEG channel programmer transmits its signal in a format a cable service provider cannot transmit without altering the transmission signal, then the cable service provider must do one of the following:

(1) Alter the transmission signal to make it compatible with the technology or protocol the cable service provider uses to deliver its cable service.

(2) Provide to the county or city equipment needed to alter the transmission signal to make it compatible with the technology or protocol the cable service provider uses to deliver its cable service.

"**§ 66-359. Service to public building.**

At the written request of a county or city, a cable service provider operating under a State-issued franchise must provide cable service without charge to a public building located within 125 feet of the provider's cable system. The required service is the basic, or lowest-priced, service the provider offers to customers. The terms and conditions that apply to service provided to a retail customer apply to the service provided to the public building. Only one service outlet is required for a building. The cable service provider is not required to provide concealed inside wiring. A public building is a building used as a public school, a charter school, a county or city library, or a function of the county or city."

SECTION 2. G.S. 105-164.3 is amended by adding a new subdivision to read:

"**§ 105-164.3. Definitions.**

The following definitions apply in this Article:

…

(50c) Video programming. – Programming provided by, or generally considered comparable to programming provided by, a television broadcast station, regardless of the method of delivery."

SECTION 3. G.S. 105-164.4(a)(6) reads as rewritten:

"(6) The combined general rate applies to the gross receipts derived from providing ~~any of the following broadcast services~~ video programming to a subscriber in this State. A cable service provider, a direct-to-home satellite service provider, and any other person engaged in the business of providing ~~any of these services~~ video programming is considered a retailer under this ~~Article:~~Article.

~~a. Direct-to-home satellite service.~~

~~b. Cable service.~~"

SECTION 4. G.S. 105-164.4C(d) is recodified as G.S. 105-164.4D with the catchline "Bundled services."

SECTION 5. G.S. 105-164.4D, as recodified by Section 4 of this act, reads as rewritten:

"**§ 105-164.4D. Bundled services.**

~~Bundled Services.~~ When a taxable ~~telecommunications~~ service is bundled with a service that is not taxable, the tax applies to the gross receipts from the taxable service in the bundle as follows:

(1) If the service provider offers all the services in the bundle on an unbundled basis, tax is due on the unbundled price of the taxable service, less the discount resulting from the bundling. The discount for a service as the result of bundling is the proportionate price decrease of the service, determined on the basis of the total unbundled price of all the services in the bundle compared to the bundled price of the services.

(2) If the service provider does not offer one or more of the services in the bundle on an unbundled basis, tax is due on the taxable service based on a reasonable allocation of revenue to that service. If the service provider maintains an account for revenue from a taxable service, the service provider's allocation of revenue to that service for the purpose of determining the tax due on the service must reflect its accounting allocation of revenue to that service."

SECTION 6. The catchline to G.S. 105-164.12B reads as rewritten:

"**§ 105-164.12B. ~~Bundled transactions.~~Tangible personal property bundled with service contract.**"

SECTION 7. G.S. 105-164.44F(a) reads as rewritten:

"(a) Amount. – The Secretary must distribute ~~to the cities~~ part of the taxes imposed by G.S. 105-164.4(a)(4c) on telecommunications service. The Secretary must make the distribution within 75 days after the end of each calendar quarter. The amount the Secretary must distribute is ~~eighteen and three one-hundredths percent (18.03%)~~ the following percentages of the net proceeds of the taxes collected during the ~~quarter,~~ quarter:

(1) Eighteen and three one-hundredths percent (18.03%), minus two million six hundred twenty thousand nine hundred forty-eight dollars ~~($2,620,948).~~($2,620,948), must be distributed to cities in accordance with this section. ~~This~~ The deduction is one-fourth of the annual amount by which the distribution to cities of the gross receipts franchise tax on telephone companies, imposed by former G.S. 105-20, was required to be reduced beginning in fiscal year 1995-96 as a result of the "freeze deduction." ~~The Secretary must distribute the specified percentage of the proceeds, less the "freeze deduction" among the cities in accordance with this section.~~

(2) Seven and twenty-three one-hundredths percent (7.23%) must be distributed to counties and cities as provided in G.S. 105-164.44I."

SECTION 8. Article 5 of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-164.44I. Distribution of part of sales tax on video programming service and telecommunications service to counties and cities.**

(a) Distribution. – The Secretary must distribute to the counties and cities part of the taxes imposed by G.S. 105-164.4(a)(4c) on telecommunications service and G.S. 105-164.4(a)(6) on video programming service. The Secretary must make the distribution within 75 days after the end of each calendar quarter. The amount the Secretary must distribute is the sum of the following:

(1) The amount specified in G.S. 105-164.44F(a)(2).

(2) Twenty-two and sixty-one one-hundredths percent (22.61%) of the net proceeds of the taxes collected during the quarter on video programming, other than on direct-to-home satellite service.

(3) Thirty-seven percent (37%) of the net proceeds of the taxes collected during the quarter on direct-to-home satellite service.

(b) Supplemental PEG Support. – The Secretary must include the applicable amount of supplemental PEG channel support in each quarterly distribution to a county or city. The amount to include is one-fourth of sixteen thousand dollars ($16,000) for each qualifying PEG channel operated by the county or city. The amount of money distributed under this subsection may not exceed two million dollars ($2,000,000) in a calendar year. If the amount to be distributed for qualifying PEG channels in a calendar year would otherwise exceed this maximum amount, the Secretary must proportionately reduce the applicable amount distributable for each PEG channel. The amount included under this subsection in a distribution to a county or city is intended to supplement the PEG channel support available in the amount distributed under this section.

A county or city must certify to the Secretary by January 15 of each year the number of qualifying PEG channels it operates. A qualifying PEG channel is one that meets the programming requirements under G.S. 66-357(d). A county or city may not receive PEG channel support for more than three qualifying PEG channels.

The money distributed to a county or city under this subsection must be used by it for the operation and support of PEG channels. For purposes of this subsection, the term "PEG channel" has the same meaning as in G.S. 66-350.

(c) Counties and Cities Without Local Cable Revenue. – The share of a county that did not impose a cable franchise tax under G.S. 153A-154 before January 1, 2007, is one dollar ($1.00) times the most recent annual population estimate for that county. The share of a city that did not impose a cable franchise tax under G.S. 160A-214 before January 1, 2007, is two dollars ($2.00) times the most recent annual population estimate for that city.

(d) Counties and Cities With Local Cable Revenue. – The share of a county or city that imposed a cable franchise tax under either G.S. 153A-154 or G.S. 160A-214 before January 1, 2007, is its proportionate share of the amount to be distributed to all counties and to all cities eligible to receive a distribution under this subsection. The amount to be distributed under this subsection is the amount determined under subsection (a) of this section, minus the amount distributed under subsections (b) and (c) of this section. A county's and city's proportionate share is the amount of cable franchise tax it received under G.S. 153A-154 or G.S. 160A-214 during the 2005-06 fiscal year plus the amount of a subscriber fee imposed during the 2005-06 fiscal year compared to the amount of cable franchise tax revenue and subscriber fee revenue all counties and cities received in that fiscal year. Each county or city that imposed a franchise tax under G.S. 153A-154 or G.S. 160A-214 must certify to the Secretary by January 15, 2007, the amount of cable franchise tax revenue and subscriber fee revenue it received in the 2005-06 fiscal year.

For subsequent fiscal years, the Secretary must multiply the amount of a county's or city's share under this subsection for the preceding year by the percentage change in its population for that fiscal year and add the result to the county's or city's share for the preceding fiscal year to obtain the county's or city's adjusted amount. Each county's or city's proportionate share for that year is its adjusted amount compared to the sum of the adjusted amounts for all counties and cities.

(e) Population Determination. – In making population determinations under this section, the Secretary must use the most recent annual population estimates certified to the Secretary by the State Budget Officer. For purposes of the distributions made under this section, the population of a county is the population of its unincorporated areas plus the population of an ineligible city in the county, as determined under subsection (g) of this section.

(f) Change in City Structure. – The following changes apply when a city alters its corporate structure:

(1) If a city dissolves and is no longer incorporated, the proportional shares of the remaining counties and cities must be recalculated to adjust for the dissolution of that city.

(2) If two or more cities merge or otherwise consolidate, their proportional shares are combined.

(3) If a city divides into two or more cities, the proportional share of the city that divides is allocated among the new cities on a per capita basis.

(g) Ineligible Cities. – An ineligible city is disregarded for all purposes under this section. A city incorporated on or after January 1, 2000, is not eligible for a distribution under this section unless it meets both of the following requirements:

(1) It is eligible to receive funds under G.S. 136-41.2.

(2) A majority of the mileage of its streets is open to the public.

(h) Nature. – The General Assembly finds that the revenue distributed under this section is local revenue, not a State expenditure, for the purpose of Section 5(3) of Article III of the North Carolina Constitution. Therefore, the Governor may not reduce or withhold the distribution."

SECTION 9. G.S. 105-164.21B is repealed.

SECTION 10. G.S. 153A-137 is repealed.

SECTION 11. G.S. 153A-154 is repealed.

SECTION 12. G.S. 160A-211 reads as rewritten:

"**§ 160A-211. Privilege license taxes.**

(a) Authority. – Except as otherwise provided by law, a city shall have power to levy privilege license taxes on all trades, occupations, professions, businesses, and franchises carried on within the city. A city may levy privilege license taxes on the businesses that were formerly taxed by the State under the following sections of Article 2 of Chapter 105 of the General Statutes only to the extent the sections authorized cities to tax the businesses before the sections were repealed:

G.S. 105-36	Amusements – Manufacturing, selling, leasing, or distributing moving picture films.
G.S. 105-36.1	Amusements – Outdoor theatres.
G.S. 105-37	Amusements – Moving pictures – Admission.
G.S. 105-42	Private detectives and investigators.
G.S. 105-45	Collecting agencies.
G.S. 105-46	Undertakers and retail dealers in coffins.
G.S. 105-50	Pawnbrokers.
G.S. 105-51.1	Alarm systems.
G.S. 105-53	Peddlers, itinerant merchants, and specialty market operators.
G.S. 105-54	Contractors and construction companies.
G.S. 105-55	Installing elevators and automatic sprinkler systems.
G.S. 105-61	Hotels, motels, tourist courts and tourist homes.
G.S. 105-62	Restaurants.
G.S. 105-65	Music machines.
G.S. 105-65.1	Merchandising dispensers and weighing machines.
G.S. 105-66.1	Electronic video games.
G.S. 105-74	Pressing clubs, dry cleaning plants, and hat blockers.

G.S. 105-77	Tobacco warehouses.
G.S. 105-80	Firearms dealers and dealers in other weapons.
G.S. 105-85	Laundries.
G.S. 105-86	Outdoor advertising.
G.S. 105-89	Automobiles, wholesale supply dealers, and service stations.
G.S. 105-89.1	Motorcycle dealers.
G.S. 105-90	Emigrant and employment agents.
G.S. 105-91	Plumbers, heating contractors, and electricians.
G.S. 105-97	Manufacturers of ice cream.
G.S. 105-98	Branch or chain stores.
G.S. 105-99	Wholesale distributors of motor fuels.
G.S. 105-102.1	Certain cooperative associations.
G.S. 105-102.5	General business license.

(b) Barbershop and Salon Restriction. – A privilege license tax levied by a city on a barbershop or a beauty salon may not exceed two dollars and fifty cents ($2.50) for each barber, manicurist, cosmetologist, beautician, or other operator employed in the barbershop or beauty salon.

(c) ~~Piped Gas Restriction.~~ Prohibition.– A city may not ~~levy a privilege license tax on a person who is engaged in the business of supplying piped natural gas and is subject to tax under Article 5E of Chapter 105 of the General Statutes.~~ impose a license, franchise, or privilege tax on a person engaged in any of the businesses listed in this subsection. These businesses are subject to a State tax for which the city receives a share of the tax revenue.

(1) Supplying piped natural gas taxed under Article 5E of Chapter 105 of the General Statutes.

(2) Providing telecommunications service taxed under G.S. 105-164.4(a)(4c).

(3) Providing video programming taxed under G.S. 105-164.4(a)(6).

~~(d) Telecommunications Restriction. A city may not impose a license, franchise, or privilege tax on a company taxed under G.S. 105-164.4(a)(4c).~~"

SECTION 13. G.S. 160A-214 is repealed.

SECTION 14. G.S. 160A-319(a) reads as rewritten:

"(a) A city shall have authority to grant upon reasonable terms franchises for ~~the operation within the city of~~ a telephone system and any of the enterprises listed in ~~G.S. 160A-311 and for the operation of telephone systems.~~ G.S. 160A-311, except a cable television system. A franchise granted by a city authorizes the operation of the franchised activity within the city. No franchise shall be granted for a period of more than 60 years, except that a franchise for solid waste collection or disposal systems and facilities shall not be granted for a period of more than 30 ~~years and cable television franchises shall not be granted for a period of more than 20~~ years. Except as otherwise provided by law, when a city operates an enterprise, or upon granting a franchise, a city may by ordinance make it unlawful to operate an enterprise without a franchise."

SECTION 15. An award of a State-issued franchise under Article 42 of Chapter 66 of the General Statutes, as enacted by this act, does not affect a determination of whether video programming provided by the holder of the franchise is considered cable service provided over a cable system under federal law or under a state law that applies substantially the same definitions of "cable service" and "cable system" as federal law.

SECTION 16. If any provision of this act or its application is held invalid, the invalidity does not affect other provisions or applications of this act that can be given effect without the invalid provisions or application, and to this end the provisions of this act are severable.

SECTION 17. The Revenue Laws Study Committee must review the effect Article 42 of Chapter 66, as enacted by this act, has on the following to determine if any changes to the law are needed and must report its findings to the 2009 Session of the North Carolina General Assembly:

(1) Competition in video programming services.

(2) The number of cable service subscribers, the price of cable service by service tier, and the technology used to deliver the service.

(3) The deployment of broadband in the State.

SECTION 18. This act becomes effective January 1, 2007. Sections 7 and 8 of this act apply to the distribution made within 75 days after March 31, 2007, for the quarter starting January 1, 2007.

VIDEO SERVICE COMPETITION ACT

May 2, 2006

Executive Summary

- **Provides equal taxation of same service**
  - Defines video programming to include all programming comparable to television broadcast, regardless of provider
  - Repeals local authority to impose local franchise tax
  - Applies existing 7% State sales tax to video programming service
- **Promotes competition in video programming service**
  - Requires State franchising of cable service providers
  - Repeals local authority to award or renew a local cable franchise, effective January 1, 2007
- **Preserves local government revenue stream**
  - Distributes share of sales tax imposed on video programming to counties and cities
  - Distribution of video programming revenues based on the amount of cable franchise tax received in fiscal year 05-06 PLUS any subscriber revenues received in fiscal year 05-06. Subsequent annual distributions adjusted for population growth
- **Protects PEG Channels**
  - Provides up to $2 million for additional PEG support
  - Includes per subscriber revenue in local government distribution base
  - Sets number, service tier placement, and transmission quality of PEG channels
  - Provides mechanism to acquire additional PEG channels
  - Provides equipment assistance for transmitting PEG channel signals
- **Requires cable service provider to provide free basic service to local public buildings**
- **Preserves local regulation of rights-of-way**
- **Provides competitive neutrality**
  - Existing local franchises cannot be renewed
  - Opt out provision for cable service providers under existing local agreements when one or more households in the franchise area may be served by both the existing provider and the holder of a State-issued franchise
- **Prohibits discrimination**
  - Bill specifically prohibits discrimination of service based on income or race
  - Violation of the law declared an unfair or deceptive trade practice
- **Preserves service standards**
  - Franchisee must comply with customer service standards and emergency alert requirements of FCC

BILL DRAFT 2005-RBxz-36B: Video Service Competition Act

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	May 2, 2006
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Draft		Committee Counsel

SUMMARY: This bill would provide equal taxation of video programming services regardless of how the service is delivered and it would replace locally negotiated franchises of cable service provided over a cable system with a State-issued franchise. The bill would become effective January 1, 2007.

CURRENT LAW: North Carolina began taxing communication services when the technologies enabling the services were separate and distinct technologies and the providers of the services were separate and distinct taxpayers. Over the past several years, the technology used to provide these services has converged so that the line between the services is no longer separate and distinct. The Current Operations and Capital Improvements Appropriations Act of 2005 directed the Revenue Laws Study Committee to study the equity of taxation of providers of cable service, direct-to-home satellite service, satellite digital audio radio service, video programming service, and data service.

The Revenue Laws Study Committee spent a considerable amount of time on this issue.[1] The Committee found that the State taxes these services based upon who provides the service rather than the service itself. Despite the General Assembly's repeated attempts to provide tax equity among these providers, it is debatable whether that has been accomplished:

- The State imposes a 7% State sales tax on telecommunication services and it earmark a percentage of the revenues to cities. The amount each city receives is based upon a per capita statutory formula. State law prohibits counties and cities from imposing local taxes on this service.
- The State imposes a 7% State sales tax on direct-to-home satellite service. Federal law prohibits a local tax on this service and it prohibits local regulation of this service. The tax revenue is not shared with local governments.
- The State imposes a 4.5% State sales tax and a 2.5% local sales tax on digital audio radio service.
- The State imposes a 7% State sales tax on cable services, with a credit equal to the amount of local franchise tax paid on the service. Counties and cities may impose a local franchise tax on this service; the tax may not exceed 5% of gross receipts. Cable service has been subject to local regulation since 1973. The local regulation of cable services varies from county to county and from city to city, depending on the terms of the locally negotiated agreements. The definition of 'gross receipts' may also vary from agreement to agreement. The cable boxes rented to customers is subject to the State and local sales tax. The gross receipts from the rental of these

[1] The Revenue Laws Study Committee staff met separately with representatives of the cable industry, the telephone industry, the cable administrators, and the counties and cities. It also held a series of four meetings with the all the affected parties and solicited comments from the parties on numerous occasions. The staff prepared a survey given to all the local governments in the State to determine their franchise fee collections and other nonmonetary contributions received in accordance with their cable franchise agreements.

boxes may also be included in the company's gross receipts for local franchise tax purposes, depending upon how the term is defined in the local agreement.

The Revenue Laws Study Committee acknowledged that the method of taxation should not provide one provider of a service with a competitive advantage over another. The Committee expressed a goal to establish a method of taxation that applies equally to the same service, regardless of who provides it. The Committee established the following principles:

- Equal taxation of the same service.
- A tax system that is easy to administer.
- A tax and regulatory system that do not impede competition.
- Equal compensation to cities for the use of their public rights-of-way.
- PEG channels service a public purpose and should be supported.

Based upon those principles, it desired a proposal that met the following goals:

- Applies the principles stated above.
- Contains no tax or fee increase.
- Preserves local government revenue stream.
- Promotes competition in the marketplace.
- Promotes deployment of broadband as a basic communication tool.

North Carolina is not alone in grappling with the issue of how to tax and regulate telecommunications and video programming services. Congress as well as other states is considering legislation on this issue. At this time, at least three states have enacted legislation changing the regulation and taxation of telecommunications and video programming services and at least eight other states have legislation pending on the issue.

BILL ANALYSIS: Legislative Proposal #1, *Video Service Competition Act,* establishes uniform taxes for video programming services and seeks to promote consumer choice. It establishes equal taxation of the same service by applying the State 7% sales tax to all video programming services, repealing the local authority to impose a local franchise tax, and repealing the sales tax credit allowed to cable companies for local franchise tax paid. It preserves the local government revenue stream by distributing part of the sales tax revenues from telecommunications and video programming services to the counties and cities. The distribution formula is based upon the amount of cable franchise tax revenue received in fiscal year 2005-2006 plus any subscriber fees received that year.

The proposal promotes competition by providing a State franchise process, in lieu of the current locally negotiated franchise agreements. It seeks to ensure competitive neutrality by allowing cable providers to opt-out of existing local agreements when one or more households in the franchise area may be served by both the existing provider and the holder of a State-issued franchise. The proposal specifically prohibits discrimination in the provision of video programming services and declares a violation of this law to be an unfair or deceptive trade practice. The holder of a State-issued franchise must comply with customer service and emergency alert requirements established by the Federal Communications Commission. The proposal designates the Consumer Protection Division of the Attorney General's Office as the State agency to receive customer complaints regarding video programming services.

The proposal preserves local regulation of public rights-of-way and provides for PEG channel support and growth. In addition to including the per subscriber revenues in the distribution base to local governments, the proposal provides up to $2 million for supplemental PEG support. The proposal provides that existing franchise agreements will determine the number, service tier placement, and

transmission quality required of PEG channels under a State-issued franchise. In the absence of an existing agreement, the number of PEG channels a county or city may have is determined by the area's population. A local entity may acquire additional PEG channels, with the maximum number of channels set at seven. The proposal also requires cable service providers to provide free basic service to local public buildings.

Section-by-section analysis of the proposal:

Section 1 of the proposal replaces the authorization to counties and cities to award a franchise for cable service with a State franchising authority, effective January 1, 2007. The proposal provides that a county or city may not award or renew a franchise for cable service after this date. The proposal designates the North Carolina Utilities Commission as the exclusive franchising authority in the State for cable service provided over a cable system. The terms 'cable service' and 'cable system' are defined by federal law. The proposal would require the franchising of cable service that is required to be franchised under federal law. The proposal does not expand the services that need to be franchised beyond those currently required to be franchised under federal law.

State issued franchise. The State franchise process is one of notice, not regulation. To receive a State-issued franchise, a person must file a notice of service with the Utilities Commission. A person who files a notice of service with the Commission must begin providing cable service within 120 days after the notice is filed. If service is not provided within this period, the notice of service terminates 130 days after it was filed. The notice of service must include the applicant's name and principal place of business, a description and map of the area to be served, a list of each county and city in which the described service area is located, and a schedule indicating when service is expected to be offered in part or all of the service area.

Report of initial service. Once cable service is provided, the holder of a State-issued franchise must file a report of initial service with the Commission. The report of initial service must include the effective date of the notice of service for that area, a description and map of the service area, and a statement that cable service has begun in the service area. The holder of a State-issued franchise must also file an annual service report on or before July 15 of each year. The annual service report must include all of the following: the effective date of a notice of service for that area, a description and map of the service area, the approximate number of households in the service area, a description and map of the households passed in the service area as of July 1, the percentage of households passed in the service area as of July 1, the percentage of households passed in the service area as of July 1 of any preceding year for which a report was required, and a schedule indicating when service is expected to be offered in part or all of the service area, to the extent the schedule differs from one included in the notice of service or in a report previously submitted, and an explanation of the reason for the new schedule.

Existing agreements. The State franchising authority does not affect a local franchise agreement that was awarded by a county or city and is in effect on January 1, 2007, except as follows:

- Effective January 1, 2007, gross revenue used to calculate the payment of a local franchise tax does not include gross receipts from cable service subject to the State sales tax.
- A local franchise agreement may be terminated when a report of initial service indicates that one or more households in the franchise area of the existing agreement are passed by both the cable provider under the existing agreement and the holder of a State-issued franchise.

Termination of existing agreements. To terminate an existing agreement, a cable service provider must file a notice of termination with the affected county or city and file a notice of service with the Utilities Commission. A notice of termination becomes effective at the end of a calendar quarter that is at least 30 days after the notice of termination is filed with the affected county or city. A termination of an existing agreement ends the obligations under the agreement as of the effective date of the termination.

Service standards and requirements. The proposal specifically prohibits discrimination in the provision of the cable service. A violation of the law is considered an unfair and deceptive trade practice. In determining whether a cable service provider has violated the law, the following factors may be considered: the length of time since the provider filed the notice of service for the area, the cost of providing service to an area, technological impediments to providing service to an area, and the inability to obtain access to property required to provide service to an area.

A cable service provider must comply with the customer service requirements and emergency alert requirements established by the Federal Communications Commission. The Consumer Protection Agency of the Attorney General's Office is designated as the State agency to receive and respond to consumer complaints.

PEG channels. The proposal requires a cable service provider operating under a State-issued franchise to include the transmission of PEG channels. A county or city may make a written request for PEG channel capacity and the cable service provider must provide the requested capacity within 120 days after it receives the request. If the area is included in both the franchise area of an existing agreement and the service area of a State-issued franchise, then the terms of the existing agreement as of the filing date of the notice of service determine the number, service tier placement, and transmission quality of the initial PEG channels required under the State-issued franchise. If no existing agreement includes any part of the service area of a State-issued franchise, then the number of PEG channels required under the State-issued franchise depends upon the population of the city in which part or all of the service area is located. If the city's population is at least 50,000, the provider must provide up to three PEG channels. If the city's population is less than 50,000, the provider must provide up to two PEG channels. The PEG channels must be placed on a basic service tier and the transmission quality must be equivalent to those of the closest city covered by an existing agreement.

The maximum number of PEG channels a cable service provider must provide to a county or city is seven. If a county or city does not have seven PEG channels, including the initial PEG channels, it may request additional channels. The additional channels may be provided on any service tier and the transmission quality of the additional channels must be at least equivalent to the transmission quality of the other channels provided. The PEG channels operated by a county or city must meet the following programming requirements in order for the county or city to obtain additional channels:

- All of the PEG channels must have scheduled programming for at least 80% of the time for at least 8 hours a day.
- The programming content of each PEG channel must not repeat more than 15% of the programming content on any of the other PEG channels.
- No more than 15% of the programming content on any PEG channel may be character-generated programming.

A cable service provider is responsible only for the transmission of a PEG channel. A county or city to which the PEG channel is provided is responsible for the operation and content of the channel.

Service to public buildings. At the written request of a county or city, a cable service provider operating under a State-issued franchise must provide cable service without charge to a public building located within 125 feet of the provider's cable system. The required service is the basic, or lowest-priced, service the provider offers to customers. Only one service outlet is required for a building. A public building is a building used as a public school, a charter school, a library, or a function of the county or city.

Sections 2 and 3 of the proposal would apply the State sales tax equally to all video programming services, regardless of who provides the service. Section 2 defines the term 'video programming' to be programming provided by, or generally considered comparable to programming provided by, a television broadcast station, regardless of the method of delivery. The term is broader than 'cable

service provided over a cable system'. It would include cable services offered over private rights-of-way as well as those offered over public rights-of-way. Section 3 imposes the State's 7% sales tax on the gross receipts derived from providing video programming to a subscriber in this State.[2]

Sections 4 through 6 of the proposal would make technical and conforming changes to the provisions governing bundled transactions.

Sections 7 and 8 of the proposal would distribute a share of the sales tax revenues imposed on video programming to counties and cities. The revenue distributed is local revenue, not a State expenditure. Therefore, the Governor may not reduce or withhold the distribution.

Section 7 would increase the amount of the sales tax revenue derived from telecommunication services distributed to cities and counties. Section 8 would distribute the following portion of the gross receipts derived from video programming to counties and cities: 22.61% of the net proceeds collected on video programming, other than on direct-to-home services and 37% of the net proceeds collected on direct-to-home satellite service.[3] The distributions would be made quarterly.

The amount distributed would be allocated as follows:

- An amount, not to exceed $2,000,000 a year, would be distributed as supplement PEG channel support to counties and cities with qualifying PEG channels. The amount per qualifying PEG channel would be $16,000. A county or city could not receive supplemental PEG channel support for more than three PEG channels. The amount distributed to a county or city as supplemental PEG channel support must be used by it for the operation and support of PEG channels.
- The remainder of the revenues to be distributed would be allocated between the counties and cities as follows:
    - The share of a county that did not impose a cable franchise tax before January 1, 2007, would be $1 times the most recent annual population estimate for that county. The population of the county would be the population of its unincorporated areas plus the population of an ineligible city in the county.
    - The share of a city that did not impose a cable franchise tax before January 1, 2007, would be $2 times the most recent annual population estimate for that city.
    - The share of a county or city that did impose a cable franchise tax before January 1, 2007, would be its proportionate share of the remaining amount to be distributed to all counties and cities that imposed a cable franchise tax before January 1, 2007. A county's or city's proportionate share would be the amount of cable franchise tax revenue it received in fiscal year 05-06 plus the amount of a subscriber fee imposed in fiscal year 05-06 compared to the amount of cable franchise tax revenue and subscriber fee revenue all counties and cities received in that fiscal year. For subsequent fiscal years, the amount each county or city receives would be adjusted based upon its percentage change in population.

Section 9 would repeal the credit against the State sales tax on cable services for local franchise tax paid since the local franchise tax is repealed in Section 13.

Section 10 would repeal the county's authority to franchise cable television services.

Section 11 would repeal the county's authority to impose a franchise tax on cable services.

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[2] Although the term video programming includes broadcast services, the provision of these services would not be taxed unless the provider sells the service to subscribers and thus realizes gross receipts from the provision of the services.

[3] This percentage distribution from satellite TV services mirrors the 2.5% local sales tax on satellite radio services.

Section 12 would prohibit a city from imposing a tax on video programming services.

Section 13 would repeal the city's authority to impose a franchise tax on cable services.

Section 14 would repeal the city's authority to franchise cable television services.

Section 15 would provide that an award of a State-issued franchise does not affect a determination of whether video programming provided by the holder of the franchise is considered cable service provided over a cable system under federal law.

Section 16 would provide that the provisions of this act are severable.

Section 17 would direct the Revenue Laws Study Committee to review the effects of this act on competition in video programming services, the number of cable service subscribers, the price of cable service by service tier, the technology used to deliver the service, and the deployment of broadband in the State. The Committee would see if any changes to the law are necessary and would report its findings and recommendations to the 2009 General Assembly.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

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, 2006

TO: Revenue Laws Study Committee

FROM: Brenna Erford
Fiscal Research Division

RE: Consumer Choice in Cable and Uniform Taxation of Video Programming Services

FISCAL IMPACT

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

	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
REVENUES:					
General Fund	No Impact to General Fund				
Local governments	**Possible net gain up to $3.3 million; see Assumptions & Methodology**				
EXPENDITURES:	**See Assumptions & Methodology**				
POSITIONS (cumulative):	**See Assumptions & Methodology**				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue, NC Utilities Commission, local governments

EFFECTIVE DATE: January 1, 2007

BILL SUMMARY: The Consumer Choice in Cable and Uniform Taxation of Video Programming Services Act:

- Establishes a statewide video service franchising process;
- Makes changes to the regulatory treatment of existing local cable franchises;
- Eliminates local governments' authority to assess and collect cable franchise fees;

- Replaces local revenues from franchise fees with a new distribution of shared sales tax collections from telecommunications, cable service, and satellite television service;
- Removes the state tax credit for franchise fees paid to local governments;
- Provides for a proportional tax distribution to local governments based on previous revenues from cable, including franchise fees and per subscriber charges;
- Provides for public, educational, and governmental (PEG) channel funding;
- Designates the North Carolina Utilities Commission as the agency responsible for administering statewide video service franchises and consumer complaints.

This bill does not raise taxes on cable service, telecommunications, or home satellite television services. All these services remain subject to the general shared sales tax rate of 7%. However, this bill significantly alters the calculation of the local share of shared sales tax and creates an entirely new distribution method for the local share of shared sales tax collections. The bill does three things that significantly alter the composition of the local share:

- Local governments will no longer be able to assess and collect cable franchise fees. This revenue will be replaced by the local distribution scheme set forth in the bill. Under this proposal, local governments will receive a portion of sales tax collections from cable service equal to 22.61%, an increased portion of the existing telecommunications sales tax, and a share of sales tax collections on satellite television service.
- The tax credit equal to the amount of franchise fees paid to local governments created in 2005 is eliminated.
- Local governments will effectively receive a larger portion of state sales tax collections on telecommunications. This new portion will be equal to 7.23% of total telecommunications sales tax collections, which is equivalent to 22.61% of total sales tax collections for telecommunications less the local share already received pursuant to G.S. 105-164.44F according to Fiscal Research estimates.
- Local governments will be granted a share of sales tax collections from home satellite television service equal to 2.5% of the 7% general sales tax, or approximately 37% of sales tax collections.

ASSUMPTIONS AND METHODOLOGY: Fiscal Research estimates that all North Carolina local governments will be effectively be held harmless by this change, and that some local governments may even see slightly higher revenues. The sum of the local shares of these three industries (approximately $65.3 million) is estimated to slightly exceed actual aggregate local collections of cable franchise fees.

During the 2005 session, cable service, telecommunications, and home satellite television service were brought under the general state sales tax rate of 7%.

Current Law and Estimated Tax Collections by Industry

The chart below shows estimated total sales tax collections for cable service, telecommunications, and home satellite television service for FY 2005-06. These amounts have been adjusted to reflect the 2005 rate changes. The municipal share amount shows the amount received or collected by local governments under current law.

Estimated Sales Tax Collections by Industry and State/Local Share under Current Law			
	2005-06 Adjusted		
	Net collections	State share	Local share*
Telecommunications sales tax	395,714,195	334,850,718	60,863,477
Cable service**	91,350,000	26,100,000	65,250,000
Satellite	43,220,000	43,220,000	N/A
Total, all industries	530,284,195	404,170,718	126,113,477

*Local share reflects 18.03% of total telecommunications sales tax less the "freeze deduction" as required in G.S. 105-164.44F

**Net collections for cable have been estimated from municipal share. The local share ($65.3 million) reflects estimated total cable revenues collected directly by local governments, not by the state.

- For telecommunications, the $60.9 million local share is the 18.03% of telecommunications sales tax less a "freeze distribution" created under G.S. 105-164.44F. This portion of local share is not altered by this legislation.
- For cable service, the local share shown ($65.3 million) is the estimated amount of cable revenues assessed and collected by local governments in 2005. Currently this money is collected directly by local governments, primarily in the form of cable franchise fees. Under federal law, local government units can assess a franchise fee of up to 5% on a locally negotiated definition of gross revenues. This is also the estimated amount of the cable tax credit.
- Sales tax collections from home satellite television service are not currently shared with local governments.

The following sections outline the change in calculation of the local share of cable, telecommunications, and satellite sales tax collections as well as the change in distribution to local governments as it pertains to each industry.

Telecommunications

In 2005, the tax on telecommunications was increased from 6.0% to the general sales tax rate of 7.0%. The change was effective Oct. 1, 2005. Under G.S. 105-164.44F local governments receive a per capita distribution of 18.03% of sales tax collections on telecommunications service less a "freeze deduction" of $2,620,948 on a quarterly basis. This legislation does not alter this portion of the local government share of sales tax on telecommunications. Under this bill, local governments will continue to receive a distribution of total sales tax collections on telecommunications pursuant to G.S. 105-164.44F, plus an additional share of collections equal to 7.23% of gross sales tax collections on telecommunications. This additional share of collections is estimated at $28.6 million based on 2005-06 estimated collections.

Cable Service

Effective January 1, 2006, the general sales tax rate of 7% was applied to cable service, which had previously only been taxed at the local level. Taxpayers also receive an approximate 5% credit against this tax for local cable franchise taxes paid,[1] which is removed by the bill.

At this time, the two months of collections data available for this tax expenditure are not sufficient to estimate the credit's actual cost, so this memo assumes an estimated $65 million for the cost of the cable tax credit.[2] However, survey research conducted by the Fiscal Research Division suggests that the actual amount of cable franchise fees and per subscriber charges collected by North Carolina local governments is approximately $62 million, which suggests that local governments may gain up to $3.3 million in new money from this legislation.

The local share of cable sales tax collections under the distribution established by this bill is estimated at $20.7 million based on 2005-06 estimated collections.

Satellite

The tax on home satellite television service was increased from 5.0% to 7.0% effective Oct. 1, 2005. Currently, all collections of this tax go to the General Fund. Under this legislation, 37% (or 2.5% of the 7.0% general sales tax rate) of satellite tax collections would be shared with local governments.

Based on early Department of Revenue data, satellite tax collections are exhibiting a rapid rate of growth, especially in relation to collections from cable service. This estimate for satellite uses a conservative annual growth rate of 8%.

Fiscal Research estimates that sales tax collections for satellite will be approximately $43.2 million for FY 2005-06. The 37% local share would be $16.0 million based on 2005-06 estimated collections.

Proposed Local Share of Sales Tax Collections by Industry

The chart below illustrates the local share of sales tax collections by industry. **This local share calculation is intended to hold local governments whole with the elimination of local franchise fees and to supply local governments with funds for PEG channel support.** The $65.3 million local share calculated through this distribution equals the estimated 2005 cable franchise fee revenues that would be foregone under this legislation.

[1] Federal law caps local franchise taxes at 5% of gross revenues, suggesting 2% of the 7% state sales tax goes to the state. Fiscal Research Division survey research suggests that not all North Carolina local governments with cable franchises assess franchise fees at the maximum 5% rate, and that the actual value of the tax credit may be somewhat less than 5% of cable's total sales tax liability.

[2] The cost of the cable tax credit was estimated at $65 million in the 2005 Tax Expenditure Report published by the North Carolina Department of Revenue

Proposed Local Share of Sales Tax Collections by Industry	
2005-06 Adjusted	
Industry	Local share
Telecommunications***	28,607,502
Cable	20,654,235
Subtotal	*49,261,737*
Satellite	15,991,400
Total	**65,253,137**

Distribution of Sales Tax to Local Governments

Under this bill, the combined 7.23% of sales tax collections on telecommunications, 22.61% of state sales tax collections on cable service and 37% of sales tax collections on home satellite television service would be distributed to North Carolina local governments on a proportional basis. The proportionate share for each local government is calculated by dividing its actual 2005 revenues from cable services, including actual franchise fee collections and any per subscriber charges for PEG support, by the total of all 2005 local government cable revenues. In subsequent years, the proportionate share for each municipality will be recalculated to reflect per capita growth. The distribution would be effective January 1, 2006.

Based on available data, Fiscal Research believes that under this distribution scheme no municipality will receive less revenue than they would without this legislation, and some may actually realize small gains.

PEG Support

The bill allows local governments that operate PEG channels providing local programming to collect $16,000 per channel, up to 3 channels, per year in the form of four quarterly installments of $4,000. **These funds are to be deducted from the total local share of sales tax collections before the local distribution formula is applied.** The bill caps the amount of annual PEG support to local governments at $2 million. Reliable data on the number of qualifying PEG channels in North Carolina is not available, but based on discussions with public programming interests, this memo assumes there are 33 PEG channels currently operating in North Carolina that would qualify for this funding. In total, the impact of this provision is estimated at $576,000 annually.

Franchise Administration and Consumer Issues

The North Carolina Utilities Commission is named as the agency responsible for administering cable franchises and addressing consumer issues. At this time, the Utilities Commission has not indicated a need for additional staff or appropriations to meet these demands.

Conclusion

The chart below contrasts current law with the proposed tax changes in this bill and illustrates how the total shared sales tax revenue to both the state and local governments is held the same.

Comparison of State and Local Share under Current and Proposed Law						
	(in millions)					
	Current law		Proposed		Change	
	State	Local	State	Local	State	Local
Telecommunications	334.8	60.9	306.2	89.5	(28.6)	28.6
Cable service	26.1	65.3	70.7	20.7	44.6	(44.6)
Satellite	43.2	-	27.2	16.0	(16.0)	16.0
Total	**404.1**	**126.2**	**404.1**	**126.2**	-	-

SOURCES OF DATA: North Carolina Department of Revenue, North Carolina Fiscal Research Division, North Carolina State Data Center, Federal Communications Commission, U.S. Census Bureau, North Carolina Utilities Commission

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #2

AMEND TAXATION OF LOGGING MACHINERY

LEGISLATIVE PROPOSAL #2

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO TREAT COMMERCIAL LOGGING MACHINERY THE SAME AS FARM MACHINERY UNDER THE SALES TAX.

SHORT TITLE: Amend Taxation of Logging Machinery

SPONSORS: **Wilkins, McComas, Wainwright**; Carney, Church, Hill, Luebke

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BRIEF OVERVIEW: This bill would exempt from the 1% privilege tax, with an $80 maximum tax per article, commercial logging machinery, attachments, repair parts for commercial logging machinery, lubricants applied to commercial logging machinery, and fuel to operate commercial logging machinery for use in commercial logging operations.

FISCAL IMPACT: This bill would result in an annual loss to the General Fund of approximately $2.19 million.

EFFECTIVE DATE: This act would become effective July 1, 2006 and applies to items purchased on or after that date.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-SVz-16A [v.5] (03/01)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/18/2006 3:51:59 PM

Short Title: Amend Taxation of Logging Machinery. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO TREAT COMMERCIAL LOGGING MACHINERY THE SAME AS FARM MACHINERY UNDER THE SALES TAX.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-164.13 is amended by adding a new subdivision to read:

"..

(4f) Sales of the following to a person who is engaged in the commercial logging business:

a. Logging machinery. Logging machinery is machinery used to harvest raw forest products for transport to first market.

b. Attachments and repair parts for logging machinery.

c. Lubricants applied to logging machinery.

d. Fuel used to operate logging machinery.

..."

SECTION 2. Article 5F of Chapter 105 of the General Statutes is amended by adding a new section to read:

"**§ 105-187.53. Commercial logging items.**

This Article does not apply to an item that is exempt from sales and use tax under G.S. 105-164.13(4f)."

SECTION 3. This act does not affect the rights or liabilities of the State, a taxpayer, or another person arising under a statute amended by this act before the effective date of this act, nor does it affect the right to any refund of a tax that accrued under the amended statute before the effective date of its amendment.

SECTION 4. This act becomes effective July 1, 2006 and applies to items purchased on or after that date.

LEGISLATIVE PROPOSAL 2005-SVz-16A: Amend Taxation of Logging Machinery

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	April 19, 2006
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft 2005-SVz-16A		Committee Counsel

SUMMARY: ***This legislative proposal would exempt from the 1% privilege tax, with an $80 maximum tax per article, commercial logging machinery, attachments, repair parts for commercial logging machinery, lubricants applied to commercial logging machinery, and fuel to operate commercial logging machinery for use in commercial logging operations, effective for purchases made on or after July 1, 2006.***

BACKGROUND & CURRENT LAW: For years, State tax law has provided that the sales and use tax rate on mill machinery is 1%, with an $80 maximum tax per article. There has never been a specific reference in the sales tax statutes to machinery used in the forestry and logging business. However, based on a long-standing interpretation by the Department of Revenue, logging firms that had contracts with wood product manufacturers to cut timber were deemed to be entitled to the 1% rate, $80 cap based on the preferential rate afforded to manufacturing industries and plants.

For several years, North Carolina has worked toward simplifying its sales and use tax statutes in an effort to conform to the Streamlined Sales and Use Tax Agreement. One of the conforming changes the State had to make was to simplify its sales tax rates. Under the Streamlined Sales and Use Tax Agreement, a state must have one rate, with no caps or thresholds, by January 2006. North Carolina had several different rates, including this 1% rate with an $80 cap. In 2001, at the request of North Carolina Citizens for Business and Industry, the General Assembly maintained the preferential tax rate on mill machinery by removing it from the sales tax statutes. By changing the nature of the tax from a sales tax to a privilege tax, the industry kept its preferential rate and the State conformed to the Streamlined Sales and Use Tax Agreement. The change in the law, made in 2001, became effective January 1, 2006.

Thus, as of January 1, 2006, purchases of mill machinery, which includes commercial logging equipment, and mill machinery parts or accessories and manufacturing fuel, are exempt from sales and use tax, but are subject to the new privilege tax. The privilege tax is imposed on the purchaser of qualifying property, and the purchaser is liable for accruing and remitting the tax to the Department of Revenue. Examples of qualifying commercial logging equipment include log skidders, log carts, tree shears, feller bunchers, winches, chain saws, tractors, axes, and mallets when the items are used to cut and transport timber to a wood products manufacturer.

BILL ANALYSIS: This legislative proposal would treat commercial logging machinery and related items the same as farm machinery under the current sales tax laws. First, the bill exempts commercial logging items from the 1%/$80 maximum privilege tax, to which they are currently subject. The bill also creates a new exemption in the sales and use tax statutes for commercial logging machinery, attachments and repair parts, lubricants, and fuel used to operate commercial logging machinery. The language of the exemption tracks the current exemption for farm machinery.

EFFECTIVE DATE: The exemption would become effective for qualifying purchases made on or after July 1, 2006.

2005-SVz-16A-SMSV

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

FISCAL ANALYSIS MEMORANDUM

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DATE: April 19, 2006

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: 2005-SVz-16 v.3 - Exempt Forestry Mill Machinery from Priv. Tax

FISCAL IMPACT

	Yes (x)	No ( )	No Estimate Available ( )		
	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
REVENUES:	(2.19)	(2.19)	(2.19)	(2.19)	(2.19)
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE: July 1, 2006

BILL SUMMARY: Historically mill machinery, including commercial logging equipment, has been subject to state sales tax at the rate of 1.0%, with an $80 cap per item. Because such special sales tax rates do not conform to the Streamlined Sales Tax Agreement, to which North Carolina is a party, in 2001 the General Assembly chose to move this remove this special treatment from the sales tax statutes, and instead created a special privilege tax of the same amount. This change effectively exempted these purchases of mill machinery from sales tax, but made the purchaser liable for remitting a similar amount of tax under the privilege tax statutes, directly to the Department of Revenue. This change became

effective January 1, 2006. The legislation exempts commercial logging equipment from this new privilege tax, treating it the same as agricultural equipment.

ASSUMPTIONS AND METHODOLOGY: No data specific to loggers or logging operations is available from the North Carolina Department of Revenue. Thus an alternative means of estimating is required.

The North Carolina Forestry Association provides specialized continuing education for logging professionals entitled Pro-Logger. To be a Pro-Logger an individual must participate in 24 hours of baseline training, and attend an additional two classes a year to maintain certification. Such certification is often required to deliver wood to certain wood processing facilities. The Forestry Association reports that approximately 1,600 individuals are currently qualified as North Carolina Pro-Loggers. The Association estimates that one-half of those individuals, or 800 individuals, actually representing logging operations. Using this number as a proxy suggests that there are approximately 800 logging operations in North Carolina.

A February 2006 issue of Texas Logger magazine suggests the following taxable operating costs for a biomass logging facility:

Operating Costs:	
Repair/Maintenance (100% of depreciation):	113, 250
Diesel Fuel (Off highway)	141,039
Large Parts (Tires, etc.)	16,200
Total	270,489

Using this number as a proxy for the operating costs associated with a North Carolina logging facility suggests that exempting these purchases from tax would result in a revenue loss of approximately $2.16 million annually ($270,489 x 800 loggers x 1.0% tax).

The same Texas Logger magazine article suggests that a logging operation requires approximately $755,000 in capital investment. This amount represents purchase of six (6) items: a feller buncher, grapple skidder, whole tree chipper, bulldozer and two service trucks. According to "The Used Connection" web site, the used prices for all these items exceed $8,000. As such, all six items would be taxed at the maximum amount of $80.00 per item, for a total tax on equipment of $480.00. Assuming this equipment is replaced every 15 years suggests that 53 loggers will replace their equipment each year. Thus the annual revenue loss associated with these purchases is $25,440 ($480 x 53 loggers).

The total annual loss associated with this legislation is reflected in the fiscal impact box.

SOURCES OF DATA: North Carolina Forestry Association, Texas Logger magazine.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #3

SSTA SALES TAX DEFN/SALES TAX PAYMENTS

LEGISLATIVE PROPOSAL #3

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO INCORPORATE THE STREAMLINED SALES TAX DEFINITIONS CONCERNING TELECOMMUNICATIONS AND TO SIMPLIFY THE TAX PAYMENT REQUIREMENTS FOR SEMIMONTHLY TAXPAYERS.

SHORT TITLE: SSTA Sales Tax Defn/Sales Tax Payments

SPONSORS: **Kerr**; Clodfelter, Dalton, Hartsell, Hoyle
Hill; Carney, Church, Luebke, McComas, Wainwright, Wilkins

BRIEF OVERVIEW: The bill modifies the definitions used in the sales and use tax law that apply to telecommunications to conform to the definitions adopted in the Streamlined Sales Tax Agreement. It also replaces the semimonthly payment sales tax schedule with a single monthly payment and a prepayment of the next month's liability due on the same day as the monthly payment.

FISCAL IMPACT: Negligible fiscal impact.

EFFECTIVE DATE: The definitional changes become effective January 1, 2007. The sales tax payment changes become effective October 1, 2007.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

U D

BILL DRAFT 2005-RBxz-33 [v.7] (02/27)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/19/2006 9:36:11 AM

Short Title: SSTA Sales Tax Defn/Sales Tax Payments. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO INCORPORATE THE STREAMLINED SALES TAX DEFINITIONS CONCERNING TELECOMMUNICATIONS AND TO SIMPLIFY THE TAX PAYMENT REQUIREMENTS FOR SEMIMONTHLY TAXPAYERS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-164.3 is amended by amending or adding the following definitions to read:

"**§ 105-164.3. Definitions.**

The following definitions apply in this Article:

(01) Ancillary service. – A service associated with or incidental to the provision of a telecommunications service. The term includes detailed communications billing, directory assistance, vertical service, and voice mail service. A vertical service is a service, such as call forwarding, caller ID, three-way calling, and conference bridging, that allows a customer to identify a caller or manage multiple calls and call connections.

...

(27) Prepaid telephone calling service. – Prepaid wireline calling service or prepaid wireless calling service.

(27a) Prepaid Wireline Calling Service. – A right that meets all of the following requirements:

a. Authorizes the exclusive purchase of wireline telecommunications service.

b. Must be paid for in advance.

c. Enables the origination of calls by means of an access number, authorization code, or another similar means, regardless of

whether the access number or authorization code is manually or electronically dialed.

d. Is sold in units or dollars whose number or dollar value declines with use and is known on a continuous basis.

(27b) Prepaid Wireless Calling Service. – A right that meets all of the following requirements:

a. Authorizes the purchase of mobile telecommunications service, either exclusively or in conjunction with other services.

b. Must be paid for in advance.

c. Is sold in units or dollars whose number or dollar value declines with use and is known on a continuous basis.

...

(45a) Streamlined Agreement. – The Streamlined Sales and Use Tax Agreement ~~adopted November 12, 2002,~~ as amended on ~~November 19, 2003, November 16, 2004, and April 16, 2005.~~November, 2005.

...

(48) Telecommunications service. – The electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among ~~points, by or through any electronic, radio, satellite, optical, microwave, or other medium, regardless of the protocol used for the transmission, conveyance, or routing. The term includes mobile telecommunications service and vertical services. Vertical services are switch-based services offered in connection with a telecommunications service, such as call forwarding services, caller ID services, and three-way calling services.~~ points. The term includes any transmission, conveyance, or routing in which a computer processing application is used to act on the form, code, or protocol of the content for purposes of the transmission, conveyance, or routing, regardless of whether it is referred to as voice over Internet protocol or the Federal Communications Commission classifies it as enhanced or valued added. The term does not include the following:

a. Data processing and information services that allow data to be generated, acquired, stored, processed, or retrieved and delivered by an electronic transmission to a customer whose primary purpose for using the service is to obtain the processed data or information.

b. The sale, installation, maintenance, or repair of tangible personal property.

c. Directory advertising and other advertising.

d. Billing and collection services provided to a third party.

e. Internet access service.

f. Radio and television audio and video programming service, regardless of the medium of delivery, and the transmission, conveyance, or routing of the service by the programming service

provider. The term includes cable service and audio and video programming service provided by a mobile telecommunications service provider.

g. Ancillary service.

h. A digital product delivered electronically, including software, music, a ring tone, video, and reading material."

SECTION 2. G.S. 105-164.4(a)(4c) and (4d) read as rewritten:

"**§ 105-164.4. Tax imposed on retailers.**

(a) **(Effective for sales made before July 1, 2007)** A privilege tax is imposed on a retailer at the following percentage rates of the retailer's net taxable sales or gross receipts, as appropriate. The general rate of tax is four and one-half percent (4 1/2%).

(4c) The combined general rate applies to the gross receipts derived from providing telecommunications service and ancillary service. A person who provides telecommunications service or ancillary service is considered a retailer under this Article. ~~Telecommunications service is~~ These services are taxed in accordance with G.S. 105-164.4C.

(4d) The sale or recharge of prepaid telephone calling service is taxable at the general rate of tax. The tax applies regardless of whether tangible personal property, such as a card or a telephone, is transferred. The tax applies to a service that is sold in conjunction with prepaid wireless calling service. Prepaid telephone calling service is taxable at the point of sale instead of at the point of use and is sourced in accordance with G.S. 105-164.4B. Prepaid telephone calling service taxed under this subdivision is not subject to tax as a telecommunications service."

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

"**§ 105-164.4B. Sourcing principles.**

(a) General Principles. – The following principles apply in determining where to source the sale of a product. These principles apply regardless of the nature of the product.

(1) Over-the-counter. – When a purchaser receives a product at a business location of the seller, the sale is sourced to that business location.

(2) Delivery to specified address. – When a purchaser receives a product at a location specified by the purchaser and the location is not a business location of the seller, the sale is sourced to the location where the purchaser receives the product.

(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~~ wireless calling ~~service that authorizes the purchase of mobile telecommunications~~ service, the location associated with the mobile telephone number.

c. The address from which tangible personal property was shipped or from which a service was provided."

SECTION 4. G.S. 105-164.4C reads as rewritten:

"**§ 105-164.4C. ~~Tax on telecommunications.~~Telecommunications service and ancillary service.**

(a) General. – The gross receipts derived from providing telecommunications service or ancillary service in this State are taxed at the rate set in G.S. 105-164.4(a)(4c). Telecommunications service is provided in this State if the service is sourced to this State under the sourcing principles set out in subsections (a1) and (a2) of this section. Ancillary service is provided in this State if the telecommunications service to which it is ancillary is provided in this State. The definitions and provisions of the federal Mobile Telecommunications Sourcing Act apply to the sourcing and taxation of mobile telecommunications services.

(a1) General Sourcing Principles. – The following general sourcing principles apply to telecommunications services. If a service falls within one of the exceptions set out in subsection (a2) of this section, the service is sourced in accordance with the exception instead of the general principle.

(1) Flat rate. – A telecommunications service that is not sold on a call-by-call basis is sourced to this State if the place of primary use is in this State.

(2) General call-by-call. – A telecommunications service that is sold on a call-by-call basis and is not a postpaid calling service is sourced to this State in the following circumstances:

a. The call both originates and terminates in this State.

b. The call either originates or terminates in this State and the telecommunications equipment from which the call originates or terminates and to which the call is charged is located in this State. This applies regardless of where the call is billed or paid.

(3) Postpaid. – A postpaid calling service is sourced to the origination point of the telecommunications signal as first identified by either the seller's telecommunications system or, if the system used to transport the signal is not the seller's system, by information the seller receives from its service provider.

(a2) Sourcing Exceptions. – The following telecommunications services and products are sourced in accordance with the principles set out in this subsection:

(1) Mobile. – Mobile telecommunications service is sourced to the place of primary use, unless the service is ~~authorized by a~~ prepaid ~~telephone~~ wireless calling service or is air-to-ground radiotelephone service. Air-to-ground radiotelephone service is a postpaid calling service that is offered by an aircraft common carrier to passengers on its aircraft and enables a telephone call to be made from the aircraft. The sourcing principle in this subdivision applies to a service provided as an adjunct to mobile telecommunications service if the charge for the service is

included within the term "charges for mobile telecommunications services" under the federal Mobile Telecommunications Sourcing Act.

(2) Prepaid. – Prepaid telephone calling service is sourced in accordance with G.S. 105-164.4B.

(3) Private. – Private telecommunications service is sourced in accordance with subsection (e) of this section.

~~(b) Included in Gross Receipts. – Gross receipts derived from telecommunications service include the following:~~

~~(1) Receipts from flat-rate service, service provided on a call-by-call basis, mobile telecommunications service, and private telecommunications service.~~

~~(2) Charges for directory assistance, directory listing that is not yellow-page classified listing, call forwarding, call waiting, three-way calling, caller ID, voice mail, and other similar services.~~

~~(3) Customer access line charges billed to subscribers for access to the intrastate or interstate interexchange network.~~

~~(4) Charges billed to a pay telephone provider who uses the telecommunications service to provide pay telephone service.~~

~~(c) Excluded From Gross Receipts. – Gross receipts derived from telecommunications service do not include any of the following:~~

~~(1) Charges for telecommunications services that are a component part of or are integrated into a telecommunications service that is resold. Examples of services that are resold include carrier charges for access to an intrastate or interstate interexchange network, interconnection charges paid by a provider of mobile telecommunications service, and charges for the sale of unbundled network elements. An unbundled network element is a network element, as defined in 47 U.S.C. § 153(29), to which access is provided on an unbundled basis pursuant to 47 U.S.C. § 251(c)(3).~~

~~(2) Telecommunications services that are resold as part of a prepaid telephone calling service.~~

~~(3) 911 charges imposed under G.S. 62A-4 or G.S. 62A-23 and remitted to the Emergency Telephone System Fund under G.S. 62A-7 or the Wireless Fund under G.S. 62A-24.~~

~~(4) Allowable surcharges imposed to recoup assessments for the Universal Service Fund.~~

~~(5) Receipts of a pay telephone provider from the sale of pay telephone service.~~

~~(6) Charges for commercial, cable, mobile, broadcast, or satellite video or audio service unless the service provides two-way communication, other than the customer's interactive communication in connection with the customer's selection or use of the video or audio service.~~

~~(7) Paging service, unless the service provides two-way communication.~~

~~(8) Charges for telephone service made by a hotel, motel, or another entity whose gross receipts are taxable under G.S. 105-164.4(a)(3) when the charges are incidental to the occupancy of the entity's accommodations.~~

~~(9) Receipts from the sale, installation, maintenance, or repair of tangible personal property.~~

~~(10) Directory advertising and yellow page classified listings.~~

(11) Repealed by Session Laws 2005-276, s. 33.7, effective October 1, 2005.

~~(12) Information services. An information service is a service that can generate, acquire, store, transform, process, retrieve, use, or make available information through a communications service. Examples of an information service include an electronic publishing service and a web hosting service.~~

~~(13) Internet access service, electronic mail service, electronic bulletin board service, or similar on-line services.~~

~~(14) Billing and collection services.~~

~~(15) Charges for bad checks or late payments.~~

~~(16) Charges to a State agency or to a local unit of government for the North Carolina Information Highway and other data networks owned or leased by the State or unit of local government.~~

(d) Bundled Services. – When a taxable telecommunications service is bundled with a service that is not taxable, the tax applies to the gross receipts from the taxable service in the bundle as follows:

(1) If the service provider offers all the services in the bundle on an unbundled basis, tax is due on the unbundled price of the taxable service, less the discount resulting from the bundling. The discount for a service as the result of bundling is the proportionate price decrease of the service, determined on the basis of the total unbundled price of all the services in the bundle compared to the bundled price of the services.

(2) If the service provider does not offer one or more of the services in the bundle on an unbundled basis, tax is due on the taxable service based on a reasonable allocation of revenue to that service. If the service provider maintains an account for revenue from a taxable service, the service provider's allocation of revenue to that service for the purpose of determining the tax due on the service must reflect its accounting allocation of revenue to that service.

(e) Private Line. – The gross receipts derived from private telecommunications service are sourced as follows:

(1) If all the customer's channel termination points are located in this State, the service is sourced to this State.

(2) If all the customer's channel termination points are not located in this State and the service is billed on the basis of channel termination

points, the charge for each channel termination point located in this State is sourced to this State.

(3) If all the customer's channel termination points are not located in this State and the service is billed on the basis of channel mileage, the following applies:

a. A charge for a channel segment between two channel termination points located in this State is sourced to this State.

b. Fifty percent (50%) of a charge for a channel segment between a channel termination point located in this State and a channel termination point located in another state is sourced to this State.

(4) If all the customer's channel termination points are not located in this State and the service is not billed on the basis of channel termination points or channel mileage, a percentage of the charge for the service is sourced to this State. The percentage is determined by dividing the number of channel termination points in this State by the total number of channel termination points.

(f) Call Center Cap. The gross receipts tax on telecommunications service that originates outside this State, terminates in this State, and is provided to a call center that has a direct pay permit issued by the Department under G.S. 105-164.27A may not exceed fifty thousand dollars ($50,000) a calendar year. This cap applies separately to each legal entity.

(g) Credit. – A taxpayer who pays a tax legally imposed by another state on a telecommunications service taxable under this section is allowed a credit against the tax imposed in this section.

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

(01) Ancillary service. – Defined in G.S. 105-164.3.

(1) Call-by-call basis. – A method of charging for a telecommunications service whereby the price of the service is measured by individual calls.

(2) Call center. – Defined in G.S. 105-164.27A.

(3) Mobile telecommunications service. – Defined in G.S. 105-164.3.

(4) Place of primary use. – Defined in G.S. 105-164.3.

(5) Postpaid calling service. – A telecommunications service that is charged on a call-by-call basis and is obtained by making payment at the time of the call either through the use of a credit or payment mechanism, such as a bank card, travel card, credit card, or debit card, or by charging the call to a telephone number that is not associated with the origination or termination of the telecommunications service. A postpaid calling service includes a service that meets all the requirements of a prepaid wireline telephone calling service, except the exclusive use requirement.

(6) Prepaid telephone calling service. – Defined in G.S. 105-164.3.

(7) Private telecommunications service. – Telecommunications service that entitles a subscriber of the service to exclusive or priority use of a communications channel or group of channels.

(8) Telecommunications service. – Defined in G.S. 105-164.3."

SECTION 5. G.S. 105-164.13 is amended by adding the following subdivision to read:

"(54) The following telecommunications services and charges:

a. Telecommunications service that is a component part of or is integrated into a telecommunications service that is resold. This exemption does not apply to service purchased by a pay telephone provider who uses the service to provide pay telephone service. Examples of services that are resold include carrier charges for access to an intrastate or interstate interexchange network, interconnection charges paid by a provider of mobile telecommunications service, and charges for the sale of unbundled network elements. An unbundled network element is a network element, as defined in 47 U.S.C. § 153(29), to which access is provided on an unbundled basis pursuant to 47 U.S.C. § 251(c)(3).

b. Pay telephone service.

c. 911 charges imposed under G.S. 62A-4 or G.S. 62A-23 and remitted to the Emergency Telephone System Fund under G.S. 62A-7 or the Wireless Fund under G.S. 62A-24.

d. Charges for telecommunications service made by a hotel, motel, or another entity whose gross receipts are taxable under G.S. 105-164.4(a)(3) when the charges are incidental to the occupancy of the entity's accommodations.

e. Telecommunications service purchased by a State agency or a unit of local government for the North Carolina Information Highway or another data network owned or leased by the State or unit of local government."

SECTION 6. G.S. 105-164.14(b) and (c) read as rewritten:

"(b) Nonprofit Entities and Hospital Drugs. – A nonprofit entity included in the following list is allowed a semiannual refund of sales and use taxes paid by it under this Article on direct purchases of tangible personal property and services, other than ~~electricity and telecommunications~~ electricity, telecommunications service, and ancillary service, for use in carrying on the work of the nonprofit entity:

(1) Hospitals not operated for profit, including hospitals and medical accommodations operated by an authority created under the Hospital Authorities Law, Article 2 of Chapter 131E of the General Statutes.

(2) Educational institutions not operated for profit.

(3) Churches, orphanages, and other charitable or religious institutions and organizations not operated for profit.

(4) Qualified retirement facilities whose property is excluded from property tax under G.S. 105-278.6A.

Sales and use tax liability indirectly incurred by a nonprofit entity on building materials, supplies, fixtures, and equipment that become a part of or annexed to any building or structure that is owned or leased by the nonprofit entity and is being erected, altered, or repaired for use by the nonprofit entity for carrying on its nonprofit activities is considered a sales or use tax liability incurred on direct purchases by the nonprofit entity.

A hospital that is not allowed a refund under this subsection of sales and use taxes paid on its direct purchases of tangible personal property is allowed a semiannual refund of sales and use taxes paid by it on medicines and drugs purchased for use in carrying out its work.

The refunds allowed under this subsection for certain nonprofit entities and for medicines and drugs purchased by hospitals do not apply to organizations, corporations, and institutions that are owned and controlled by the United States, the State, or a unit of local government, except hospital facilities created under Article 2 of Chapter 131E of the General Statutes and nonprofit hospitals owned and controlled by a unit of local government that elect to receive semiannual refunds under this subsection instead of annual refunds under subsection (c).

A request for a refund must be in writing and must include any information and documentation required by the Secretary. A request for a refund for the first six months of a calendar year is due the following October 15; a request for a refund for the second six months of a calendar year is due the following April 15.

(c) Certain Governmental Entities. – A governmental entity listed in this subsection is allowed an annual refund of sales and use taxes paid by it under this Article on direct purchases of tangible personal property and services, other than ~~electricity and telecommunications~~ electricity, telecommunications service, and ancillary service. Sales and use tax liability indirectly incurred by a governmental entity on building materials, supplies, fixtures, and equipment that become a part of or annexed to any building or structure that is owned or leased by the governmental entity and is being erected, altered, or repaired for use by the governmental entity is considered a sales or use tax liability incurred on direct purchases by the governmental entity for the purpose of this subsection. A request for a refund must be in writing and must include any information and documentation required by the Secretary. A request for a refund is due within six months after the end of the governmental entity's fiscal year. The Secretary shall make an annual report to the Department of Public Instruction and the Fiscal Research Division of the General Assembly by March 1 of the amount of refunds, identified by taxpayer, claimed under subdivisions (2b) and (2c) of this subsection over the preceding year.

This subsection applies only to the following governmental entities:

(1) A county.

(2) A city as defined in G.S. 160A-1.

(2a) A consolidated city-county as defined in G.S. 160B-2.

(2b), (2c) Repealed by Session Laws 2005-276, s. 7.51(a), effective July 1, 2005, and applicable to sales made on or after that date.

(3) A metropolitan sewerage district or a metropolitan water district in this State.
(4) A water and sewer authority created under Chapter 162A of the General Statutes.
(5) A lake authority created by a board of county commissioners pursuant to an act of the General Assembly.
(6) A sanitary district.
(7) A regional solid waste management authority created pursuant to G.S. 153A-421.
(8) An area mental health, developmental disabilities, and substance abuse authority, other than a single-county area authority, established pursuant to Article 4 of Chapter 122C of the General Statutes.
(9) A district health department, or a public health authority created pursuant to Part 1A of Article 2 of Chapter 130A of the General Statutes.
(10) A regional council of governments created pursuant to G.S. 160A-470.
(11) A regional planning and economic development commission or a regional economic development commission created pursuant to Chapter 158 of the General Statutes.
(12) A regional planning commission created pursuant to G.S. 153A-391.
(13) A regional sports authority created pursuant to G.S. 160A-479.
(14) A public transportation authority created pursuant to Article 25 of Chapter 160A of the General Statutes.
(14a) A facility authority created pursuant to Part 4 of Article 20 of Chapter 160A of the General Statutes.
(15) A regional public transportation authority created pursuant to Article 26 of Chapter 160A of the General Statutes, or a regional transportation authority created pursuant to Article 27 of Chapter 160A of the General Statutes.
(16) A local airport authority that was created pursuant to a local act of the General Assembly.
(17) A joint agency created by interlocal agreement pursuant to G.S. 160A-462 to operate a public broadcasting television station.
(18) Repealed by Session Laws 2001-474, s. 7, effective November 29, 2001.
(19) Repealed by Session Laws 2001-474, s. 7, effective November 29, 2001.
(20) A constituent institution of The University of North Carolina, but only with respect to sales and use tax paid by it for tangible personal property or services that are eligible for refund under this subsection acquired by it through the expenditure of contract and grant funds.
(21) The University of North Carolina Health Care System.
(22) A regional natural gas district created pursuant to Article 28 of Chapter 160A of the General Statutes."

SECTION 7. G.S. 105-164.27A(b) reads as rewritten:

"(b) Telecommunications Service. – A direct pay permit for telecommunications service authorizes its holder to purchase telecommunications service and ancillary service without paying tax to the seller and authorizes the seller to not collect any tax on a sale to the permit holder. A person who purchases ~~telecommunications service~~ these services under a direct pay permit must file a return and pay the tax due monthly to the Secretary. A direct pay permit issued under this subsection does not apply to any tax other than the tax on telecommunications service and ancillary service.

A call center that purchases telecommunications service that originates outside this State and terminates in this State may apply to the Secretary for a direct pay permit for telecommunications service and ancillary service. A call center is a business that is primarily engaged in providing support services to customers by telephone to support products or services of the business. A business is primarily engaged in providing support services by telephone if at least sixty percent (60%) of its calls are incoming."

SECTION 8. G.S. 105-164.44F(a) reads as rewritten:

"(a) Amount. – The Secretary must distribute to the cities part of the taxes imposed by G.S. 105-164.4(a)(4c) on telecommunications service and ancillary service. The Secretary must make the distribution within 75 days after the end of each calendar quarter. The amount the Secretary must distribute is eighteen and three one-hundredths percent (18.03%) of the net proceeds of the taxes collected during the quarter, minus two million six hundred twenty thousand nine hundred forty-eight dollars ($2,620,948). This deduction is one-fourth of the annual amount by which the distribution to cities of the gross receipts franchise tax on telephone companies, imposed by former G.S. 105-120, was required to be reduced beginning in fiscal year 1995-96 as a result of the "freeze deduction." The Secretary must distribute the specified percentage of the proceeds, less the "freeze deduction" among the cities in accordance with this section."

SECTION 9. G.S. 105-164.16 reads as rewritten:

"**§ 105-164.16. Returns and payment of taxes.**

(a) General. – Sales and use taxes are payable ~~quarterly, monthly, or semimonthly as specified in this section.~~ when a return is due. A return is due quarterly or monthly as specified in this section. A return must be filed with the Secretary on a form prescribed by the Secretary and in the manner required by the Secretary. A return must be signed by the taxpayer or the taxpayer's agent.

A sales tax return must state the taxpayer's gross sales for the reporting period, the amount and type of sales made in the period that are exempt from tax under G.S. 105-164.13 or are elsewhere excluded from tax, the amount of tax due, and any other information required by the Secretary. A use tax return must state the purchase price of tangible personal property that was purchased or received during the reporting period and is subject to tax under G.S. 105-164.6, the amount of tax due, and any other information required by the Secretary. Returns that do not contain the required information will not be accepted. When an unacceptable return is submitted, the Secretary will require a corrected return to be filed.

(b) Quarterly. – A taxpayer who is consistently liable for less than one hundred dollars ($100.00) a month in State and local sales and use taxes must file a return and

pay the taxes due on a quarterly basis. A quarterly return covers a calendar quarter and is due by the last day of the month following the end of the quarter.

(b1) Monthly. – A taxpayer who is consistently liable for more than one hundred dollars ($100.00) ~~but less than ten thousand dollars ($10,000)~~ a month in State and local sales and use taxes must file a return and pay the taxes due on a monthly basis. A monthly return is due by the 20th day of the month following the calendar month covered by the return.

(b2) ~~Semimonthly.~~ Prepayment. ~~–~~ A taxpayer who is consistently liable for at least ten thousand dollars ($10,000) a month in State and local sales and use taxes must ~~pay the tax twice a month and must file a return on a monthly basis. One semimonthly payment covers the period from the first day of the month through the 15th day of the month. The other semimonthly payment covers the period from the 16th day of the month through the last day of the month. The semimonthly payment for the period that ends on the 15th day of the month is due by the 25th day of that month. The semimonthly payment for the period that ends on the last day of the month is due by the 10th day of the following month.~~

~~A return covers both semimonthly payment periods. The return is due by the 20th day of the month following the month of the payment periods covered by the return. A taxpayer is not subject to interest on or penalties for an underpayment for a semimonthly payment period if the taxpayer timely pays at least ninety-five percent (95%) of the lesser of the following and includes the underpayment with the monthly return for those semimonthly payment periods:~~

~~(1) The amount due for each semimonthly payment period.~~

~~(2) The average semimonthly payment for the prior calendar year.~~

make a monthly prepayment of the next month's tax liability. The prepayment is due on the date a monthly return is due. The prepayment must equal at least sixty-five percent (65%) of any of the following:

(1) The amount of tax due for the current month.

(2) The amount of tax due for the same month in the preceding year.

(3) The average monthly amount of tax due in the preceding calendar year.

(b3) Category. – The Secretary must monitor the amount of State and local sales and use taxes paid by a taxpayer or estimate the amount of taxes to be paid by a new taxpayer and must direct each taxpayer to pay tax and file returns ~~in accordance with the appropriate schedule.~~ as required by this section. In determining the amount of taxes due from a taxpayer, the Secretary must consider the total amount due from all places of business owned or operated by the same person as the amount due from that person. A taxpayer must file a return and pay tax in accordance with the Secretary's ~~direction until notified in writing to file and pay under a different schedule.~~direction.

(c) Repealed by Session Laws 2001-427, s. 6(a), effective January 1, 2002, and applicable to taxes levied on or after that date.

(d) **(Effective for taxable years ending before January 1, 2010)** Use Tax on Out-of-State Purchases. – Use tax payable by an individual who purchases tangible personal property outside the State for a nonbusiness purpose is due on an annual basis.

For an individual who is not required to file an individual income tax return under Part 2 of Article 4 of this Chapter, the annual reporting period ends on the last day of the calendar year and a use tax return is due by the following April 15. For an individual who is required to file an individual income tax return, the annual reporting period ends on the last day of the individual's income tax year, and the use tax must be paid on the income tax return as provided in G.S. 105-269.14.

(d) **(Effective for taxable years beginning on or after January 1, 2010)** Use Tax on Out-of-State Purchases. – Notwithstanding subsection (b), an individual who purchases tangible personal property outside the State for a nonbusiness purpose shall file a use tax return on an annual basis. The annual reporting period ends on the last day of the calendar year. The return is due by the due date, including any approved extensions, for filing the individual's income tax return.

SECTION 10. G.S. 105-113(b) reads as rewritten:

(b) Report and Payment. – The tax imposed by this section is payable ~~quarterly, semimonthly,~~ quarterly or monthly as specified in this subsection. A return is due quarterly.

A water company or public sewerage company must pay tax quarterly when filing a return. An electric power company must pay tax in accordance with the schedule ~~that applies to its~~ and requirements that apply to payments of sales and use tax under G.S. 105-164.16 and must file a return quarterly. ~~An electric power company is not subject to interest on or penalties for an underpayment for a semimonthly or monthly payment period if the electric power company timely pays at least ninety-five percent (95%) of the amount due for each semimonthly or monthly payment period and includes the underpayment with the quarterly return for those semimonthly or monthly payment periods.~~

A quarterly return covers a calendar quarter and is due by the last day of the month that follows the quarter covered by the return. A taxpayer must submit a return on a form provided by the Secretary. The return must include the taxpayer's gross receipts from all property it owned or operated during the reporting period in connection with its business taxed under this section. A taxpayer must report its gross receipts on an accrual basis. A return must contain the following information:

(1) The taxpayer's gross receipts for the reporting period from business inside and outside this State, stated separately.

(2) The taxpayer's gross receipts from commodities or services described in subsection (a) that are sold to a vendee subject to the tax levied by this section or to a joint agency established under Chapter 159B of the General Statutes or a city having an ownership share in a project established under that Chapter.

(3) The amount of and price paid by the taxpayer for commodities or services described in subsection (a) that are purchased from others engaged in business in this State and the name of each vendor.

(4) For an electric power company the entity's gross receipts from the sale within each city of the commodities and services described in subsection (a).

SECTION 11. G.S. 105-187.43 reads as rewritten:

§ 105-187.43. Payment of the tax.

(a) Payment. – The tax imposed by this Article is payable ~~semimonthly in accordance with the schedule set in~~ G.S. ~~105-164.16 for semimonthly payments of sales and use taxes.~~ monthly. A monthly payment is due by the 20th day of the month following the calendar month in which liability for the tax accrues. The tax imposed by this Article on piped natural gas delivered to a sales or transportation customer accrues when the gas is delivered. The tax payable on piped natural gas received by a person who has direct access to an interstate pipeline for consumption by that person accrues when the gas is received.

(b) ~~Small Underpayments. – A person is not subject to interest on or penalties for an underpayment of a semimonthly amount due if the person timely pays at least ninety-five percent (95%) of the amount due and includes the underpayment with the next return the person files.~~ Prepayment. –A taxpayer who is consistently liable for at least ten thousand dollars ($10,000) of tax a month must make a monthly prepayment of the next month's tax liability. This requirement applies when the taxpayer meets the threshold and the Secretary notifies the taxpayer to make prepayments. A prepayment is due on the date a monthly payment is due. The prepayment must equal at least sixty-five percent (65%) of any of the following:

(1) The amount of tax due for the current month.

(2) The amount of tax due for the same month in the preceding year.

(3) The average monthly amount of tax due in the preceding calendar year.

(c) Return. – A return is due quarterly. A quarterly return covers a calendar quarter and is due by the last day of the month that follows the quarter covered by the return.

SECTION 12. Sections 9 through 11 of this act become effective October 1, 2007. The remainder of this act becomes effective January 1, 2007.

BILL DRAFT 2005-RBxz-33: SSTA Sales Tax Definitions/Sales Tax Payments

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	May 2, 2006
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Draft		Committee Counsel

SUMMARY: Draft Proposal 2005-RBxz-33 does two things:

- *It modifies the definitions used in the sales and use tax law that apply to telecommunications to conform to the definitions adopted in the Streamlined Sales Tax Agreement. This part of the bill becomes effective January 1, 2007.*
- *It replaces the semimonthly payment sales tax schedule with a single monthly payment and a prepayment of the next month's liability due on the same day as the monthly payment. This part of the bill would become effective October 1, 2007.*

DEFINITIONAL CHANGES: Sections 1 through 8 of the bill modify the definitions used in the sales and use tax law that apply to telecommunications services. The changes are made to adopt the definitions in the Streamlined Sales Tax Agreements. These changes become effective January 1, 2007.

Section 1 makes the following changes in G.S. 105-164.3, the definitional section of the sales and use tax laws:

- Adds a definition of the term "ancillary service" in new (01) because the Streamlined definitions separate ancillary services from telecommunications services. Current North Carolina law considers ancillary services to be part of telecommunications services. All of the ancillary services are currently taxed and will continue to be taxed.
- Modifies the definition of "prepaid telephone calling service" in (27) to include the newly defined terms for "prepaid wireless calling service" and prepaid wireline calling service." Current law does not distinguish between prepaid wireline and prepaid wireless. The definition of prepaid wireless was added to recognize that prepaid wireless includes whatever services can be obtained with the same card used to obtain wireless telecommunications service. Prepaid cards are taxed at the point of sale rather than as telecommunications when the minutes are used. Some services that are not within the definition of telecommunications service can be purchased with the card that authorizes prepaid wireless use. The current definition of prepaid telephone calling service has an exclusive use requirement that conflicts with the practice for prepaid wireless.
- Converts the current definition of prepaid telephone calling service into the definition of "prepaid wireline calling service" in new 27(a). This is a technical change for prepaid wireline with no change in meaning.
- Adds a definition for "prepaid wireless calling service" in new (27b). This does not have an exclusive use requirement, in contrast to prepaid wireline.

- Updates the definition for "Streamlined Agreement" in (45a) to include the latest (January 13, 2006) amendments.
- Conforms the definition of "telecommunications service" in (48) to the Streamlined definition and incorporates into the definition the appropriate inclusions and exclusions that are now in G.S. 105-164.4C(b) and (c). (See also the new exemptions in G.S. 105-164.13(54) in Section 5.) As changed, the definition is the same as current law with two exceptions. The first is Universal Service Fund surcharges. These surcharges are part of the sales price and will be subject to tax. The second is paging service. Universal Service Fund surcharges cannot be "carved out" and remain as is because there is no Streamlined "carve out" in sales price or telecommunications service for this. Paging service could be carved out because there is a Streamlined definition for this, but this draft does not include that carve out. The subparts of new (48) match up with current law as follows:

Subpart in (48)	Location in Current Law
a. (info service)	105-164.4C(c)(12) and (13)
b. (sale, etc. of tpp)	105-164.4C(c)(9)
c. (advertising)	105-164.4C(c)(10)
d. (billing)	105-164.4C(c)(14)
e. (Internet)	105-164.4C(c)(13)
f. (cable and radio)	105-164.4C(c)(6)
g. (ancillary)	105-164.4C(b)(2)
h. (digital)	No specific exclusion but not taxed now.

Section 2 changes the tax imposition statute to add the now-separate category of "ancillary service" and to include non-telecommunications services that are sold as part of a prepaid wireless calling service.

Section 3 makes a conforming change to the sourcing statute to apply the new definition of prepaid wireless call service.

Section 4 makes conforming changes to the separate statute on telecommunications to include ancillary service and to apply the new definition of prepaid wireless calling service. The items that were in subsections (b) and (c) are now either part of the definition of telecommunications or are exempt in Section 5.

Section 5 moves to the exemption statute the items that were formerly excluded from the definition of telecommunications and are not intended to be taxed. The items in new (54) were all in G.S. 105-164.4C(c).

Sections 6 through 8 add the now separate category of "ancillary service" in the exemption statute (G.S. 105-164.14), in the direct pay permit statute (G.S. 105-164.27A), and in the local distribution statute (G.S. 105-164.44F).

SIMPLIFY SEMI-MONTHLY SALES TAX PAYMENTS: Taxpayers that are liable for at least $10,000 a month in sales tax, electric utility tax, or piped gas excise tax must pay tax twice a month.

For these taxpayers, the month is split into two periods – the first day of the month through the 15th of the month, and the 16th of the month through the end of the month. The tax payment for the 1st through 15th period is due by the 25th of the same month and the tax payment for the 16th through the end of the month is due by the 10th day of the following month. Taxpayers therefore have 10 days after the end of a semimonthly period to make a payment.

In addition to the payments, these taxpayers also file a return. The sales tax return is due monthly by the 20th and the electric utility and piped gas returns are due quarterly by the end of the month after the close of the quarter.

Several large retailers in the Streamlined Sales Tax project asked North Carolina to look at its payment schedule to determine if it could require payments to be made only once a month. North Carolina is one of only a few states that require payments twice a month.

Sections 9 through 11 of the bill replace the semimonthly payment schedule with a single monthly payment and a prepayment of the next month's liability due on the same day as the monthly payment. The result is that taxpayers would have more time to gather data before filing a return and make payments on only one day of the month. Under the bill, the State receives the payment that would otherwise be due on the 25th in the form of a prepayment made on the 20th and it also receives some of the revenue it would have received on the 10th of the following month in the form of the prepayment made on the 20th. The State will experience a slight one-time increase in revenue in the first month that the prepayment schedule takes effect.

The prepayment must equal at least 65% of one of three thresholds:

- The current month's liability.
- The liability for the same month the preceding year.
- The average monthly liability for the past calendar year.

These thresholds are easily determined and eliminate the need for the taxpayer to calculate actual liability for periods of less than a month. The 65% threshold was chosen because it was suggested by the retailers who requested North Carolina to review its law and the prepayment date is about 2/3 of the time in a month. A similar method and threshold are already in place in Florida and Arkansas. Florida sets the prepayment threshold at 60% and Arkansas sets it at 80%.

The bill eliminates the provisions concerning penalty relief for small underpayments because the relief is no longer needed. The relief is provided under current law because the law requires taxpayers to calculate liability for short periods within 10 days after the end of the period. Under the bill, sales tax taxpayers have 20 days after the end of the month to file a return and electric utility and piped gas taxpayers have a full month after the end of a quarter to file a return.

This part of the bill becomes effective October 1, 2007.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

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 25, 2006

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: 2005-RBxz-33A v. 1 – SSTA Sales Tax Definitions/Sales Tax Payments

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:	**See Assumptions and Methodology**				
EXPENDITURES:	**See Assumptions and Methodology**				
POSITIONS (cumulative):					

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

EFFECTIVE DATE: Sections 9 through 11 (semi-monthly filers) becomes effective October 1, 2007. The remainder becomes effective January 1, 2007.

BILL SUMMARY: The legislation makes three changes related to the Streamlined Sales Tax Agreement (SSTA). First, it alters the definition of telecommunications services and adds a definition of "ancillary services" to the sales tax statutes. This change must be made by January 1, 2008 to continue to be in compliance with the Agreement. Second, the bill changes the sales tax payment schedule for semi-monthly filers. Under existing law the state's largest taxpayers, those who regularly owe at least $10,000 a month is sales taxes, must make sales tax payments twice a month. The first payment is due the 25th of the month and reflects sales made between the 1st and 15th of that month. The

second payment reflects sales made after the 16th day of the month, and is due the 10th day of the following month. The proposal replaces the twice a month payment with a single monthly payment. The new payment, due on the 20th, should reflect sales made in the previous month along with an estimated amount for the current month. The estimated amount is to be 65% of either 1) the current month's liability, 2) the liability for the same month in the previous year, or 3) the average monthly liability for the past calendar year. The taxpayer can choose their method of calculation. Finally, the legislation eliminates statutory provisions to deal with small underpayments; as such a provision is no longer necessary with the proposed pre-payment plan. While these last two changes are related to SSTA, they are not required for compliance with the Agreement.

ASSUMPTIONS AND METHODOLOGY:

Sections 1 and 2 make several changes to telecommunications related definitions. Definitions altered or added include ancillary service, prepaid wireless calling service, and telecommunications service. The first to of these changes are technical in nature and are not expected to have a fiscal impact. The third – telecommunications service – actually consolidates and clarifies some definitions already addressed by the General Assembly in previous sessions. This change is also not expected to have a significant fiscal impact. Section 1 also updates the reference date for the Agreement, which has no fiscal affect.

Section 3 addresses the sourcing of sales of prepaid wireless services. Because it only impacts local revenues, no state impact is expected. Moreover, because the change is not expected to actually alter the treatment of these sales, no local impact is expected.

Section 4 makes conforming definitional changes and is not expected to have a fiscal impact.

Section 5 moves to the exemption statute the items that were formerly excluded from the definition of telecommunications and are not intended to be taxed. The items in exemption section were all in the prior telecommunication section statutes. No fiscal impact is expected.

Sections 6 – 8 make conforming changes by inserting the newly defined term 'ancillary services', with the term 'telecommunications services'. All items covered under the new definitions are currently taxed under the existing definition of telecommunications services. While the new definitions create two separate categories – ancillary services and telecommunications services – they are both subject to the general sales tax. As a result, this change is only technical and has no revenue impact.

Sections 9 – 11 alter the sales tax payment schedules for the state's largest retailers. According to the North Carolina Department of Revenue, these retailers represent approximately 68% of total sales tax collections. Because the legislation does not affect the retailer's liability there is no recurring cost or gain associated with the bill. However, the shift from semi-monthly to monthly payments does create a potential one time revenue change. By shifting the payment date for part of the liability from the 25th to the 20th, the state gains five days of interest on the float, creating a small revenue gain. However, because retailers can select which method they will use to calculate their pre-payment, there is a potential for a short term revenue loss, as the state would lose interest on the under-payment. The Department of Revenue indicates that if average pre-payments fall below 60% of actual liabilities, the state could see a small fiscal loss. Given the uncertainty surrounding retailer responses, it is not possible to estimate the potential loss or gain. However, data from the Department indicate that whatever change is seen in either direction would likely be substantially less than $1.0 million.

There may also be some computer programming costs associated with the payment schedule change. However, at this point Fiscal Research cannot determine the exact cost associated with this computer change.

SOURCES OF DATA: North Carolina Department of Revenue.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #4

PROPERTY TAX CHANGES

LEGISLATIVE PROPOSAL #4

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO MAKE CLARIFYING CHANGES TO THE PROPERTY TAX LAWS.

SHORT TITLE: Property Tax Changes

SPONSORS: **Brubaker**; Carney, Church, Hill, Luebke, McComas, Wainwright, Wilkins
Hartsell; Clodfelter, Dalton, Hoyle, Kerr, Webster

BRIEF OVERVIEW: This bill would make clarifying changes to the property tax laws.

FISCAL IMPACT: No fiscal impact.

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 2005

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BILL DRAFT 2005-LAz-18 [v.8] (1/24)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/19/2006 11:52:11 AM

Short Title: Property Tax Changes.	(Public)
Sponsors: .	
Referred to:	

A BILL TO BE ENTITLED

AN ACT TO MAKE CLARIFYING CHANGES TO THE PROPERTY TAX LAWS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-304(a1) reads as rewritten:

"(a1) Electronic Listing. – The board of county commissioners may, by resolution, provide for electronic listing of ~~business~~ personal property in accordance with procedures prescribed by the board. If the board of county commissioners allows electronic listing of ~~business~~ personal property, the assessor must publish this information, including the timetable and procedures for electronic listing, in the notice required by G.S. 105-296(c)."

SECTION 2. G.S. 105-307 reads as rewritten:

"**§ 105-307. Length of listing period; extension; preliminary work.**

(a) Listing Period. – Unless extended as provided in this section, the period during which property is to be listed for taxation each year begins on the first business day of January and ends on January 31.

(b) General Extensions. – The board of county commissioners may, by resolution, extend the time during which property is to be listed for taxation as provided in this subsection. Any action by the board of county commissioners extending the listing period must be recorded in the minutes of the board, and notice of the extensions must be published as required by G.S. 105-296(c). The entire period for listing, including any extension of time granted, is considered the regular listing period for the particular year within the meaning of this Subchapter.

(1) In nonrevaluation years, the listing period may be extended for up to 30 additional days.

(2) In years of octennial appraisal of real property, the listing period may be extended for up to 60 additional days.

(3) If the county has provided for electronic listing of ~~business~~ personal property under G.S. 105-304, the period for electronic listing of business personal property may be extended up to June 1.

(c) Individual Extensions. – The board of county commissioners shall grant individual extensions of time for the listing of real and personal property upon written request and for good cause shown. The request must be filed with the assessor no later than the ending date of the regular listing period. The board may delegate the authority to grant extensions to the assessor. Extensions granted under this subsection shall not extend beyond April 15. If the county has provided for electronic listing of ~~business~~ personal property under G.S. 105-304, the period for electronic listing of business personal property is as provided in subsection (b) of this section.

(d) Preliminary Work. – The assessor may conduct preparatory work before the listing period begins, but may not make a final appraisal of property before the day as of which the value of the property is to be determined under G.S. 105-285."

SECTION 3. G.S. 105-330.10 reads as rewritten:

"**§ 105-330.10. (Effective until July 1, 2009) Disposition of interest.**

Sixty percent (60%) of the first month's interest collected on unpaid taxes pursuant to G.S. 105-330.4 shall be transferred on a monthly basis to the Combined Motor Vehicle and Registration Account created within the Treasurer's Office. The North Carolina Association of County Commissioners shall direct the Treasurer to distribute the funds in the Account to the Division of Motor Vehicles for the purpose of developing and implementing an integrated computer system within the Division of Motor Vehicles that would allow for the combined assessment, billing, and collection of property taxes on motor vehicles and the issuance of registration plates. The Treasurer shall report to the Revenue Laws Study Committee semiannually with the first report due by April 30, 2006. The report shall contain a detailed description of the amount of moneys transferred to the Account and distributed from the Account."

SECTION 4. G.S. 105-277.4 is amended by adding a new subdivision to read:

"(a1) Late Application. – Upon a showing of good cause by the applicant for failure to make a timely application as required by subsection (a) of this section, an application may be approved by the board of equalization and review or, if that board is not in session, by the board of county commissioners. An untimely application approved under this subsection applies only to property taxes levied by the county or municipality in the calendar year in which the untimely application is filed. Decisions of the county board may be appealed to the Property Tax Commission."

SECTION 5. G.S. 105-321(d) is repealed.

SECTION 6. G.S. 105-378 is amended adding a new subsection to read:

"(d) Enforcement and Collection Delayed Pending Appeal. -- When the board of county commissioners or municipal governing body delivers a tax receipt to a tax collector for any assessment that has been or is subsequently appealed to the Property Tax Commission, the tax collector may not seek collection of taxes or enforcement of a tax lien resulting from the assessment until the appeal has been finally adjudicated. The tax collector, however, may send an initial bill or notice to the taxpayer."

SECTION 7. G.S. 105-373(a) reads as rewritten:

"(a) Annual Settlement of Tax Collector. –

(1) Preliminary Report. – After July 1 and before he is charged with taxes for the current fiscal year, the tax collector shall make a sworn report to the governing body of the taxing unit showing:

a. A list of the persons owning real property whose taxes for the preceding fiscal year remain unpaid and the principal amount owed by each person; and

b. A list of the persons not owning real property whose personal property taxes for the preceding fiscal year remain unpaid and the principal amount owed by each person. (To this list the tax collector shall append his statement under oath that he has made diligent efforts to collect the taxes due from the persons listed out of their personal property and by other means available to him for collection, and he shall report such other information concerning these taxpayers as may be of interest to or required by the governing body, including a report of his efforts to make collection outside the taxing unit under the provisions of G.S. 105-364.) The governing body of the taxing unit may publish this list in any newspaper in the taxing unit. The cost of publishing this list shall be paid by the taxing unit.

(2) Insolvents. – Upon receiving the report required by subdivision (a)(1), above the governing body of the taxing unit shall enter upon its minutes the names of persons owing taxes (but who listed no real property) whom it finds to be insolvent, and it shall by resolution designate the list entered in its minutes as the insolvent list to be credited to the tax collector in his settlement.

(3) Settlement for Current Taxes. – After July 1 and before he is charged with taxes for the current fiscal year, the tax collector shall make full settlement with the governing body of the taxing unit for all taxes in his hands for collection for the preceding fiscal year.

a. In the settlement the tax collector shall be charged with:

1. The total amount of all taxes in his hands for collection for the year, including amounts originally charged to him and all amounts subsequently charged on account of discoveries;

2. All penalties, interest, and costs collected by him in connection with taxes for the current year; and

3. All other sums collected by him.

b. The tax collector shall be credited with:

1. All sums representing taxes for the year deposited by him to the credit of the taxing unit or receipted for by a proper official of the unit;

2. Releases duly allowed by the governing body;

3. The principal amount of taxes constituting liens on real property;
4. The principal amount of taxes included in the insolvent list determined in accordance with subdivision (a)(2), above;
5. Discounts allowed by law; ~~and~~
6. Commissions (if any) lawfully payable to the tax collector as ~~compensation.~~compensation; and
7. The principal amount of taxes for any assessment appealed to the Property Tax Commission when the appeal has not been finally adjudicated.

The tax collector shall be liable on his bond for both honesty and faithful performance of duty; for any deficiencies; and, in addition, for all criminal penalties provided by law.

The settlement, together with the action of the governing body with respect thereto, shall be entered in full upon the minutes of the governing body.

(4) Disposition of Tax Receipts after Settlement. – Uncollected taxes allowed as credits in the settlement prescribed in subdivision (a)(3), above, whether represented by tax liens held by the taxing unit or included in the list of insolvents, shall, for purposes of collection, be recharged to the tax collector or charged to some other person designated by the governing body of the taxing unit under statutory authority. The person charged with uncollected taxes shall:

a. Give bond satisfactory to the governing body;
b. Receive the tax receipts and tax records representing the uncollected taxes;
c. Have and exercise all powers and duties conferred or imposed by law upon tax collectors; and
d. Receive compensation as determined by the governing body."

SECTION 8. This act is effective when it becomes law.

DRAFT 2005-LAz-18: Property Tax Changes

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	April 27, 2006
Introduced by:		**Summary by:**	Martha Walston Committee Counsel
Version:	Draft 2005-LAz-18		

SUMMARY: ***This bill is a recommendation of the Department of Revenue and would make the following clarifying changes to the property tax laws:***

- ***Provides for the electronic filing of both business and individual personal property.***
- ***Amends S.L. 2005-294 (AN ACT TO CREATE A COMBINED MOTOR VEHICLE REGISTRATION RENEWAL AND PROPERTY TAX COLLECTION SYSTEM) to clarify that the first month's interest on past due bills would be transferred to a special account. This change reflects the intent of the bill sponsors and supporters.***
- ***Authorizes a county board of equalization and review to approve a late application for present-use value appraisal of property if the applicant demonstrates good cause for the delay.***
- ***Authorizes a tax collector to receive tax receipts for assessments that have been or are subsequently appealed to the Property Tax Commission and to send the taxpayer an initial tax bill or notice; however, the tax collector may not collect on the tax or enforce a tax lien until the appeal has been finally adjudicated.***
- ***Clarifies that the list of items credited to the tax collector in the final assessment to the governing body of the taxing unit shall include the principal amount of taxes for any assessment appealed to the Property Tax Commission when the appeal has not been finally adjudicated.***

BILL ANALYSIS:

Sections 1 and 2 of the bill provides for the electronic filing of any personal property. Current law allows the board of county commissioners, by resolution, to provide for the electronic listing of business personal property. This language excludes the electronic filing of unlisted automobiles, jet skis, mobile homes, and boats by personal taxpayers. The Department states that there is no reason to limit electronic filing to business personal property.

Current law allows the period for electronic listing of business personal property to be extended to June 1. Section 2 of the bill clarifies that this extension is provided only to business personal property.

Section 3 of the bill makes a clarifying change to legislation that was enacted during the 2005 Session. This change would clarify the intent of the bill's sponsors and supporters. Last Session, the General Assembly ratified House Bill 1779, which creates a combined system for registration and taxation of motor vehicles to become effective July 1, 2009, or upon the earlier creation of a combined registration renewal and tax collection computer system within the Division of Motor Vehicles. Under the new combined system, consumers will receive one statement per registered vehicle, containing both registration fees and the property taxes and vehicle fees due. Payment of the property taxes are a prerequisite to issuance of or renewal for the registration. Property taxes on the vehicle become due on the date a new registration is applied for or at the end of the grace period following the expiration of a

vehicle's current registration. Taxes and registration fees may be collected by the DMV or a DMV agent.

To pay for the new system, the act increased the first month's interest on delinquent registered motor vehicle taxes from 2% to 5%, effective January 1, 2006, and required that 60% of the interest collected on unpaid taxes be transferred on a monthly basis to the Combined Motor Vehicle and Registration Account in the Treasurer's Office. Funds in this Account may only be transferred to the DMV for the purpose of implementing the combined system, at the direction of the North Carolina Association of County Commissioners. The intent of the sponsors to House Bill 1779 and supporters of the bill was that 60% of only the **first month's** interest would be transferred to the Account, not the total interest collected on unpaid taxes. In December, 2005, the North Carolina Department of State Treasurer issued a memorandum directing counties to only remit 60% of the first month's interest to the Treasurer. The memorandum stated that this was the true intent of the bill and that it is anticipated that the language will be corrected during the 2006 Session. The memorandum was sent to all county managers, finance officers, tax administrators, tax assessor, tax collectors, and certified public accountants.

Section 4 of the bill would give a county board of equalization and review the authority to approve a late application for present-use value appraisal of property if the applicant demonstrates good cause for the delay. Under current law, a taxpayer seeking present-use value appraisal of farmland, must file the application within the following time periods:

- An initial application must be filed during the regular listing period of the year for which the benefit of the classification is first claimed, or within 30 days of the date shown on a notice of a change in valuation made pursuant to a county's general reappraisal or horizontal adjustment of real property.
- An application required due to transfer of the land may be submitted at any time during the calendar year but must be submitted within 60 days of the date of the property's transfer.

The bill would allow approval of a late application upon a showing of good cause by the applicant to the board of equalization and review. If the county board of equalization and review is not in session, then the late filing may be approved by the board of county commissioners. Current law allows similar approval for late applications for property tax exemptions or exclusions. (G.S. 105-282.1(a1).)

Sections 5 and 6 of the bill would allow a tax collector to receive tax receipts for assessments that have been appealed or are subsequently appealed to the Property Tax Commission, but would prohibit the tax collector from collecting the tax or enforcing a tax lien resulting from the assessment until the appeal has been finally adjudicated. Pending final adjudication, the tax collector may send an initial tax bill or notice to the taxpayer.

Each year, the county board of commissioners or the municipal governing body directs the tax collector to collect taxes charged in the tax records and receipts. The tax receipt sets out the name and address of the taxpayer, the assessment of the taxpayer's property, the rate of tax levied, and the amount of property taxes and any penalties due. Current law states that no tax receipts are to be delivered to the tax collector for any assessment appealed to the Property Tax Commission until the appeal has been finally adjudicated. In practice, boards of equalization and review often adjourn on June 30th, except to hear appeals filed prior to June 30th. By August 1, however, the tax collector has received the tax receipts. The proposal validates this practice, but clarifies that the tax collector may not seek any remedies for collection of the taxes or enforcement of the tax lien pending final adjudication of appeal from the assessment. The tax collector, however, may send an initial bill or notice to the taxpayer pending final adjudication. By providing notice pending appeal, the taxpayer may choose to avoid the amount of interest that accrues while the appeal is pending. If the taxpayer wins on appeal, the taxpayer receives a refund of any taxes paid plus interests. Finally, the proposal would put a potential buyer of the property on notice of a tax bill, if the property is transferred pending the appeal.

Section 7 of the bill makes clarifying changes to the lists of items credited to the tax collector in the collector's final settlement with the governing body for all taxes in his hands for collection for the preceding fiscal year. Current law provides that the final settlement must contain the items to be charged against the tax collector and the items to be allowed as credits for the collector.[1] The charges and credits should balance. The proposal adds to the lists of credits the principal amount of taxes for any assessment appealed to the Property Tax Commission when the appeal has not been finally adjudicated.

EFFECTIVE DATE: The bill is effective when it becomes law.

2005-LAz-18-SMLA

[1] Charges include the total amount of all taxes placed in the collector's hands for collection for the year, all late-listing penalties and costs collected by the collector, all interests on taxes collected by the collector, and any other sums collected or received by the tax collector. Credits include all sums deposited by the collector to the credit of the taxing unit, releases allowed by the governing body, discounts allowed for early payment of taxes, the principal amount of taxes constituting liens against real property, the principal amount of taxes determined to be insolvent and to be allowed as credits, and any commission the collector is entitled to deduct from amounts collected.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

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: January 8, 2006

TO: Revenue Laws

FROM: Rodney Bizzell
Fiscal Research Division

RE: Property Tax Changes

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:	**No Significant Impact**				
EXPENDITURES:					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue, North Carolina Local Governments

EFFECTIVE DATE: Becomes effective when law.

BILL SUMMARY:
Sections 1 and 2 of the bill provide for the electronic filing of personal property. Currently, counties are allowed to provide for electronic listing only for business personal property. The Department indicates no reason that this listing mechanism should not be allowed for all personal property. Current law allows the period for electronic listing of business personal property to be extended to June 1. Section 2 of this bill clarifies that this extension is provided only to business personal property.

Section 3 of the bill makes a clarifying change to House Bill 1779, which was enacted during the 2005 Session. The bill creates a combined system for registration and taxation of motor vehicles. The bill increases the first-month interest payments on unpaid vehicle property taxes from 2% to 5% and directs

60% of interest revenue to a special account within the Department of State Treasurer for the purpose of creating a registration renewal and property tax collection computer system within the Division of Motor Vehicles. The intent of the bill, and the practice put into place by the Department of State Treasurer, is to transfer 60% of only the first month of interest on unpaid taxes to the special account. This bill clarifies that the transfer applies to only the month of interest.

Section 4 of the bill would give county boards of equalization and review the authority to approve a late application for present-use value appraisal of property if the applicant demonstrates a good cause for the delay. Current law allows similar approvals for property tax exemptions or exclusions.

Sections 5 and 6 of the bill would allow tax collectors to receive tax receipts for assessments that have been appealed to the Property Tax Commission, but would not allow the collector to collect the tax or enforce a tax lien resulting from the assessment while the appeal is pending. This bill would validate the current practice in which boards of equalization provide tax receipts to collectors by August 1, but clarifies that the collector may not seek remedies for appealed assessments until the appeal is adjudicated.

Section 7 of the bill makes a clarifying change to add taxes appealed to the Property Tax Commission to the list of items credited to the tax collector in the collector's final settlement with the governing body.

ASSUMPTIONS AND METHODOLOGY: All of the proposed changes contained in the bill are administrative or clarifying in nature and would result in no significant fiscal impact.

SOURCES OF DATA: North Carolina Department of Revenue

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #5

AMEND DELINQUENT PROPERTY TAX COLLECTION

LEGISLATIVE PROPOSAL #5

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO ENFORCE COLLECTION OF PROPERTY TAXES ON REAL PROPERTY AGAINST THE RECORD OWNER AS OF THE DATE THE TAXES BECOME DELINQUENT AND TO CODIFY THE PRORATION OF TAXES ON REAL PROPERTY.

SHORT TITLE: Amend Delinquent Property Tax Collection

SPONSORS: **Hartsell**; Clodfelter, Dalton, Hoyle, Kerr, Webster
Brubaker; Carney, Church, Hill, Luebke, McComas, Wainwright, Wilkins

BRIEF OVERVIEW: This bill makes changes to the property tax laws to relieve the seller of personal liability for property taxes assessed on real property when the seller transfers the property before the taxes become delinquent or when the seller transfers the property before it is annexed by the taxing unit and taxes are imposed by the taxing unit. the bill also codifies the practice of prorating property on a calendar-year basis when the property is sold, unless the terms of the contract provide otherwise.

FISCAL IMPACT: No fiscal impact.

EFFECTIVE DATE: This bill is effective for taxes imposed for taxable years beginning on or after July 1, 2006, except that section 5 of the bill becomes effective for contracts entered into on or after October 1, 2006.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-LAz-29 [v.9] (4/17)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/27/2006 12:43:09 PM

Short Title: Amend Delinquent Property Tax Collection.	(Public)
Sponsors: .	
Referred to:	

A BILL TO BE ENTITLED

AN ACT TO ENFORCE COLLECTION OF PROPERTY TAXES ON REAL PROPERTY AGAINST THE RECORD OWNER AS OF THE DATE THE TAXES BECOME DELINQUENT AND TO CODIFY THE PRORATION OF TAXES ON REAL PROPERTY.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-273(17) reads as rewritten:

""**§ 105-273. Definitions.**

When used in this Subchapter (unless the context requires a different meaning):

...

(17) "Taxpayer" means any person whose property is subject to ad valorem property taxation by any county or municipality and any person who, under the terms of this Subchapter, has a duty to list property for taxation. For purposes of collecting delinquent ad valorem taxes assessed on real property under G.S. 105-366 through G.S. 105-375, "taxpayer" means the owner of record on the date the taxes become delinquent and any subsequent owner of record of the real property if conveyed after that date."

SECTION 2. G.S. 105-369 reads as rewritten:

"**§ 105-369. Advertisement of tax liens on real property for failure to pay taxes.**

(a) Report of Unpaid Taxes That Are Liens on Real Property. – In February of each year, the tax collector must report to the governing body the total amount of unpaid taxes for the current fiscal year that are liens on real property. A county tax collector's report is due the first Monday in February, and a municipal tax collector's report is due the second Monday in February. Upon receipt of the report, the governing body must order the tax collector to advertise the tax liens. For purposes of this section, district

taxes collected by county tax collectors shall be regarded as county taxes and district taxes collected by municipal tax collectors shall be regarded as municipal taxes.

(b) Repealed by Session Laws 1983 (Regular Session, 1984), c. 1013.

(b1) Notice to Owner. – After the governing body orders the tax collector to advertise the tax liens, the tax collector must send a notice to the ~~listing owner and to the~~ record owner of each affected parcel of property, as determined as of ~~December 31 of the fiscal year for which the taxes are due.~~the date the taxes became delinquent. The notice must be sent to each owner's last known address by first-class mail at least 30 days before the date the advertisement is to be published. The notice must state the principal amount of unpaid taxes that are a lien on the parcel to be advertised and inform the owner that the ~~names~~ name of ~~the listing owner and~~ the record owner as of the date the taxes became delinquent will appear in a newspaper advertisement of delinquent taxes if the taxes are not paid before the publication date. Failure to mail the notice required by this section to the correct ~~listing owner or~~ record owner does not affect the validity of the tax lien or of any foreclosure action.

(c) Time and Contents of Advertisement. – A tax collector's failure to comply with this subsection does not affect the validity of the taxes or tax liens. The county tax collector shall advertise county tax liens by posting a notice of the liens at the county courthouse and by publishing each lien at least one time in one or more newspapers having general circulation in the taxing unit. The municipal tax collector shall advertise municipal tax liens by posting a notice of the liens at the city or town hall and by publishing each lien at least one time in one or more newspapers having general circulation in the taxing unit. Advertisements of tax liens shall be made during the period March 1 through June 30. The costs of newspaper advertising shall be paid by the taxing unit. If the taxes of two or more taxing units are collected by the same tax collector, the tax liens of each unit shall be advertised separately unless, under the provisions of a special act or contractual agreement between the taxing units, joint advertisement is permitted.

The posted notice and newspaper advertisement shall set forth the following information:

~~(1) In the case of property that the listing owner has not transferred after January 1 preceding the fiscal year for which the tax liens are advertised, the name of each person to whom is listed real property on which the taxing unit has a lien for unpaid taxes, in alphabetical order.~~

(1a) ~~In the case of property that the listing owner has transferred after January 1 preceding the fiscal year for which the tax liens are advertised, the name of the record owner as of December 31 of each parcel on which the taxing unit has a lien for unpaid taxes, in alphabetical order, followed by a notation that the property was transferred to the record owner and a notation of the name of the listing owner.~~The name of the record owner as of the date the taxes became delinquent for each parcel on which the taxing unit has a lien for unpaid taxes, in alphabetical order.

(1b) After the information required by subdivision ~~(1) or~~ (1a) of this subsection for each parcel, a brief description of each parcel of land to which a lien has attached and a statement of the principal amount of the taxes constituting a lien against the parcel.

(2) A statement that the amounts advertised will be increased by interest and costs and that the omission of interest and costs from the amounts advertised will not constitute waiver of the taxing unit's claim for those items.

(3) In the event the list of tax liens has been divided for purposes of advertisement in more than one newspaper, a statement of the names of all newspapers in which advertisements will appear and the dates on which they will be published.

(4) A statement that the taxing unit may foreclose the tax liens and sell the real property subject to the liens in satisfaction of its claim for taxes.

(d) Costs. – Each parcel of real property advertised pursuant to this section shall be assessed an advertising fee to cover the actual cost of the advertisement. Actual advertising costs per parcel shall be determined by the tax collector on any reasonable basis. Advertising costs assessed pursuant to this subsection are taxes.

(e) Payments during Advertising Period. – At any time during the advertisement period, any parcel may be withdrawn from the list by payment of the taxes plus interest that has accrued to the time of payment and a proportionate part of the advertising fee to be determined by the tax collector. Thereafter, the tax collector shall delete that parcel from any subsequent advertisement, but the tax collector is not liable for failure to make the deletion.

(f) Listing and Advertising in Wrong Name. – No tax lien is void because the real property to which the lien attached was listed or advertised in the name of a person other than the person in whose name the property should have been listed for taxation if the property was in other respects correctly described on the abstract or in the advertisement.

(g) Wrongful Advertisement. – Any tax collector or deputy tax collector who willfully advertises any tax lien knowing that the property is not subject to taxation or that the taxes advertised have been paid is guilty of a Class 3 misdemeanor, and shall be required to pay the injured party all damages sustained in consequence."

SECTION 3. G.S. 105-374(c) reads as rewritten:

"(c) Parties; Summonses. – The ~~listing taxpayer~~owner of record as of the date the taxes became delinquent and spouse (if any), ~~the current owner,~~any subsequent owner, all other taxing units having tax liens, all other lienholders of record, and all persons who would be entitled to be made parties to a court action (in which no deficiency judgment is sought) to foreclose a mortgage on such property, shall be made parties and served with summonses in the manner provided by G.S. 1A-1, Rule 4.

The fact that the ~~listing taxpayer~~owner of record, any subsequent owner, or any other defendant is a minor, is incompetent, or is under any other disability shall not prevent or delay the tax lien sale or the foreclosure of the tax lien; and all such persons

shall be made parties and served with summons in the same manner as in other civil actions.

Persons who have disappeared or who cannot be located and persons whose names and whereabouts are unknown, and all possible heirs or assignees of such persons, may be served by publication; and such persons, their heirs, and assignees may be designated by general description or by fictitious names in such an action."

SECTION 4. G.S. 105-375(c) reads as rewritten:

"(c) Notice Listing Taxpayer and Others. – The tax collector filing the certificate provided for in subsection (b), above, shall, at least 30 days prior to docketing the judgment, send a registered or certified letter, return receipt requested, to the ~~listing taxpayer at his~~owner of record as of the date the taxes became delinquent at the owner's last known address, and to all lienholders of record who have a lien against the ~~listing taxpayer~~owner of record or against any subsequent owner of the property (including any liens referred to in the conveyance of the property to the ~~listing taxpayer~~owner of record or to the subsequent owner of the property), stating that the judgment will be docketed and the execution will be issued thereon in the manner provided by law. ~~A notice stating that the judgment will be docketed and that execution will be issued thereon shall also be mailed by certified or registered mail, return receipt requested, to the current owner of the property (if different from the listing owner) if: (i) a deed or other instrument transferring title to and containing the name of the current owner was recorded in the office of the register of deeds or filed or docketed in the office of the clerk of superior court after January 1 of the first year in which the property was listed in the name of the listing owner, and (ii) the tax collector can obtain the current owner's mailing address through the exercise of due diligence.~~ If within 10 days following the mailing of said letters of notice, a return receipt has not been received by the tax collector indicating receipt of the letter, then the tax collector shall have a notice published in a newspaper of general circulation in said county once a week for two consecutive weeks directed to, and naming, all unnotified lienholders and the ~~listing taxpayer~~owner of record that a judgment will be docketed against the ~~listing taxpayer.~~owner of record. The notice shall contain the proposed date of such docketing, that execution will issue thereon as provided by law, a brief description of the real property affected, and notice that the lien may be paid off prior to judgment being entered. All costs of mailing and publication, plus a charge of fifty dollars ($50.00) to defray administrative costs, shall be added to the amount of taxes that are a lien on the real property and shall be paid by the taxpayer to the taxing unit at the time the taxes are collected or the property is sold."

SECTION 5. Chapter 39 of the General Statutes is amended by adding the following new Article to read:

"**Article 10.**

"Real Property Tax Proration.

"**§ 39-60. Property tax proration on sale of real property.**

Unless otherwise provided by contract, property taxes on the real property being sold shall be prorated between the seller and buyer of the real property on a calendar-year basis."

SECTION 6. Section 5 of this act becomes effective for contracts entered into on or after October 1, 2006. The remainder of this act is effective for taxes imposed for taxable years beginning on or after July 1, 2006.

BILL DRAFT: 2005-LAz-29: Amend Delinquent Property Tax Collection

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	April 27, 2006
Introduced by:		**Summary by:**	Martha Walston Committee Counsel
Version:	Draft 2005-LAz-29		

SUMMARY: ***The following changes to the property tax laws relieve the seller of personal liability for property taxes assessed on real property when the seller transfers the property before the taxes become delinquent or when the seller transfers the property before it is annexed by the taxing unit and taxes are imposed by the taxing unit:***

- ***Authorizes the tax collector to enforce the remedy of attachment and garnishment against the record owner of real property as of the date the taxes on the real property become delinquent instead of the listing owner of the real property.***
- ***Requires the tax collector to send the notice of a tax lien on real property to the record owner of the property as determined as of the date property taxes become delinquent instead of the listing owner of the property. The advertisement must also state the name of the record owner instead of the listing owner.***
- ***Amends the definition of "Taxpayer" in the property tax laws to clarify that when collecting delinquent taxes assessed on real property, "taxpayer" means owner of record on the date the taxes become delinquent and any subsequent owner of record of the real property if conveyed after the delinquent date.***

The bill also amends Chapter 39 of the General Statutes by adding a new Article that codifies the practice of prorating property taxes on a calendar-year basis when the property is sold, unless the parties' contract states otherwise.

CURRENT LAW: Under North Carolina property tax laws, the date of January 1 applies to the following events:

- The date the value of real property is determined for tax purposes.
- The date property is listed in the name of the owner on that date.
- The date a tax lien attaches to the real property.

The owner of the property as of January 1 generally receives a property tax bill in July or August for property taxes owing on the property for the fiscal year that runs from July 1 of the year the property is required to be listed to the following June 30. Taxes become due and payable on September 1, and are payable at face amount if paid before January 6 following the due date. Taxes are delinquent if paid on or after January 6 following the due date and are subject to interest charges.[1] For example, if a taxpayer lists his or her property on January 1, 2006, then taxes on the property become due on September 1,

[1] For the period January 6 to February 1, interest rate accrues at 2%. For the period February 1 until the principal amount of taxes, the accrued interest, and any penalties are paid, interest accrues at the rate of ¾% a month or fraction thereof.

2006, for the fiscal year beginning July 1, 2006, and ending June 30, 2007. Taxes on the property are delinquent beginning January 6, 2007.[2]

In February of each year, the tax collector must report to the governing body the total amount of unpaid taxes for the current fiscal year that are liens on real property. After the governing body orders the tax collector to advertise tax liens, the tax collector must send a notice to the record owner of each affected parcel as determined as of December 31 of the fiscal year for which taxes are due. If the property was transferred during the one year period beginning on the listing date preceding the fiscal year in which the taxes become due, then the notice of tax lien on the property must be sent to each listing owner and record owner of the parcel as determined as of December 31 of the fiscal year for which taxes are due. The notice must inform the owners that their names will appear in a newspaper advertisement of delinquent taxes if the taxes are not paid before the publication date. If the listing owner transferred the property after the listing date, the advertisement will state the record owner's name followed by a notation that the property was transferred to the record owner and a notation of the name of the listing owner.

In addition to the remedy of foreclosing on the real property, the taxing unit may also attach and garnish the wages and other compensation, rents, bank deposits, and other intangible personal property of the listing owner of the property. Attachment and garnishment may only be enforced against the listing owner because the pertinent statutes provide that the remedy may be enforced against the taxpayer. Taxpayer is defined in G.S. 105-273(17) as the person whose property is subject to property tax by a county or municipality and any person who has a duty to list property for taxation.

BILL ANALYSIS: The draft is an attempt to solve the following problems:

- Seller conveys real property to Buyer on July 8, 2006. After the transfer, Buyer petitions for annexation to the city. On October 2006, seller receives a bill due September 1, 2006 for the partial year annexation. If Seller does not pay this before January 6, 2007, the tax collector can garnish Seller's bank account, because Seller was the owner of the property on the listing date. (January 1 immediately preceding the beginning of the fiscal year to which the annexation becomes effective) G.S. 160A-58.10.
- Seller conveys real property to Buyer in May, 2006. The closing attorney prorates the taxes giving Buyer credit for the months Seller owned the property and directs Buyer to pay the taxes. Buyer does not pay the taxes by January 6, 2007. Seller disregards the notice of delinquent taxes because he had his share of the taxes deducted from his net proceeds at closing and Seller believes his share of taxes was paid at closing. The tax collector has the authority to garnish the wages of Seller.

The draft amends the definition of "Taxpayer" in the property tax laws so that for purposes of collecting delinquent property taxes assessed on real property, the remedies against personal property may only be enforced against the record owner of the real property on the date the taxes become delinquent and against any subsequent record owner of the real property if conveyed after the delinquent date. This means that the tax collector would have the authority to garnish the wages, bank account, or other intangible property of the owner of the property at the time the taxes on that property become delinquent and any subsequent record owner instead of the listing owner of the property.

The draft provides that the notice of the tax lien would be sent to the record owner of the real property as of the date the taxes became delinquent instead of the listing owner. The advertisement of the tax lien

[2] When real property is acquired after January 1, but prior to July 1, and the property was not subject to taxation on January 1 on account of its exempt status, it is listed for tax by the transferee as of the date of acquisition and is appraised at its true value as of January 1 preceding the date of acquisition. The property is taxed for the fiscal year of the taxing unit beginning on July 1 of the year in which it is acquired.

would not set out the name of the listing owner, unless the listing owner and owner of record on the delinquent date is the same person.

The draft also codifies the practice of prorating property taxes between the seller and buyer of real property on a calendar-year basis, unless the contract states otherwise.

EFFECTIVE DATE: The draft is effective for taxes imposed for taxable years beginning on or after July 1, 2006, except that section 5 of the draft becomes effective for contracts entered into on or after October 1, 2006.

2005-LAz-29-SMLA

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 2, 2006

TO: Revenue Laws Study Committee

FROM: Rodney Bizzell
Fiscal Research Division

RE: 2005-LAz-29 v4 – Amend Delinquent Property Tax Collection

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES: **Local Governments**	**"See Assumptions and Methodology"**				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Local Governments

EFFECTIVE DATE: Section 5 of this act becomes effective for contracts entered into on or after October 1, 2006. The remainder of this act is effective upon ratification and applies to tax years beginning on or after July 1, 2006.

BILL SUMMARY:
This bill makes the following changes to the property tax laws to relieve the seller of personal liability for property taxes assessed on real property when the seller transfers the property before the taxes become delinquent or when the seller transfers the property before it is annexed by the taxing unit and taxes are imposed by the taxing unit:

- Authorizes the tax collector to enforce the remedy of attachment and garnishment against the record owner of real property as of the date the taxes on the real property become delinquent instead of the listing owner of the real property.

- Requires the tax collector to send the notice of a tax lien on real property to the record owner of the property as determined as of the date property taxes become delinquent and to any subsequent record owner instead of the listing owner of the property. The advertisement must also state the names of the record owner and any subsequent owner instead of the listing owner.
- Amends the definition of "Taxpayer" in the property tax laws to clarify that when collecting delinquent taxes assessed on real property, "taxpayer" means owner of record on the date the taxes become delinquent and any subsequent owner of record of the real property if conveyed after the delinquent date.
- Amends Chapter 39 of the General Statutes by adding a new Article that codifies the practice of prorating property taxes on a calendar-year basis when the property is sold.

ASSUMPTIONS AND METHODOLOGY:
The bill corrects the problems that occur when an owner sells property after the listing date, and the property taxes later become delinquent under the new owner. Current law allows the tax assessor to use remedies of attachment and wage garnishment against the listing owner. This bill allows tax assessors to use these tax collection remedies against owner of record as opposed to the listing owner. The bill does not change the types of remedies available to assessors and is not projected to significantly impact revenue collection.

SOURCES OF DATA: NC Department of Revenue

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #6

IRC UPDATE

LEGISLATIVE PROPOSAL #6

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2006 GENERAL ASSEMBLY

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: **Wainwright;** Carney, Church, Hill, Luebke, McComas, Wilkins

BRIEF OVERVIEW: This proposal would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. In addition the proposal would shorten the time span in which a taxpayer would have to file an amended estate, income, or gift tax return when the federal government corrects or otherwise determines the amount on which the tax is based. The proposal would also conform the filing date for income tax returns for a nonresident alien to the federal dates. Finally, the bill would conform the amounts for the credit for child care and certain employment-related expenses to the amounts allowed for the corresponding federal credit.

FISCAL IMPACT: The increase in the limit of the State's child-care and employment-related expenses to conform to the federal limits will result in an annual $5 million General Fund revenue loss.

EFFECTIVE DATE: Different portions of the proposal would become effective when it became law, on July 1, 2006, or for taxable years beginning on or after January 1, 2006

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-LYxz-284 [v.4] (1/20)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
5/2/2006 9:55:53 AM

Short Title: IRC Update. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO UPDATE THE REFERENCE TO THE INTERNAL REVENUE CODE USED IN DEFINING AND DETERMINING CERTAIN STATE TAX PROVISIONS AND TO MAKE OTHER CHANGES TO MORE CLOSELY CONFORM TO FEDERAL TAX LAW.

The General Assembly of North Carolina enacts:

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

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

...

(1b) Code. – The Internal Revenue Code as enacted as of January 1, ~~2005,~~2006, including any provisions enacted as of that date which become effective either before or after that date."

SECTION 2. Notwithstanding Section 1 of this act, any amendments to the Internal Revenue Code enacted after January 1, 2005, that increase North Carolina taxable income for the 2005 taxable year become effective for taxable years beginning on or after January 1, 2006.

SECTION 3. G.S. 105-32.8 reads as rewritten:

"**§ 105-32.8. Federal determination that changes the amount of tax payable to the State.**

If the federal government corrects or otherwise determines the gross estate tax imposed under section 2001 of the Code or the amount of the maximum state death tax credit allowed an estate under section 2011 of the Code, the personal representative must, within ~~two years~~ six months after being notified of the correction or final determination by the federal government, file an estate tax return with the Secretary reflecting the correct amount of tax payable under this Article. If the federal government corrects or otherwise determines the amount of the maximum state generation-skipping transfer tax credit allowed under section 2604 of the Code, the person who made the

transfer must, within ~~two years~~six months after being notified of the correction or final determination by the federal government, file a tax return with the Secretary reflecting the correct amount of tax payable under this Article.

The Secretary must assess and collect any additional tax due as provided in Article 9 of this Chapter and must refund any overpayment of tax as provided in Article 9 of this Chapter. A person who fails to report a federal correction or determination in accordance with this section forfeits the right to any refund due by reason of the determination."

SECTION 4. G.S. 105-130.20 reads as rewritten:

"**§ 105-130.20. Federal corrections.**

If a taxpayer's federal taxable income is corrected or otherwise determined by the federal government, the taxpayer must, within ~~two years~~six months after being notified of the correction or final determination by the federal government, file an income tax return with the Secretary reflecting the corrected or determined taxable income. The Secretary shall determine from all available evidence the taxpayer's correct tax liability for the income year. As used in this section, the term 'all available evidence' means evidence of any kind that becomes available to the Secretary from any source, whether or not the evidence was considered in the federal correction or determination.

The Secretary shall assess and collect any additional tax due from the taxpayer as provided in Article 9 of this Chapter. The Secretary shall refund any overpayment of tax as provided in Article 9 of this Chapter. A taxpayer that fails to comply with this section is subject to the penalties in G.S. 105-236 and forfeits its rights to any refund due by reason of the determination."

SECTION 5. G.S. 105-159 reads as rewritten:

"**§ 105-159. Federal corrections.**

If a taxpayer's federal taxable income is corrected or otherwise determined by the federal government, the taxpayer must, within ~~two years~~ six months after being notified of the correction or final determination by the federal government, file an income tax return with the Secretary reflecting the corrected or determined taxable income. The Secretary shall determine from all available evidence the taxpayer's correct tax liability for the taxable year. As used in this section, the term 'all available evidence' means evidence of any kind that becomes available to the Secretary from any source, whether or not the evidence was considered in the federal correction or determination.

The Secretary shall assess and collect any additional tax due from the taxpayer as provided in Article 9 of this Chapter. The Secretary shall refund any overpayment of tax as provided in Article 9 of this Chapter. A taxpayer who fails to comply with this section is subject to the penalties in G.S. 105-236 and forfeits the right to any refund due by reason of the determination."

SECTION 6. G.S. 105-197.1 reads as rewritten:

"**§ 105-197.1. Federal corrections.**

If the amount of a taxpayer's net gifts is corrected or otherwise determined by the federal government, the taxpayer must, within ~~two years~~ six months after being notified of the correction or final determination by the federal government, file a gift tax return with the Secretary of Revenue reflecting the corrected or determined net gifts. The

Secretary of Revenue shall determine from all available evidence the taxpayer's correct tax liability for the taxable year. As used in this section, the term 'all available evidence' means evidence of any kind that becomes available to the Secretary from any source, whether or not the evidence was considered in the federal correction or determination.

The Secretary shall assess and collect any additional tax due from the taxpayer as provided in Article 9 of this Chapter. The Secretary shall refund any overpayment of tax as provided in Article 9 of this Chapter. A taxpayer who fails to comply with this section is subject to the penalties in G.S. 105-236 and forfeits the right to any refund due by reason of the determination."

SECTION 7. G.S. 105-130.17 is amended by adding a new subsection to read:

"(g) A corporation that files a federal return pursuant to section 6072(c) of the Code shall file its return on or before the fifteenth day of the sixth month following the close of its income year"

SECTION 8. G.S. 105-155(a) reads as rewritten:

"(a) ~~Where and When to File.~~Return. – An income tax return shall be filed ~~as prescribed by the Secretary~~ at the place and in the form prescribed by the Secretary. The income tax return of every taxpayer reporting on a calendar year basis ~~shall be filed~~is due on or before the fifteenth day of April in each ~~year, and the~~year. The income tax return of every taxpayer reporting on a fiscal year basis ~~shall be filed~~is due on or before the fifteenth day of the fourth month following the close of the fiscal year. These dates do not apply to a nonresident alien whose federal income tax return is due at a later date under section 6072(c) of the Code. The return of a nonresident alien affected by that Code section is due on or before the fifteenth day of the sixth month following the close of the taxable year. An information return shall be filed at the times prescribed by the Secretary. A taxpayer may ask the Secretary for an extension of time to file a return under G.S. 105-263."

SECTION 9. G.S. 105-151.11(b) reads as rewritten:

"(b) Employment Related Expenses. – The amount of employment-related expenses for which a credit may be claimed may not exceed ~~two thousand four hundred dollars ($2,400)~~three thousand dollars ($3,000) if the taxpayer's household includes one qualifying individual, as defined in section 21(b)(1) of the Code, and may not exceed ~~four thousand eight hundred dollars ($4,800)~~ six thousand dollars ($6,000) if the taxpayer's household includes more than one qualifying individual. The amount of employment-related expenses for which a credit may be claimed is reduced by the amount of employer-provided dependent care assistance excluded from gross income."

SECTION 10. Sections 1, 2, and 10 of this act are effective when they become law. Sections 3 through 6 of this act become effective July 1, 2006, and apply to federal determinations made on or after that date. Sections 7 through 9 of this act are effective for taxable years beginning on or after January 1, 2006.

DRAFT 2005-LYxz-284: IRC Update

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	February 8, 2006
Introduced by:		**Summary by:**	Y. Canaan Huie
Version:	Draft 2005-LYxz-284		Committee Counsel

SUMMARY: ***This bill would update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions. In addition the bill would shorten the time span in which a taxpayer would have to file an amended estate, income, or gift tax return when the federal government corrects or otherwise determines the amount on which the tax is based. The bill also conforms the filing date for income tax returns for a nonresident alien to the federal dates. Finally, the bill would conform the amounts for the credit for child care and certain employment-related expenses to the amounts allowed for the corresponding federal credit.***

CURRENT LAW: Currently the reference date for the Internal Revenue Code is January 1, 2005.

When the federal government corrects or otherwise determines the amount on which an estate, income, or gift tax is based, the taxpayer must file a State return within 2 years that reflects that change.

Nonresidents aliens are currently required to file State income tax returns before their federal returns are due.

Currently, the credit for child care and certain employment-related expenses may not be based on expenses in excess of $2,400 if the household includes one qualifying individual or $4,800 if the household includes more than one qualifying individual.

BILL ANALYSIS:

IRC UPDATE

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. This bill would change the reference date from January 1, 2005, to January 1, 2006, effective when the bill become law.

[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."

Between January 1, 2005, and January 1, 2006, there were four major pieces of federal legislation that made changes to the Internal Revenue Code. This federal legislation includes the Energy Tax Incentive Act of 2005 (P.L. 109-58) signed into law on August 8, 2005, the SAFE Transportation Equity Act of 2005 (P.L. 109-59) signed into law on August 10, 2005, the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) signed into law on September 23, 2005, and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135) signed into law on December 21, 2005.

Energy Tax Incentive Act of 2005 (P.L. 109-58) (hereinafter Energy Act)

Many of the changes made in this act involve tax credits for various activities. Because they are tax credits, these provisions do not have a direct impact at the State level. There are, however, several provisions that could have an impact at the State level, most of which involve the depreciation, amortization, or expensing of certain items.

- *Elimination of deduction for clean-fuel vehicles.* Under previous law, a taxpayer was allowed a deduction for the purchase of a qualified clean-fuel vehicle. A "qualified clean-fuel vehicle" is any motor vehicle that may be propelled by a clean-burning fuel such as natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen, electricity, or any other fuel at least 85% of which is methanol, ethanol, or other alcohol or ether. The maximum amount of the deduction varied depending on the type of vehicle purchased. The deduction began to be phased out in 2004, and was set to be eliminated after the 2006 taxable year. This act moves up the phase-out so that the deduction is eliminated after the 2005 taxable year. In place of the deduction, this act creates a new federal credit for alternative fuel motor vehicles.

- *Tax deferral for gains on electric transmission assets.* Under current law, a taxpayer may elect to recognize qualified gain from a qualifying electric transmission transaction over an eight-year period. In order for a transaction to be a "qualifying electric transmission transaction" numerous conditions must be satisfied, one of which is that the transaction must be completed before January 1, 2007. This act extends that date by one year to January 1, 2008.

- *Deduction for nuclear decommissioning costs.* Utilities that own or operate a nuclear power plant are required by law to decommission the plant at the end of its useful life. A utility may elect to deduct contributions it makes to a nuclear decommissioning reserve fund established to help pay the costs associated with the eventual decommissioning. For previous tax years, contributions to such a reserve fund were limited to the lesser of the amount of nuclear decommission costs allocable to the fund that is included in the taxpayer's cost of services for ratemaking purposes for the taxable year and the ruling amount. The "ruling amount" is a schedule obtained from the IRS that specifies the annual payments that must be made into the fund to cover of the amount of the decommission costs allocable to the fund over its existence. This act eliminates the "lesser of" test for taxable years beginning on or after January 1, 2006, and instead limits the deduction to the ruling amount.

- *Energy efficient commercial buildings property deduction.* Despite the fact that large commercial buildings use approximately one-fourth of the electrical energy consumed in the nation, there is currently no federal tax incentive to encourage the use of energy-efficient property in the construction or renovation of commercial buildings. This act allows taxpayers to claim a deduction (as opposed to depreciation or amortization) with respect to costs associated with energy-efficient commercial building property placed into service between January 1, 2006, and January 1, 2008. The maximum amount that may be deducted is $1.80 per square foot of the building, less any amount deducted under this provision with respect to the same building in previous tax years. In order to qualify for the deduction, the following conditions must be satisfied: 1) The costs must be associated with depreciable or

amortizable property that is installed in a commercial building that meets certain standards for energy efficiency; 2) The property is installed as part of the interior lighting, heating, cooling, ventilation, or hot water systems or the building envelope; and 3) The property is installed as part of a plan to reduce the total annual energy costs of the building with respect to the interior lighting, heating, cooling, ventilation, and hot water systems by at least 50% as compared to a similar building that meets certain minimum standards for energy efficiency. The IRS is required to issue regulations relating to eligibility for a partial deduction and to the transfer of a deduction from a public entity (like the State) to the person responsible for designing the property.

- *Recapture of section 197 amortization.* Generally, property subject to amortization under section 197 of the Code is intangible property that is purchased and held by a taxpayer in the course of a business. Section 197 property includes goodwill, covenants not to compete, patents, copyrights, trademarks and certain licenses. The cost of section 197 property is recoverable over fifteen years using straight-line depreciation. Under general rules, gain on the sale of depreciable property must be recaptured as ordinary income to the extent of depreciation deductions previously claimed. Under general rules, the recapture amount is computed separately for each piece of property. This act provides that if multiple pieces of section 197 property are sold or disposed of in a single transaction or series of transactions, then the taxpayer must compute the recapture as if all of the property were a single asset. The effect of this change is to maximize the amount of income treated as recapture, and thus as ordinary income, and the lessen the amount treated as a capital gain, which is taxed at a lower rate.

- *Depreciation of electric transmission property.* Generally, under the modified accelerated cost recovery system (MACRS) assets used in the transmission and distribution of electricity for sale have a 20-year recovery period. This act allows the costs of certain electric transmission property placed into service after April 11, 2005, to be recovered over 15 years instead of 20.

- *Expensing liquid fuel refineries.* Under previous law, petroleum refining assets were depreciated over a 10-year recovery period using the double declining balance method. Petroleum refining assets are assets used for distillation, fractionation, and catalytic cracking of crude petroleum into gasoline and other petroleum products. This acts allows a taxpayer to make an election to expense 50% of the cost of qualified refinery property in the year in which the property is placed into service. "Qualified refinery property" includes any portion of a qualified refinery that satisfies the following conditions: 1) The original use of the property commences with the taxpayer; 2) The property is placed in service between August 8, 2005, and January 1, 2012; 3) The property satisfies certain production capacity requirements; 4) The property satisfies all applicable environmental laws in effect when it is placed into service; 5) No written binding contract for the construction of the property was in effect on or before June 14, 2005; and 6) The construction of the property is subject to a written binding contract entered into before January 1, 2008. A "qualified refinery" is one that is located in the United States and that is designed to serve the primary purpose of processing liquid fuel from crude oil or qualified fuels (including shale and tar sands and coal seams). The expensing election is not available with respect to a refinery that is used primarily as a topping plant, asphalt plant, lube oil facility, crude or product terminal, or blending facility.

- *Depreciation of natural gas distribution lines.* Under previous law, natural gas distribution lines installed by a gas company were depreciated over a 20-year period. This act allows

natural gas depreciation lines placed in service between April 11, 2005, and January 1, 2011, to be depreciated over a 15-year period.

- *Depreciation of natural gas gathering pipelines.* Prior to the enactment of this act, there was a disagreement among the courts as to what asset class natural gas gathering pipelines owned by a nonproducer belonged. The IRS maintained, and this position was supported by the Tax Court, that these pipelines belonged to an asset class subject to depreciation over 15 years. The Courts of Appeals in the Sixth, Eighth, and Tenth Circuits, however, held that these pipelines belonged to an asset class subject to depreciation over 7 years. There was agreement that natural gas gathering pipelines owned by a producer were part of the asset class subject to depreciation over 7 years. This act clarifies that all natural gas gathering pipelines, regardless of ownership, are subject to depreciation over 7 years. This provision applies to natural gas gathering pipelines placed in service after April 11, 2005.

- *Geological and geophysical costs amortized over two years.* Geological and geophysical costs are those incurred for the purpose of accumulating data that serves as the basis for the decision about acquisition or retention of mineral rights by taxpayers in the business of exploring for minerals (including gas and oil). Courts have held these costs to be capital in nature and allocable to the property acquired or retained. If no property was acquired or retained, the costs were treated as a capital loss. This act provides that these costs, when incurred in the United States for oil or gas exploration, shall be amortized ratably over a 24-month period beginning on the mid-point of the taxable year in which the costs were incurred. The act does not affect the treatment of costs incurred outside of the United States or with respect to exploration for minerals other than oil or gas.

- *84-month amortization of air pollution control facilities.* Current law allows taxpayers to amortize a certified pollution control facility used in connection with a plant that was in operation before January 1, 1976, over a 60-month period. For certified pollution control facilities placed in service after April 11, 2005, this act eliminates the requirement that the property be used in connection with a plant that was in operation before 1976 if the plant is an electric generation plant that is primarily coal fired. For property that satisfies this criteria, the amortization period is 84-months. The act does not lengthen the amortization period for property that was covered by previous law, it provides a favored, though not as generously favored, method of depreciation for another class of property.

Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005 (P.L. 109-59) (hereinafter SAFE Act)

Although this act makes numerous tax changes at the federal level, these changes have little to no direct impact at the State level

Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) (hereinafter Katrina Act)

2005 was a record-setting year on the meteorological front. Not only did the year see a record number of named storms (27) and a record number of hurricanes (14), the year also included the costliest Atlantic hurricane on record and one of the deadliest, Hurricane Katrina. Hurricane Katrina made landfall along the Gulf Coast on August 29, 2005, as a Category 4 storm. Hurricane Katrina resulted in the deaths of more than 1,400 people and caused over $80 billion in property damage.

In the aftermath of Hurricane Katrina, Congress took action to assist taxpayers in the affected region. On September 21, 2005, Congress passed the Katrina Emergency Tax Relief Act of 2005, which was signed into law by President Bush on September 23, 2005. The act is collection of tax relief provisions for individuals and businesses. Below, the key provisions of this act that could have an impact on State revenues are summarized.

General Provisions. The act contains definitions of several key phrases that are used throughout the act. Under the act, "Hurricane Katrina disaster area" means an area with respect to which a major disaster has been declared by the President before September 14, 2005, with respect to Hurricane Katrina. The states of Alabama, Florida, Louisiana, and Mississippi comprise the Hurricane Katrina disaster area. The act also defines the term "core disaster area." The core disaster area is a subset of the Hurricane Katrina disaster area that has been determined by the President to warrant individual or individual and public assistance from the federal government. The core disaster area covers certain counties and parishes in Alabama, Louisiana, and Mississippi.

Retirement Funds. The act contains a number of special rules related to retirement funds for people who lived in the Hurricane Katrina disaster area or the core disaster area. Generally, these provisions allow for a more liberal use of retirement funds for emergency needs than would otherwise be allowed without subjecting the taxpayer to some sort of penalty or disincentive. These provisions include the following:

- *Tax favored withdrawals from retirement plans for relief relating to Hurricane Katrina.* Generally, a withdrawal from a qualified retirement plan, a tax-sheltered annuity, an IRA, or an eligible deferred compensation plan maintained by a state or local government is included in taxable income in the year in which it is made. In addition, a distribution that is received before death, disability, or the age of 59 ½ is generally subject to a 10% early withdrawal tax. Some distributions are known as eligible rollover distributions and are not included in taxable income or subject to the 10% penalty tax. These distributions must be rolled over into another qualified retirement account within 60 days.

  This act provides an exception to the 10% early withdrawal tax in the case of a qualified Hurricane Katrina distribution[3] from a qualified retirement plan, tax-sheltered annuity, or IRA. In addition, any amount required to be included in income as a result of a qualified Hurricane Katrina distribution is included in income in installments over the three-year period beginning with the year in which the distribution is made rather than entirely within the year that the distribution is made. Finally, any amount of a qualified Hurricane Katrina distribution that is recontributed to an eligible retirement account within the three-year period is treated as a roll-over distribution and is not included in income.

- *Recontribution of withdrawals for home purchases cancelled due to Hurricane Katrina.* There is an exception to the 10% early withdrawal tax discussed above in the case of a qualified first-time homebuyer distribution from an eligible retirement account. A qualified first-time homebuyer distribution is one that does not exceed $10,000 and that is used within 120 days of the distribution for the purchase or construction of a principal residence of a first-time homebuyer. If the distribution is not used for the purchase of the home within 120 days or is not rolled over into an eligible retirement account within 60 days, the distribution is included in income and is subject to the 10% early withdrawal tax.

  This act allows a taxpayer that received a qualified distribution from a retirement account to recontribute that amount to an eligible retirement account without penalty. For the purposes of this provision, a "qualified distribution" is a distribution that was received after February 28, 2005, and before August 29, 2005, and that was to be used to purchase or construct a principal residence in the Hurricane Katrina disaster area, but the residence is not purchased or constructed because of Hurricane Katrina. Any portion of a qualified distribution may be contributed to an eligible retirement account and treated as a roll-over if it is recontributed

[3] A "qualified Hurricane Katrina distribution" is a distribution made from an eligible retirement plan on or after August 25, 2005, and before January 1, 2007, to an individual whose primary place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss due to Hurricane Katrina. The total amount of qualified Hurricane Katrina distributions to a taxpayer from all accounts may not exceed $100,000.

between August 25, 2005, and February 28, 2006. Because it is treated as a roll-over, that portion will not be included in income or subject to the 10% early withdrawal tax.

- *Loans from qualified plans for relief relating to Hurricane Katrina.* An individual is allowed to borrow from an qualified employer plan in which the individual participates provided the loan satisfies certain conditions. Generally, a loan from a qualified employer plan is treated as a taxable distribution of plan benefits. A loan is not treated as a tax distribution of benefits to the extent that the loan, when added to the outstanding balance of all other loans to the individual from all plans maintained by the employer, does not exceed the lesser of 1) $50,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or 2) the greater of $10,000 or one half the individual's accrued benefit under the plan. For this exception to apply, the loan must have a repayment period of five years or less, must be amortized in level payments, and must have payments due at least quarterly.

  This act provides special rules in the case of a loan from a qualified plan to a qualified individual. For the purposes of this provision, a "qualified individual" is one whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area and who has sustained an economic loss because of Hurricane Katrina. Under this provision, the loan limit discussed above is increased to the lesser of 1) $100,000 reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made or 2) the greater of $10,000 or the individual's accrued benefit under the plan.

  In addition, this act provides that in the case of a qualified individual with an outstanding loan from a qualified plan on or after August 25, 2005, if the due date for any repayment with respect to the loan occurs during the period from August 25, 2005, to December 31, 2006, the due date is delayed for one year.

Charitable Giving Incentives. In the wake of Hurricane Katrina, people from around the nation rushed to the aid of people in the affected areas with unprecedented amounts of charitable giving. As part of this act, Congress further encouraged and rewarded charitable giving.

- *Temporary suspension of limitations on charitable contributions.* In general, the income tax deduction allowed for charitable contributions is subject to limitations based on the type of taxpayer, the property contributed, and the donee organization. Subject to certain limitations, discussed further below, the following general rules apply: 1) Contributions of cash are deductible in the amount contributed; 2) Contributions of capital gain property[4] to a qualified charity are deductible at fair market value; 3) Contributions of other appreciated property are deductible at the donor's basis in the property; and 4) Contributions of depreciated property are deductible at the fair market value of the property.

  Most contributions are subject to percentage limitations. For individuals, the amount deductible is limited to a percentage of the taxpayer's contribution base[5]. The percentage varies depending on the type of donee organization and the type of property contributed. Contributions by an individual of property other than appreciated capital gain property to a charitable organization described in section 170(b)(1)(A) of the Code (public charities,

[4] "Capital gain property" means any capital asset or property used in the taxpayer's trade or business the sale which at its fair market value, at the time of contribution, would have resulted in a gain that would have been a long-term capital gain.
[5] The "contribution base" is the taxpayer's adjusted gross income computed without regard to any net operating loss carryback.

private foundations other than private non-operating foundations, and certain governmental units) are deductible up to 50% of the contribution base. Contributions of this type of property to nonoperating private foundations and certain other organizations are deductible up to 30% of the contribution base. Contributions of appreciated capital gain property to an organization described in section 170(b)(1)(A) of the Code are generally deductible up to 30% of the contribution base. A taxpayer may elect to bring all of these contributions of appreciated capital gain property under the 50% limitation by reducing the amount of the deduction by the amount of the appreciation of the property. Contributions of appreciated capital gains property to a private nonoperating foundation are deductible up to 20% of the contribution base. For corporations, charitable contributions are deductible up to 10% of the corporations taxable income computed without regard to net operating loss or capital loss carrybacks. For both individuals and corporations, excess charitable contributions may be carried forward for up to five years.

There is also an overall limitation on most itemized deductions for individuals. The total amount of otherwise allowable itemized deductions is reduced by three percent of the amount of the taxpayer adjusted gross income in excess of a certain threshold. However, the otherwise allowed deductions may not be reduced by more than 80%. This reduction is reduced to two percent for the 2006 and 2007 taxable years and to one percent for the 2008 and 2009 taxable years, is repealed for the 2010 taxable year, and is reinstated for the 2011 taxable year.

This act provides several exceptions to the limitations on charitable contribution deductions. For individuals, the deduction for qualified contributions is allowed up to the amount by which the taxpayer's contribution base exceeds the taxpayer's deductions for other charitable contributions. In most cases, this means that an individual may deduct charitable contributions up to 100% of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback. For corporations, the deduction for a qualified contribution is allowed up to amount by which the corporation's taxable income exceeds the deduction for other charitable contributions. For the purposes of these provisions, a "qualified contribution" is a cash contribution that is made between August 28, 2005, and December 31, 2005, to an organization described in section 170(b)(1)(A) of the Code. The term does not include a contribution of noncash property or one that is for the establishment or maintenance of a segregated fund or account with respect to which the donor reasonably expects to have advisory privileges with respect to the fund or account because of his status as donor. In the case of a corporation, the contribution must be for relief efforts related to Hurricane Katrina in order to be a qualified contribution.

In addition, for individuals the charitable deduction contribution, up to the amount of qualified contributions, is not treated as an itemized deduction and is not subject to the reduction for higher-income taxpayers.

- *Additional exemption for housing Hurricane Katrina displaced individuals.* In the aftermath of Hurricane Katrina, hundreds of thousands of residents of the affected areas were displaced. During this time of displacement, many individuals opened their homes to those who had been displaced. Generally, individuals are allowed personal exemptions in computing taxable income. Personal exemptions are allowed for the taxpayer, the taxpayer's spouse, and the taxpayer's dependents. Personal exemptions are phased out for higher-income taxpayers.

  This act allowed a taxpayer an additional $500 exemption for each Hurricane Katrina displaced individual of the taxpayer, up to a maximum additional exemption of $2,000. The additional exemption is not subject to the phase out for higher-income taxpayers. For the

purposes of this provision, a "Hurricane Katrina displaced individual" is a person 1) whose principal place of abode on August 28, 2005, was in the Hurricane Katrina disaster area, 2) who was displaced from the abode, 3) who is provided housing free of charge in the taxpayer's principal place residence for a period of 60 consecutive days that ends in the taxable year in which the exemption is claimed, and 4) is not the spouse or dependent of the taxpayer. For a person whose principal place of abode on August 28, 2005, was outside of the core disaster area, the person's abode must have been damaged by Hurricane Katrina or the person must have been evacuated from the abode by reason of Hurricane Katrina.

- *Increase in standard mileage rate for charitable use of vehicles.* In determining the amount of the charitable contribution deduction when a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer may either deduct actual operating expenditures or use the charitable standard mileage rate. The charitable standard mileage rate, 14 cents per mile, is significantly less than the business standard mileage rate[6]. The charitable rate is less than the business rate because it is meant to offset direct operating expenses, such as gas, only and not other expenses, such as a depreciation, insurance, or general maintenance.

  This act allows a taxpayer who uses a vehicle in providing donated service to charity for Hurricane Katrina relief only to compute the charitable mileage deduction at a rate equal to 70% of the business standard mileage rate, rounded to the next highest cent, on the date of the contribution. In the alternative, the taxpayer may continue to use actual operating expenditures to determine the amount of the deduction.

- *Mileage reimbursement to charitable volunteers excluded from gross income.* Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent that the reimbursement exceeds deductible expenses computed using either direct expenses or the charitable standard mileage rate. Under this act, reimbursement for mileage expenses by a charitable organization described in section 170(c) of the Code to a volunteer for the costs of using a passenger vehicle for Hurricane Katrina relief only are not included in income to the extent that the reimbursement does not exceed the amount that would be allowed using the business standard mileage rate. A taxpayer may not claim a deduction or credit for amounts excluded under this provision.

- *Charitable deduction for contribution of food inventories.* A taxpayer's deduction for charitable contributions of inventory is generally limited to the lesser of the taxpayer's basis in the inventory (usually cost) or the fair market value of the inventory. For certain contributions of inventory, a C corporation may claim an enhanced deduction equal to the lesser of 1) basis plus one-half on the item's appreciation or 2) two times basis. To be eligible for the enhanced deduction, the contributed property must generally be inventory of the corporation, contributed to a charitable organization described in section 501(c)(3) of the Code, and the donee must 1) use the property consistent with the donee's exempt purpose only for the care of the ill, the needy, or infants, 2) not transfer the property in exchange for money, other property, or services, and 3) provide the taxpayer with a written statement attesting to the proper use of the property.

  This act allows the enhanced deduction to any taxpayer engaged in a trade or business that makes a donation of food inventory. For taxpayers other than C corporations, the total deduction for contributions of food inventory may not exceed 10% of the taxpayer's income from all business entities from which a contribution of food inventory is made. The enhanced deduction is available only for food that qualifies as "apparently wholesome food,"

[6] For expenses incurred between January 1, 2005, and September 1, 2005, the standard business mileage rate was 40.5 cents per mile. For expenses incurred between September 1, 2005, and January 1, 2006, the standard business mileage rate was 48.5 cents per mile.

– food intended for human consumption that meets all quality and labeling standards imposed by federal, state, and local laws even though the food may not be readily marketable for any number of reasons.

- *Charitable deduction for contribution of book inventories.* A taxpayer's deduction for charitable contributions of inventory is generally limited to the lesser of the taxpayer's basis in the inventory (usually cost) or the fair market value of the inventory. For certain contributions of inventory, a C corporation may claim an enhanced deduction equal to the lesser of 1) basis plus one-half on the item's appreciation or 2) two times basis. To be eligible for the enhanced deduction, the contributed property must generally be inventory of the corporation, contributed to a charitable organization described in section 501(c)(3) of the Code, and the donee must 1) use the property consistent with the donee's exempt purpose only for the care of the ill, the needy, or infants, 2) not transfer the property in exchange for money, other property, or services, and 3) provide the taxpayer with a written statement attesting to the proper use of the property.

  This act extends the enhanced deduction for C corporations to qualified book contributions. A "qualified book contribution" is a charitable contribution of books to a public school that provides elementary education or secondary education and that is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils in attendance at the place where its education activities are regularly carried on.

Miscellaneous Provisions.

- *Exclusion for certain cancellations of indebtedness by reason of Hurricane Katrina.* Gross income includes income that is realized by a debtor for the discharge of indebtedness, subject to certain exceptions. This act provides that the gross income of a qualified individual does not include any amount which would otherwise by includible in gross income by reason of a discharge of nonbusiness debt if the indebtedness is discharged by an applicable entity. The relief allowed under this provision does not apply to any indebtedness to the extent that real property outside of the Hurricane Katrina disaster area serves as security for the debts. For the purposes of this provision, a "qualified individual" is any natural person whose principal place of abode on August 25, 2005, was located 1) in the core disaster area or 2) in the Hurricane Katrina disaster area and the person suffered economic loss as a result of Hurricane Katrina. An "applicable entity" includes the following: a financial institution; a credit union; a corporation that is a direct or indirect subsidiary of a financial institution or credit union and as such is subject to regulation by federal or state agencies; the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, the National Credit Union Administration, and certain other federal executive agencies; an executive, judicial, or legislative agency; and any other organization the for whom the lending of money is a significant trade or business.

- *Suspension of certain limitations on personal casualty losses.* A taxpayer may generally claim a deduction for any loss sustained during the taxable year for which he is not compensated by insurance or otherwise. For individuals, the loss must be incurred in a trade or business or consist of property loss attributable to casualty or theft. Losses are deductible only if they exceed $100 per casualty or theft and total casualty and theft losses exceed 10% of the taxpayer's adjusted gross income. This act removes the $100 and 10% limitations on casualty and theft losses to the extent those losses are in the Hurricane Katrina disaster area on or after August 25, 2005, and are attributable to Hurricane Katrina.

- *Required exercise of IRS administrative authority.* In general, the Secretary of the Treasury may grant reasonable extensions of time to taxpayers to perform certain acts. In addition, for

certain military personnel, the time period for performing certain acts (such as filing returns, paying taxes, bringing suit) is automatically suspended. In the case of a Presidentially declared disaster or terroristic or military action, the Secretary has the authority to prescribe a period of up to one year in which the time period for the same actions is suspended. This act requires the Secretary to suspend those time periods at least until February 28, 2006, for taxpayers determined to have been affected by the Presidentially declared disaster relating to Hurricane Katrina. In addition, this act adds employment and excise taxes to the list of taxes for which the Secretary may extend filing and payment time periods.

- *Special rules for mortgage revenue bonds.* A qualified mortgage bond is a type of private activity bonds for which interest is excluded from gross income. Qualified mortgage bonds are issued to make mortgage loans to qualified mortgagors for the purchase, improvement, or rehabilitation of owner-occupied residences and to finance qualified home improvement loans. There are several limitations on qualified mortgage bonds, including income limitations for homebuyers, purchase price limitations, and a the requirement that the mortgagor be a "first-time homebuyer" – one that did not have any ownership interest in a primary residence for the previous three years. The first-time home buyer requirement does not apply to targeted area residences – one that is located in an area of chronic economic distress or a census tract in which at least 70% of the families have an income that is 80% or less of the statewide median income. A qualified home improvement loan may not exceed $15,000.

  This act eliminates the first-time homebuyer requirement with respect to qualified Hurricane Katrina recovery residences. A "qualified Hurricane Katrina recovery residence" is one that is financed before January 1, 2008, and is either 1) located in the core disaster area or 2) the mortgagor of which owned a principal residence in the Hurricane Katrina disaster area that was rendered uninhabitable by Hurricane Katrina and the residence financed is in the same state as the previous residence.

  The act also increases the maximum amount of a qualified home improvement loan to $150,000 for residences located in the Hurricane Katrina disaster area to the extent that the loan is for repair of damage caused by Hurricane Katrina.

- *Extension of replacement period for nonrecognition of gain.* A taxpayer generally realizes gain to the extent the sales price of property exceeds the taxpayer's basis in the property. The realized gain is subject to taxation unless it is deferred or not recognized under some special provision. Gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent the taxpayer replaces the property within the applicable period. The applicable period begins when property is converted and ends two years after the close of the first taxable year in which the gain is realized.

  This act extends the applicable period from two years to five years for property that is located within the Hurricane Katrina disaster area that is compulsorily or involuntarily converted after August 25, 2005, by reason of Hurricane Katrina. Substantially all of the use of the replacement property must be in this area for this provision to apply.

- *Secretarial authority to make adjustments regarding taxpayer and dependency status for taxpayers affected by Hurricane Katrina.* This provision allows the Secretary of the Treasury to make adjustments to the tax laws to ensure that taxpayers do not lose eligibility for credits or deductions or experience a change in filing status due to temporary relocations caused by Hurricane Katrina. An example of such an adjustment would be allowing a parent to claim a personal exemption for a child even if the child did not satisfy the residency requirement as a result of a relocation due to Hurricane Katrina. Any adjustment must ensure

that an individual is not taken into account by more than one taxpayer with respect to the same benefit.

Gulf Opportunity Zone Act of 2005 (P.L. 109-135) (GO Act)

The Gulf Opportunity Zone Act of 2005 expanded upon the relief offered in the Katrina Emergency Tax Relief Act of 2005. In some instances, this expansion meant extending the additional benefits allowed under the Katrina Act to taxpayers affected by Hurricanes Rita or Wilma. In other cases, the expansion created new tax benefits for taxpayers in one or more of the disaster areas. The act also made numerous technical corrections.

General Provisions. First, the GO Zone Act added several new definitions. First, the "Gulf Opportunity Zone" or "GO Zone" is a subset of the Hurricane Katrina disaster area that has been determined by the President to warrant individual or individual and public assistance from the federal government and is the same as the "core disaster area" under the Katrina Act. The "Hurricane Rita disaster area" means an area with respect to which the President has declared a major disaster before October 6, 2005, with respect to Hurricane Rita. The "Hurricane Wilma disaster area" means an area with respect to which the President has declared a major disaster before November 14, 2005, with respect to Hurricane Wilma. The "Rita GO Zone" and "Wilma GO Zone" are, respectively, the portions of the Hurricane Rita disaster area and Hurricane Wilma disaster area that have been determined by the President to warrant individual or individual and public assistance from the federal government.

Extensions of Hurricane Katrina benefits. The GO Zone Act extended some of the benefits of the Katrina Act to areas affected by Hurricanes Rita and Wilma. The following changes fall into this category.

- *Retirement plans.* The specific provisions discussed under the Katrina Act were repealed and replaced with more general provisions relating to all of the hurricanes. The provisions under this act were substantively identical to those discussed under the Katrina Act with some timing differences related to the different dates of the three storms.
- *Casualty losses.* The specific provisions discussed under the Katrina Act were repealed and replaced with more general provisions relating to all of the hurricanes. The provisions under this act were substantively identical to that discussed under the Katrina Act with some timing differences related to the different dates of the three storms.
- *Secretarial authority to make adjustments.* The specific provisions discussed under the Katrina Act were repealed and replaced with more general provisions relating to all of the hurricanes. The provisions under this act were substantively identical to those discussed under the Katrina Act with some timing differences related to the different dates of the three storms.
- *Mortgage revenue bonds.* The first-time homebuyer requirement is eliminated for residences in the Rita GO Zone or the Wilma GO Zone. In addition, the increased maximum amount of a qualified home improvement loan is applied to residences in the Rita GO Zone and the Wilma GO Zone.

Housing relief for Hurricane Katrina. As discussed above, the Katrina Act provided some relief to individuals who provided housing for Hurricane Katrina evacuees. In this act, Congress provided further tax relief relating to housing expenditures. Employer-provided housing is generally included in income as a form of compensation. An exception to this general rule exists when an employee is required to accept the lodging on business premises as a condition of employment. This act provides that a qualified employee's gross income does not include the value of any in-kind lodging furnished to the employee, the employee's spouse, or the employee's dependents by or on behalf of the qualified employer. The exclusion applies only to lodging furnished during the six-month period beginning

January 1, 2006 and may not exceed $600 for any month in which lodging is furnished. For the purposes of this provision, a "qualified employee" is an individual who on August 28, 2005, had a principal residence in the GO Zone and who performs substantially all of his or her employment services in the GO Zone for a qualified employer. For the purposes of this provision, a "qualified employer" is an employer with a trade or business located in the GO Zone.

Depreciation and expensing.

- *Bonus depreciation for Gulf Opportunity Zone property.* In 2002 and 2003, Congress acted to allow for bonus depreciation (either 30% or 50% depending on when the property was purchased) for property that was purchased after September 10, 2001. In order to qualify for the bonus depreciation, the property had to have been placed into service before January 1, 2005. For certain transportation property, noncommercial aircraft, or property with a long production period, the property must have been placed into service before January 1, 2006.

  This act allows a taxpayer to claim an additional first-year depreciation allowance equal to 50% of the adjusted basis of qualified Gulf Opportunity Zone property acquired on or after August 25, 2005, and placed into service before January 1, 2008 (the sunset date is January 1, 2009, for nonresidential real property and residential rental property). "Qualified Gulf Opportunity Zone property must satisfy all of the following conditions: 1) It must be depreciable modified accelerated cost recovery systems (MACRS) recovery property with a recovery period of 20 years or less, MACRS water utility property, qualified leasehold improvement property, off-the-shelf computer software, residential rental property, or nonresidential real property; 2) Substantially all use of the property must be in the active conduct of a trade or business of the taxpayer in the GO Zone; 3) The original use of the property in the GO Zone must commence with the taxpayer on or after August 25, 2005; 4) The property must be purchased on or after August 25, 2005; 5) No written binding contract for the purchase of the property may be in effect before August 25, 2005; and 6) The property must be placed in service before January 1, 2008 (January 1, 2009 for nonresidential real property and residential rental property). The term does not include property that is 1) mandatory alternative depreciation system (ADS) property; 2) tax-exempt bond-financed property; 3) qualified revitalization buildings or rehabilitation expenditures for which a deduction under section 1400I of the Code is claimed; or 4) property used in connection with a private or commercial golf course, a country club, a massage parlor, a hot tub facility, a suntan facility, a liquor store, or a gambling or animal racing property.

  In addition, this act allows the Secretary to extend the placed-in-service date for noncommercial aircraft and property with longer production periods for up to one year. This extension is granted on a case-by-case basis and may only be granted if the delay in placing the property into service was caused by one of the three hurricanes and the property is placed in service in the GO Zone, the Rita GO Zone, or the Wilma GO Zone.

- *Increase in limits on section 179 deductions.* Certain taxpayers may elect to claim a section 179 expense deduction on the cost of qualifying property rather than depreciating the property over time. For the 2003 through 2007 tax years, the maximum amount of the deduction is limited to $100,000, indexed for inflation.[7] This limitation is increased by $35,000 for property that is placed in service in the New York Liberty Zone, an empowerment zone, or a renewal community. The amount of the section 179 deduction is reduced to the extent that the total amount of property placed into service exceeds an investment threshold, currently set at $400,000, indexed for inflation.[8] The section 179

[7] The adjusted dollar limitation is $105,000 for 2005 and $108,000 for 2006.
[8] The adjusted investment limitation is $420,000 for 2005 and $430,000 for 2006.

deduction may not exceed a taxpayer's taxable income from the active conduct of a trade or business.

This act increases the maximum section 179 deduction for qualified GO Zone property by the lesser of $100,000 or the amount of property placed into service in the GO Zone. In addition it increases the total investment limitation by the lesser of $600,000 or the amount of property placed into service in the GO Zone. The increased amounts apply to property acquired on or after August 25, 2005, and placed into service before January 1, 2008. "Qualified GO Zone property" must satisfy all of the following conditions: 1) It must be depreciable modified accelerated cost recovery systems (MACRS) recovery property with a recovery period of 20 years or less; 2) Substantially all use of the property must be in the active conduct of a trade or business of the taxpayer in the GO Zone; 3) The original use of the property in the GO Zone must commence with the taxpayer on or after August 25, 2005; 4) The property must be purchased on or after August 25, 2005; 5) No written binding contract for the purchase of the property may be in effect before August 25, 2005; and 6) The property must be placed in service before January 1, 2008. The term does not include property used in connection with a private or commercial golf course, a country club, a massage parlor, a hot tub facility, a suntan facility, a liquor store, or a gambling or animal racing property.

- *Deduction for demolition and clean-up costs.* Under general law, demolition costs are capitalized and added to the basis of the land on which the demolished building was located. The tax treatment of debris removal costs depends on the nature of the costs incurred. Debris removal costs that are in the nature of replacement must be capitalized and added to the basis of the property damaged. Other times, debris removal costs may be used to show a decrease in the fair market value of property which could be used to determine the amount of a casualty loss. This act allows a taxpayer to claim a current deduction for 50% of any qualified Gulf Opportunity Zone clean-up costs paid between August 25, 2005, and January 1, 2008. For the purposes of this provision, a "qualified Gulf Opportunity Zone clean-up cost" is an amount paid for the removal of debris, or the demolition of structures, on real property located in the GO Zone if the real property is either held by the taxpayer for use in a trade or business or is inventory in the hands of the taxpayer.

- *Environmental remediation costs.* Under previous law, a taxpayer may elect to deduct, rather than capitalize, certain environmental remediation expenditures incurred in connection with property used in a trade or business for the production of income. This provision expired for expenditures incurred after December 31, 2005. This act extends the expiration date for that provision until December 31, 2007 for qualified environmental remediation expenditures incurred in connection with a qualified site in the GO Zone. In addition, expenditures incurred on or after August 25, 2005, with respect to petroleum products in the GO Zone are included in the deduction.

FEDERAL DETERMINATIONS.

This bill would reduce the period of time in which a taxpayer must report a federal change from two years to six months. When the federal government corrects or otherwise determines the amount of an estate, gift, or income that is subject to tax, the taxpayer must file a State return that reflects that change. This is so because the State estate, gift, and income taxes are, to varying degrees, based on amounts determined with respect to federal law. The Multistate Tax Commission has adopted a model uniform statute for reporting federal changes. That model uniform statute requires a taxpayer to report those changes within six months. The model statute is intended to bring uniformity to this area among the states. Currently there is a great deal of variety with some states requiring changes to be reported in as

little as 90 days to as much as two years. This provision becomes effective July 1, 2006, and applies to federal determinations made on or after that date.

FILING PERIOD FOR NONRESIDENT ALIENS.

Section 6072(c) of the Code requires a nonresident alien to file an income tax return on or before the fifteenth day of the sixth month following the close of the taxable year (June 15th for taxpayer whose taxable year is the calendar year). Under current State law, nonresident alien corporate taxpayers must file a State return by the fifteenth day of the third month following the close of the taxable year (March 15th for a calendar year taxpayer) and nonresident alien individual taxpayers must file a State return by the fifteenth day of the fourth month following the close of the taxable year (April 15th for a calendar year taxpayer). Thus, under current State law a nonresident alien is required to file a State income tax return before the federal tax return is due. This provision would conform the State filing deadlines to the federal filing deadlines for nonresident aliens and would ease compliance burdens on those taxpayers. These provisions become effective for taxable years beginning on or after January 1, 2006.

CREDIT FOR CHILD-CARE AND CERTAIN EMPLOYMENT-RELATED EXPENSES.

Current State law allows a credit to a taxpayer who is eligible for the federal credit for child-care and employment-related expenses. The amount of the credit is based on a percentage of those expenses up to a certain amount. For the State credit, the amount of expenses that may be taken into consideration when computing the credit are capped at $2,400 when there is one qualifying individual in the household and $4,800 when there is more than one qualifying individual in the household. Until 2003, these limits were the same as those at the federal. In 2003, the federal limits increased to $3,000 and $6,000 respectively. This provision would conform the State limits to the federal limits. This provision also clarifies that the amount of expenses used in calculating the credit may not include any amount excluded from gross income. This provision becomes effective for taxable years beginning on or after January 1, 2006.

0284Draft-SMLY-LYx-284

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

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 2, 2006

TO: Revenue Laws Study Committee

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: 2005-LYxz-284 – IRC Update

FISCAL IMPACT (millions)

	Yes (x)	No ( )	No Estimate Available ( )		
	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:	(5.1)	(5.1)	(5.0)	(5.0)	(5.0)
EXPENDITURES:					
POSITIONS (cumulative):					

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

EFFECTIVE DATE: Sections 1, 2, and 10 are effective when law. Sections 3, 4, 5, and 6 become effective July 1, 2006 and apply to federal determinations made on or after that date. Sections 7, 8, and 9 are effective for taxable years beginning on or after January 1, 2006.

BILL SUMMARY: Generally North Carolina tracks federal law as it relates to income tax provisions. However, because of constitutional limitations, the General Assembly must proactively decide each year to update its reference to the Internal Revenue Code (IRC). Updating the reference date for the code allows the state to track recent changes in federal tax law. The legislation changes the reference date in North Carolina statutes from January 1, 2005 to January 1, 2006, effectively including several recent federal tax law changes.

The bill also makes several other changes to the State's tax law. First, it shortens the amount of time a taxpayer has to file an amended State return to reflect changes or corrections in their federal return. Currently taxpayers have two years after the change to file an amended return. The legislation shorts this period to six months. This provision applies to all state taxes which are based on federal returns including estate, income, and gift taxes. The legislation also conforms state nonresident alien return due dates to similar federal dates. Finally, the legislation conforms the state amounts associated with the child care credit and certain employment related expense credits to those allowed under federal law.

ASSUMPTIONS AND METHODOLOGY: The legislation makes numerous changes to the state's tax laws which have some revenue impact.

IRC Update: Section 1 of the bill updates the reference to the federal code from January 1, 2005 to January 1, 2006. This has the effect of including the changes associated with four pieces of federal legislation: the Energy Tax Incentive Act of 2005 (Energy Act), the Safe, Accountable, Flexible, Efficient Transportation Equity Act of 2005 (SAFE Act), the Katrina Emergency Tax Relief Act of 2005 (Katrina Act), and the Gulf Opportunity Zone Act of 2005 (GO Act). While these bills included a significant number of tax changes, only some flow through to the state return. The items with a likely fiscal impact are addressed below.

Energy Act: The Energy Act created a variety of incentives to purchase energy efficient vehicles, facilities, and home improvement items. Because many of these incentives are in the form of credits, they do not impact North Carolina taxable income. As such, they produce no revenue gain or loss. However, there are four items in the bill that do create a potential loss for the state.

- Alternative Fuel Vehicles: The Energy Act eliminated the existing deduction for clean-fuel vehicles and certain refueling property, and replaced it with a tax credit. Because federal tax credits do not affect North Carolina taxable income, the credit has no impact on state revenues, while eliminating the deduction would actually create a revenue gain. The Joint Committee on Taxation estimates a national loss in 2006 of $8.0 million from this change. Data from the Bureau of Economic Analysis and Economy.com suggest that North Carolina will be approximately 2.85% of US auto sales. Using this percent as a proxy for alternative fuel vehicle sales suggests a state revenue gain $225,000 in 2006. In future years the change will be less than $100,000.
- Electric Transmission Assets: Under previous federal law, a taxpayer could recognize a qualified gain from a qualifying electric transmission transition if that transaction was completed before January 1, 2007. The Energy Act extends that date to January 1, 2008. Conforming to the Code will also extend this date to 2008. The Joint Committee on Taxation estimates a national 2006 loss of $105 million, and a 2007 loss of $237 million. However, because of the limited information available concerning the distribution of these assets and transitions, no North Carolina estimate is possible on this portion of the bill.
- Energy Efficient Commercial Buildings Property Deduction: The Act allows taxpayers to claim a deduction (as opposed to depreciation or amortization) for costs associated with energy efficient commercial building property placed into service between January 1, 2006 and January 1, 2008. The estimated state revenue change as a result of the proposal is outlined below. It assumes an average federal tax rate of 34% and uses North Carolina's portion of federal corporate tax payments as a proxy for North Carolina's portion of the loss. In addition, because this can be used by both individuals and corporations, the average loss is used as a proxy for the actual loss.

Millions

Commercial Building Property	FY 06-07	FY 07-08	FY 08-09	FY 09-10	FY 10-11
JCT Estimate of Federal change	-81	-141	-48	6	5
Federal Tax Base Change (34%)	-238.235	-414.706	-141.176	17.64706	14.70588
NC Portion of Federal Collections	0.53%	0.53%	0.53%	0.53%	0.53%
NC Base Change	-1.26265	-2.19794	-0.74824	0.093529	0.077941
Corporate Estimate	-0.08712	0.000437	0.000437	0.000437	0.000437
Individual Estimate	-0.10417	-1.09875	-0.3739	0.046983	0.039189
Average	-0.09565	-0.54916	-0.18673	0.02371	0.019813

- Depreciation, Amortization, and Other Changes: The federal legislation creates more favorable depreciation and amortization schedules for a number of large purchases including air pollution control facilities for coal-fired plants, certain electric power purchases. The JCT has developed a series of estimates related to these changes. However, because these investments are highly concentrated, based on the individual business decisions of a limited number of companies, and are not linked to any particular state or national ratio, no exact fiscal estimate is possible on these portions of the legislation.

SAFE Act: Although the Act makes a substantial number of changes at the federal level, the changes do not impact North Carolina taxable income. As such, there is no state impact associated with this legislation.

Katrina Act: The federal legislation defines both a "Hurricane Katrina Disaster Area" and a "core disaster area" and provides additional tax advantages for individual who live in those areas, own property in those areas, or make certain charitable contributions to relief efforts in those areas.

While many of these changes could have a revenue impact, the largest potential fiscal impact will likely come from the changes related to charitable contributions. Under federal law the size of deduction allowed for charitable contributions is limited for certain types of taxpayers, certain types of property donated, and the type of organization receiving the donation. Generally cash contributions are deductible in the amount contributed, "capital gain property" is deductible at fair market value, other appreciated property donations are deductible at the donor's base in property, and depreciated property is deductible at fair market value. In addition, the tax value of the donation can not exceed a certain proportion of their adjusted gross income. The Katrina Act provides several exceptions to these limitations on charitable contribution deductions. The Joint Committee on Taxation estimates a 2006 cost associate with this change of $819.0 nationwide. Using North Carolina's proportion of charitable contributions at the federal level as a proxy suggests conforming on this change will result in a one time loss to the General Fund of $5.89 million. In addition, their were numerous changes related to the cost of assisting with the relief effort including a change in the standard deductible mileage rate, mileage reimbursements to volunteers, enhanced deductions for contributions of food and book inventories, and an increased personal exemption for housing victims of the hurricanes. Based on data from the Joint Committee on Taxation, North Carolina's portion of federal taxes, and the average North Carolina tax rate, Fiscal Research estimates a 2006-07 loss associated with this change of $142,000. In 2007-08 that number drops to $53,000.

Most of the remaining changes related specifically to residents, former residents, and property owners in the Gulf Region. Clearly most of the victims of Hurricanes Katrina and Rita were relocated to areas

closer to the gulf than North Carolina. However, the North Carolina Department of Public Instruction indicates that approximately 1,462 students entered the North Carolina school system as a result of the hurricanes. Thus, at least some form residents relocated to the state. To the extent they take advantage of the new special tax changes the State will see a loss. However, given the limited number of families involved, the potential loss is expected to be relatively insignificant.

GO Act: While this Act makes numerous tax law changes, most are related specifically to the Gulf area. Based on data provided by the Joint Committee on Taxation, it appears that the only change that will have a measurable fiscal impact on North Carolina is the temporary suspension of limitation on qualified corporate charitable contributions for Hurricanes Rita and Wilma relief efforts. The Joint Committee estimates that in 2006 this change will result in a $85 million loss for the federal government. Using the state's portion of Gross Domestic Product as a proxy for North Carolina's portion of the revenue loss, and adjusting for base differences, suggests a potential revenue loss for the state of $34,000. This is a one time loss, as it relates only to contributions made between August 28, 2005 and December 31, 2005. Any other revenue affects related to this legislation are expected to be negligible.

While the above outlines the IRC update conformity issues, the legislation also addresses several other tax issues.

Credit for Child Care: Under current law taxpayers can receive both a federal and state credit for work related child care expenses. For many years, the amount of expenses that could be considered when calculating the credit was the same at both the state and federal level. In 2003 the federal government increased the cap on those qualifying expenses from $2,400 to $3,000 ($4,800 to $6,000 if there is more than one qualifying individual in the household). At that time the state did not conform to this change. The legislation would bring state caps in line with the federal caps. According to the Policy Analysis and Statistics Division of the North Carolina Department of Revenue (formerly Tax Research), the annual cost of such a change is approximately $5.0 million.

Other: The legislation also addresses several other tax issues. First, the bill reduces the period of time in which a taxpayer must report a federal change from two years to six months. This change is expected to ease processing at the North Carolina Department of Revenue, but will have no revenue side implications. Second, the bill alters the tax filing date for nonresident aliens. Specifically, it conforms the State filing deadlines to the federal filing deadlines for nonresident aliens and would ease compliance for those taxpayers. No revenue impact is expected as a result of this change.

SOURCES OF DATA: Joint Committee on Taxation, Internal Revenue Service, North Carolina Department of Revenue, and the North Carolina Department of Public Instruction.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #7

ADDITIONAL PERSONAL INCOME TAX FILING OPTION

LEGISLATIVE PROPOSAL #7

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO ALLOW AN ADDITIONAL JOINT FILING OPTION FOR INDIVIDUAL INCOME TAXES.

SHORT TITLE: Additional Personal Income Tax Filing Option

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

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BRIEF OVERVIEW: This bill would allow married couples the option of filing a joint return if one spouse is a nonresident with no North Carolina income.

FISCAL IMPACT: Potential minimal loss.

EFFECTIVE DATE: The bill is effective for taxable years beginning on or after January 1, 2006.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-LAz-20 [v.3] (1/31)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
2/6/2006 11:26:08 AM

Short Title:	Additional Personal Income Tax Filing Option.	(Public)
Sponsors:	Unknown.	
Referred to:		

A BILL TO BE ENTITLED

AN ACT TO ALLOW AN ADDITIONAL JOINT FILING OPTION FOR INDIVIDUAL INCOME TAXES.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-162(e) reads as rewritten:

"(e) Joint Returns. – A husband and wife ~~shall file a single income tax return jointly if (i) their~~whose federal taxable income is determined on a joint federal return ~~and (ii) both spouses are residents of this State or both spouses have~~shall file a single income tax return jointly if each spouse either is a resident of this State or has North Carolina taxable ~~income.~~income, and may file a single income tax return jointly if one spouse is not a resident and has no North Carolina taxable income. Except as otherwise provided in this Part, a wife and husband filing jointly are treated as one taxpayer for the purpose of determining the tax imposed by this Part. A husband and wife filing jointly are jointly and severally liable for the tax imposed by this Part reduced by the sum of all credits allowable including tax payments made by or on behalf of the husband and wife. However, if a spouse has been relieved of liability for federal tax attributable to a substantial understatement by the other spouse pursuant to section 6015 of the Code, that spouse is not liable for the corresponding tax imposed by this Part attributable to the same substantial understatement by the other spouse. A wife and husband filing jointly have expressly agreed that if the amount of the payments made by them with respect to the taxes for which they are liable, including withheld and estimated taxes, exceeds the total of the taxes due, refund of the excess may be made payable to both spouses jointly or, if either is deceased, to the survivor alone."

SECTION 2. This act is effective for taxable years beginning on or after January 1, 2006.

DRAFT 2005-LAz-20: Additional Personal Income Tax Filing Option

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	April 28, 2006
Introduced by:		**Summary by:**	Martha Walston
Version:	Draft 2005-LAz-20		Committee Counsel

SUMMARY: ***This bill is a recommendation of the Department of Revenue and would allow married couples the option of filing a joint return if one spouse is a nonresident with no North Carolina income.***

BILL ANALYSIS: Under current law, a married couple who file a federal joint return are required to file a North Carolina joint return if each spouse is either a resident or has North Carolina income. If one spouse is a nonresident and has no North Carolina income, that spouse is not subject to North Carolina income tax and the other spouse must file a separate return. The current law is based on the fact that North Carolina has no jurisdiction to tax a person who is not a resident and does not have income from North Carolina sources. The current law makes filing more complicated because the couple must recompute their income separately in order to file a North Carolina return.

The bill would allow a married couple the option of filing jointly if they file a federal joint return and if one spouse is a nonresident with no income from North Carolina. Because North Carolina does not have jurisdiction over the nonresident spouse, the bill does not require a joint return.[1] It merely gives a couple a joint return option so that they may choose to file jointly, for example if doing so would simplify their tax preparation or reduce their North Carolina taxes. This option would also allow North Carolina residents to file jointly in Georgia and South Carolina. Currently, these two states do not allow nonresident joint filing for residents of states that do not allow joint filings for Georgia and South Carolina residents.

EFFECTIVE DATE: The bill is effective for taxable years beginning on or after January 1, 2006.

2005-LAz-20-SMLA

[1] A New York court found that a provision, which required married nonresidents to file a joint nonresident tax return in New York if they filed a joint federal return, was unconstitutional. The court explained that the provision exposed a nonresident spouse with no New York connections to civil and criminal liability in New York by virtue of that spouse's signature on the State tax return.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

FISCAL ANALYSIS MEMORANDUM

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DATE: February 6, 2006

TO: Revenue Laws

FROM: Linda Struyk Millsaps
Fiscal Research Division

RE: Additional Personal Income Tax Filing Option

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:			Potential Minimal loss		
EXPENDITURES:					

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

EFFECTIVE DATE: For taxable years beginning on or after January 1, 2006.

BILL SUMMARY: Under North Carolina law, a married couple that files a joint federal return must file a joint state return if both are residents or have North Carolina income. However, if one spouse is a non-resident and has no North Carolina income, the other spouse must file a separate return with the State. The proposed legislation would allow such a couple the option of filing a joint North Carolina return. This is a recommendation of the North Carolina Department of Revenue.

ASSUMPTIONS AND METHODOLOGY: Currently no data is available about the number of returns this change would impact or the likely amount of revenue affected. However, the Department

believes the number of taxpayers involved would be small. Because this legislation gives the couple the option of choosing to file joint or separate returns, it would be reasonable to assume there are some circumstances were the taxpayer may benefit financially from a specific filing status, and would select that status. As such, there is a potential revenue loss.

SOURCES OF DATA: North Carolina Department of Revenue.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #8

S CORP INCOME TAX ADJUSTMENTS

LEGISLATIVE PROPOSAL #8

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO MAKE CORPORATE INCOME TAX ADJUSTMENTS INAPPLICABLE TO S CORPORATIONS.

SHORT TITLE: S Corp Income Tax Adjustments

SPONSORS: **Wilkins**; Carney, Church, Hill, Luebke, McComas, Wainwright

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BRIEF OVERVIEW: This proposal would make corporate income tax adjustments inapplicable to S Corporations.

FISCAL IMPACT: Negligible fiscal impact.

EFFECTIVE DATE: This proposal would become effective with the 2006 taxable year.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-SVxz-11 [v.5] (02/13)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
2/28/2006 3:00:15 PM

Short Title: S Corp Income Tax Adjustments. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE CORPORATE INCOME TAX ADJUSTMENTS INAPPLICABLE TO S CORPORATIONS.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-131.2 reads as rewritten:

"**§ 105-131.2. Adjustment and characterization of income.**

(a) Adjustment. – ~~The pro rata share of each shareholder in the income attributable to the State of an S Corporation shall be adjusted as provided in G.S. 105-130.5. The pro rata share of each resident shareholder in the income not attributable to the State of an S Corporation shall be adjusted as provided in G.S. 105-134.6(b), (c), and (d).~~Each shareholder's pro rata share of an S Corporation's income is subject to the adjustments provided in G.S. 105-134.6.

(b) Repealed by Session Laws 1989, c. 728, s. 1.35.

(c) Characterization of Income. – S Corporation items of income, loss, deduction, and credit taken into account by a shareholder pursuant to G.S. 105-131.1(b) ~~shall be~~ are characterized as though received or incurred by the S Corporation and not its shareholder."

SECTION 2. G.S. 105-134.6(a) reads as rewritten:

"(a) S Corporations. ~~The pro rata share of each shareholder in the income attributable to the State of an S Corporation shall be adjusted as provided in G.S. 105-130.5. The pro rata share of each resident shareholder in the income not attributable to the State of an S Corporation shall be~~ Each shareholder's pro rata share of an S Corporation's income is subject to the adjustments provided in ~~subsections (b), (c), and (d) of~~ this section."

SECTION 3. This act is effective for tax years beginning on or after January 1, 2006.

LEGISLATIVE PROPOSAL 2005-SVxz-11: S Corp. Income Tax Adjustments

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	March 1, 2006
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft 2005-SVxz-11		Committee Counsel

SUMMARY: ***This legislative proposal would make corporate income tax adjustments inapplicable to S Corporations, effective beginning with the 2006 taxable year.***

CURRENT LAW: An S Corporation is a corporation that has elected to have the corporation's income pass through to the shareholders. Thus, the business profits are taxed at individual tax rates. An S Corporation election allows the shareholders to preserve the benefit of limited liability for the corporate form while at the same time being treated as partners for federal income tax purposes. The S Corporation itself does not pay any income tax, but an S Corporation is required to file an informational return with the IRS, similar to a partnership tax return, to inform the IRS of each shareholder's ownership interest in the S corporation. To be eligible for S Corporation status, a corporation must meet all of the following requirements:

- The corporation may have no more than 75 shareholders.
- The corporation may have only one class of stock, although different voting rights among shareholders are allowed.
- All shareholders must be individuals or trusts.
- The corporation must be formed in the United States.
- No shareholder may be a non-resident alien.
- The corporation may not be an insurance company or a domestic international sales corporation.

A C Corporation, on the other hand, assumes a separate legal and tax life distinct from its shareholders. A corporation pays taxes at its own corporate income tax rates and files its own corporate tax forms each year. C Corporations may choose to retain their profits and earnings as part of their operating capital, or they may choose to distribute some or all of their profits and earnings as dividends paid to shareholders. Dividends paid to shareholders are essentially taxed twice. They are taxed once at the corporate level and again at the individual level.

As noted above, C Corporations cannot be shareholders of an S Corporation. All shareholders must be individuals or trusts. Trusts, and obviously individuals, are subject to tax using the individual income tax rates. Thus, the tax imposed on the income of an S Corporation is an individual income tax, not a corporate tax. However, current law results in an individual's pro rata share of S Corporation income attributable to North Carolina being subject to corporate income tax adjustments, while S Corporation income not attributable to North Carolina is subject to individual income tax adjustments.

BILL ANALYSIS: This bill would make an individual's pro rata share of income from an S Corporation subject only to the individual income tax adjustments, rather than being subject to both individual and corporate income tax adjustments. This approach would be more consistent with the tax

treatment of an S Corporation generally and would simplify tax form preparation. Consequently, it may result in a higher degree of compliance with the law.

EFFECTIVE DATE: This act would become effective for taxable years beginning on or after January 1, 2006.

BACKGROUND: Of the approximately 20 states that tax S Corporation income at the shareholder level, 18 of those states use the individual law to make adjustments. Louisiana applies corporate adjustments. North Carolina is the only state that uses both.

2005-SVxz-11

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

FISCAL ANALYSIS MEMORANDUM

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DATE: April 25, 2006

TO: Revenue Laws

FROM: Dave Crotts
Fiscal Research Division

RE: Draft 2005-SVxz-11 (v.5) (S Corporation Income Tax Adjustments)

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:	See "Assumptions and Methodology"				
EXPENDITURES:					

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

EFFECTIVE DATE: Tax years beginning on or after January 1, 2006.

BILL SUMMARY: A C Corporation cannot be a shareholder of an S Corporation. All S shareholders must be individuals or trusts, which means that the taxpayer is subject to the individual income tax. However, current law results in an individual's pro rata share of S Corporation income attributable to North Carolina being subject to corporate income tax adjustments, while S Corporation income not attributable to North Carolina is subject to individual income tax adjustments. The proposal would make an individual's pro rata share of income from an S Corporation subject only to the individual income tax adjustments, rather than being subject to both individual and corporate income tax adjustments. This approach would be more consistent with the tax treatment of an S Corporation

generally and would simplify tax form preparation. Consequently, it may result in a higher degree of compliance with the law.

ASSUMPTIONS AND METHODOLOGY: The Department of Revenue indicates that the proposal would have a negligible revenue impact because many of the adjustments are duplicated in both individual and corporate income tax law and that some of the adjustments under the corporate income tax that are not under the individual income tax are not applicable to S corporation income tax. Thus, the change has limited application

SOURCES OF DATA: North Carolina Department of Revenue.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #9

CLARIFY ADDITIONAL GROSS PREMIUMS TAX

LEGISLATIVE PROPOSAL #9

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO CLARIFY THE APPLICATION OF THE ADDITIONAL GROSS PREMIUMS TAXES ON FIRE AND LIGHTNING COVERAGE AND TO INCLUDE ALL POLICIES.

SHORT TITLE: Clarify Additional Gross Premiums Tax

SPONSORS: **Wainwright**; Carney, Church, Hill, McComas, Luebke, Wilkins

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BRIEF OVERVIEW: The bill would specify the percentage of an insurance policy's gross premiums to which the additional gross premiums tax on fire and lightning coverage applies and it would provide that the additional tax would apply to all types of policies that insure against fire and lightning loss.

FISCAL IMPACT: The bill would expand the tax base to include automobile and marine policies. The amount of any increase in revenues will depend upon the percentages used. It is anticipated that the percentages in the bill will be changed in the finance committee to reflect loss experience data. The Department of Insurance will suggest appropriate percentages to use.

EFFECTIVE DATE: The clarifying changes would become effective January 1, 2006. The elimination of the exemption for marine and automobile policies would become effective January 1, 2007.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-RBxz-30 [v.11] (02/23)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
5/2/2006 9:01:35 AM

Short Title: Clarify Additional Gross Premiums Tax. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THE APPLICATION OF THE ADDITIONAL GROSS PREMIUMS TAXES ON FIRE AND LIGHTNING COVERAGE AND TO APPLY THE ADDITIONAL TAX TO ALL POLICIES THAT PROVIDE FIRE AND LIGHTNING COVERAGE.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-228.5(d)(3) reads as rewritten:

"(d) Tax Rates; Disposition. –

...

(3) Additional Statewide Fire and Lightning Rate. – An additional tax ~~shall be applied to gross premiums on contracts of insurance applicable to fire and lightning coverage, except in the case of marine and automobile policies,~~ at the rate of one and thirty-three hundredths percent ~~(1.33%).~~(1.33%) applies to gross premiums on insurance contracts that provide fire and lightning coverage, except in the case of marine and automobile policies. The tax is a percentage of the gross premiums from the contracts, determined in accordance with the table in this subdivision. Twenty-five percent (25%) of the net proceeds of this additional tax shall be deposited in the Volunteer Fire Department Fund established in Article 87 of Chapter 58 of the General Statutes. The remaining net proceeds shall be credited to the General Fund.

Type of Insurance Contract	Taxable Percentage
Fire Loss	100%
Commercial Multiple Peril	
Non-liability portion	100%
Liability portion	0%
Homeowner's	50%

Farm Owner's		35%."

SECTION 2. G.S. 105-228.5(d)(4) reads as rewritten:

"(d) Tax Rates; Disposition. –

...

(4) Additional Local Fire and Lightning Rate. – An additional tax ~~shall be applied to gross premiums on contracts of insurance applicable to fire and lightning coverage within fire districts~~ at the rate of one-half of one percent ~~(½ of 1%)~~.(0.5%) applies to gross premiums on insurance contracts that provide fire and lightning coverage within a fire district. The tax is a percentage of the gross premiums from the contracts, determined in accordance with the table in subdivision (3) of this subsection. The net proceeds shall be credited to the Department of Insurance for disbursement pursuant to G.S. 58-84-25."

SECTION 3. G.S. 105-228.5(d)(3), as amended by Section 1 of this act, reads as rewritten:

"(d) Tax Rates; Disposition. –

...

(3) Additional Statewide Fire and Lightning Rate. – An additional tax at the rate of one and thirty-three hundredths percent (1.33%) applies to gross premiums on insurance contracts that provide fire and lightning ~~coverage, except in the case of marine and automobile policies.~~ coverage. The tax is a percentage of the gross premiums from the contracts, determined in accordance with the table in this subdivision. Twenty-five percent (25%) of the net proceeds of this additional tax shall be deposited in the Volunteer Fire Department Fund established in Article 87 of Chapter 58 of the General Statutes. The remaining net proceeds shall be credited to the General Fund.

Type of Insurance Contract	Taxable Percentage
Fire Loss	100%
Commercial Multiple Peril	
Non-liability portion	100%
Liability portion	0%
Homeowner's	50%
Farm Owner's	35%
Marine	20%
Automobile	10%
Other	10%."

SECTION 4. Sections 1 and 2 of this act are effective for taxable years beginning on or after January 1, 2006. Section 3 of this act is effective for taxable years beginning on or after January 1, 2007. The remainder of this act is effective when it becomes law.

BILL DRAFT 2005-RBxz-30: Clarify Additional Gross Premiums Tax

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	May 2, 2006
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Draft		Committee Counsel

SUMMARY: ***Draft Proposal 2005-RBxz-30 would specify the percentage of an insurance policy's gross premiums to which the additional gross premiums tax on fire and lightning coverage applies and it would provide that the additional tax would apply to all types of policies that insure against fire and lightning loss.***

BILL ANALYSIS: North Carolina imposes a 1.9% tax rate on the gross premiums of most insurance policies.[1] In addition to the general rate, there is a 1.33% rate applied to the gross premiums on insurance policies that provide fire and lightning coverage. The statute specifically excludes marine and automobile policies from this additional tax. Twenty-five percent of the net proceeds of this additional tax are credited to the Volunteer Fire Department Fund[2] and the remainder is credited to the General Fund. There is also a 0.5% rate applied to gross premiums on insurance policies that provide fire and lightning coverage within fire districts. The statute does not provide any exceptions from this tax. The net proceeds of this tax are credited to the Department of Insurance.[3]

The General Assembly enacted the additional statewide fire and lightning tax in 1959. Although the statute does not provide that the tax will apply differently to different types of policies, the Department has administered the tax this way. The additional tax has been imposed on 100% of premiums from insurance that covers only fire losses and on a percentage of premiums from insurance that covers multiple risks. The percentages applied are neither statutory nor imposed by administrative rule. Within the past few years, the Department has been informally advised by both the Department of Insurance and the Attorney General's Office that the statute as written does not provide for assessing the tax against only a percentage of a policy's premium. Rather, without a statutory change, it is their opinion that the tax should be applied to 100% of the premiums of any policy that includes fire and lightning coverage.

Section 1 of this bill draft would codify the current administrative practice of the Department by setting in statute the percentage of an insurance policy's gross premiums to which the additional tax applies. It would provide that policies covering fire loss would be taxable at 100%. It would set by statute the taxable percentages for the following types of policies:

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[1] Workers' compensation policies are taxed at 2.5%. HMO policies are currently taxed at a rate of 1%; however, effective January 1, 2007, these policies will be taxed at the general rate of 1.9%.

[2] Funds in the Volunteer Fire Department Fund provide matching grants to volunteer fire departments to purchase equipment and make capital improvements. In 2005, the Department received 567 applications for grants requesting matching funds of $6,577,455. The available monies in the Fund totaled only $4,369,976. The Department approved 500 applications totaling $4,365,489.

[3] Three percent (3%) of the tax proceeds are credited to the State Firemen's Association for general purposes. Two percent (2%) of the proceeds are used by the Department of Insurance for the purpose of administering the disbursement. The remaining funds are allocated among the fire districts in proportion to the amount of business done in the district and used by the local district for firemen's local relief purposes. *See Article 84 of Chapter 58 of the General Statutes.*

Type of Insurance Policy	Taxable Percentage
• Non-liability portion of a Commercial Multiple Peril policy	100%
• Homeowner's Policy	50%
• Farm Owner's Policy	35%
• Marine Policy	20%
• Automobile Policy	10%
• Other types of policies that provide fire and lightning coverage	10%

The percentages in the draft proposal for CMP policies, homeowner's policies, and farm owner's policies reflect the percentages currently used by the Department of Revenue through administrative practice. The Revenue Laws Study Committee asked the Department of Insurance, working with the insurance industry, to review the percentages to verify that they accurately reflect the fire and lightning loss experience for these different types of policies. The Department anticipates that it needs an additional two weeks to gather the applicable data and determine the accurate percentages. The proposal, if adopted, would need to be amended in the Finance Committee to change the taxable percentages.

It appears 21 other states impose a gross premiums tax on policies covering fire losses. Of those states, seven provide for the taxable percentage statutorily – of those two use 100% for all policies that include fire and lightning coverage and five have a range of percentages for different types of coverage.[4] Florida sets its taxable percentages through administrative rule. At least ten states provide taxable percentages on tax forms without statutory support or administrative rule[5] and Montana instructs taxpayers to use their own experience to determine the percentage of their premiums subject to the additional tax.

Section 2 of the bill provides that the taxable percentages applicable for the statewide fire and lightning tax would also apply to the local fire and lightning tax rate.

Section 3 would eliminate the current exemption for marine and automobile policies from the additional statewide fire and lightning rate. North Carolina is the only state that imposes an additional statewide fire and lightning tax that excludes premiums from marine and automobile coverage from the taxable premiums base. The local fire and lightning tax does not exclude these policies. The bill draft provides that the taxable percentage for a marine policy would be 20% and the taxable percentage for all other types of policies would be 10%.

Sections 1 and 2 of the bill would become effective for taxable years beginning on or after January 1, 2006. Section 3 would become effective for taxable years beginning on or after January 1, 2007.

[4] Arkansas, Georgia, Kansas, Mississippi, Oregon, Tennessee, and Virginia. Arkansas and Virginia tax all policy premiums at 100%.

[5] Kentucky, Louisiana, Maine, Minnesota, Nebraska, Ohio, South Carolina, South Dakota, West Virginia, and Wisconsin. One other state, Indiana, provides percentages on the tax form, but it could not verify its authority for the percentages used.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

FISCAL ANALYSIS MEMORANDUM

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DATE: April 19, 2006

TO: Revenue Laws Study Committee

FROM: Rodney Bizzell
Fiscal Research Division

RE: 2005-RBxz-30 v.4

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:					
General Fund	**The expected annual impact of the elimination of the marine and automobile policy exemption is $7.9 million. The general fund would receive 75% of this and the remaining 25% would go to the Volunteer Fire Dept. Fund.**				
Volunteer Fire Dept. Fund					
EXPENDITURES:					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue

EFFECTIVE DATE: Sections 1 and 2 of the bill would become effective for taxable years beginning on or after January 1, 2006. Section 3 would become effective for taxable years beginning on or after January 1, 2007. The remainder of the bill becomes effective when it becomes law.

BILL SUMMARY:
Under the current insurance tax structure there is a supplemental state tax of 1.33% on the gross premiums of fire and lightning coverage and a local tax of 0.5% with fire districts. In the case of a policy that is exclusively for fire and lightning coverage, 100% of the supplemental tax is levied. For

situations where the policy provides insurance coverage in addition to these two lines, the agencies administering the tax have applied a number of different partial percentages to the policy premiums, with the percentage differing by type of auxiliary coverage. The issue is that the percentages have been not been adopted either in statutory language or formal administrative rulings. In some cases the ratios have been tied to industry loss experience data. In recent years the Department of Insurance has received inquiries about the source of the percentages as well as requests to use individual insurance carrier experience in lieu of an overall percentage. At the same time some legal experts feel that 100% of the supplemental tax is due on all premiums from policies that contain any fire and lightning coverage.

The bill would codify the current administrative practice of the Department by setting in statute the percentage of an insurance policy's gross premiums to which the additional tax applies. It would provide that policies covering fire loss would be taxable at 100% and that commercial multiple peril liability coverage would be taxable at 100%. It would provide that 50% of homeowner's policy premiums and 30% of farm owners' policy premiums would be subject to the tax. The bill also provides that taxable percentages apply to the local tax and it would eliminate an exemption that currently exists for marine and automobile policies. The bill applies the supplemental tax to 10% of auto coverage premiums and 20% of marine coverage premiums.

ASSUMPTIONS AND METHODOLOGY: Because the bill codifies existing percentages used to determine the portion of policies subject to the additional gross premiums tax, there is no fiscal impact from this portion of the bill. An annual fiscal impact of $7.9 million in additional revenue is expected from the elimination of the exemption for marine and auto coverage. The general fund receives 75% of this revenue while the remaining 25% is directed to the Volunteer Fire Department Fund.

SOURCES OF DATA: NC Department of Revenue

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #10

FRANCHISE TAX LOOPHOLE CLOSING

LEGISLATIVE PROPOSAL #10

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO APPLY THE FRANCHISE TAX TO CERTAIN LIMITED LIABILITY COMPANIES AND TO PROVIDE A CREDIT FOR ADDITIONAL ANNUAL REPORT FEES PAID BY LIMITED LIABILITY COMPANIES SUBJECT TO FRANCHISE TAX.

SHORT TITLE: Franchise Tax Loophole Closing

SPONSORS: **Luebke**; Carney, Church, Hill, McComas, Wainwright, Wilkins

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BRIEF OVERVIEW: This proposal would apply the corporate franchise tax to limited liability companies that elect to be taxed as a C Corporation for federal income tax purposes.

FISCAL IMPACT: While this proposal may have a positive impact on the General Fund, its fiscal impact cannot be estimated because the Department of Revenue has no data on how many companies are using this type of corporate structuring arrangement.

EFFECTIVE DATE: For taxable years beginning on or after January 1, 2007.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-SVxz-12 [v.2] (02/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
2/28/2006 2:51:12 PM

Short Title: Franchise Tax Loophole Closing. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO APPLY THE FRANCHISE TAX TO CERTAIN LIMITED LIABILITY COMPANIES AND TO PROVIDE A CREDIT FOR ADDITIONAL ANNUAL REPORT FEES PAID BY LIMITED LIABILITY COMPANIES SUBJECT TO FRANCHISE TAX.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-114(b) reads as rewritten:

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

(1) City. – Defined in G.S. 105-228.90.

(1a) Code. – Defined in G.S. 105-228.90.

(2) Corporation. – A domestic corporation, a foreign corporation, an electric membership corporation organized under Chapter 117 of the General Statutes or doing business in this State, or an association that is organized for pecuniary gain, has capital stock represented by shares, whether with or without par value, and has privileges not possessed by individuals or partnerships. The term includes a mutual or capital stock savings and loan association or building and loan association chartered under the laws of any state or of the United States. The term includes a limited liability company that elects to be taxed as a C Corporation under the Code, but does not otherwise include a limited liability company.

(3) Doing business. – Each and every act, power, or privilege exercised or enjoyed in this State, as an incident to, or by virtue of the powers and privileges granted by the laws of this State.

(4) Income year. – Defined in G.S. 105-130.2(5)."

SECTION 2. G.S. 105-114.1 reads as rewritten:

"**§ 105-114.1. Limited liability companies.**

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

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

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

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

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

(5) Noncorporate limited liability company. – A limited liability company that does not elect to be taxed as a C Corporation under the Code.

(b) Controlled Companies. – If a corporation or an affiliated group of corporations owns more than fifty percent (50%) of the capital interests in a noncorporate limited liability company, the corporation or group of corporations must include in its three tax bases pursuant to G.S. 105-122 the same percentage of (i) the noncorporate limited liability company's capital stock, surplus, and undivided profits; (ii) fifty-five percent (55%) of the noncorporate limited liability company's appraised ad valorem tax value of property; and (iii) the noncorporate limited liability company's actual investment in tangible property in this State, as appropriate.

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

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

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

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

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

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

(f) Exemption. – This section does not apply to assets owned by a noncorporate limited liability company if the total book value of the noncorporate limited liability

company's assets never exceeded one hundred fifty thousand dollars ($150,000) during its taxable year.

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

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

SECTION 3. Article 3 of Chapter 105 is amended by adding a new section to read:

"**§ 105-122.1. Credit for additional annual report fees paid by limited liability companies subject to franchise tax.**

A limited liability company subject to tax under this Article is allowed a credit against the tax imposed by this Article equal to the difference between the annual report fee for corporations under G.S. 55-1-22 and the annual report fee for limited liability companies under G.S. 57C-1-22(a). The credit allowed by this section may not exceed the amount of tax imposed by this Article for the taxable year reduced by the sum of all credits allowed, except payments of tax made by or on behalf of the taxpayer."

SECTION 4. This act is effective for taxable years beginning on or after January 1, 2007.

LEGISLATIVE PROPOSAL 2005-SVxz-12: Franchise Tax Loophole Closing

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	March 1, 2006
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft 2005-SVxz-12		Committee Counsel

SUMMARY: This legislative proposal would apply the corporate franchise tax to limited liability companies that elect to be taxed as a C Corporation for federal income tax purposes. The bill would also provide LLCs that elect to be taxed as a C Corporation a credit for the difference between annual report fees for corporations and LLCs such that those LLCs are paying the lower corporation annual report fee rate. This proposal is substantially similar to Senate Bill 540, introduced last session, which has passed the Senate.

CURRENT LAW: Under North Carolina law, limited liability companies[1] (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. This loophole was the first of a number of loopholes that gave rise to a series of legislative changes enacted over the last five years attempting to close those loopholes.[2]

Under current law, the franchise tax now extends to all LLC assets that a corporation controls through trusts and other entities, with some limitation. Specifically, a corporation (or an affiliated group of corporations) must own more than 50% of the capital interests in a limited liability company for the attribution rules to apply, and LLCs whose assets do not exceed $150,000 are exempt.

The concept of control is determined by tracing ownership of 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 the LLC was 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.

[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.

[2] See the BACKGROUND section of this summary for a detailed description of recent legislative changes regarding the franchise tax loophole.

BILL ANALYSIS: This legislative proposal is virtually identical to Senate Bill 540, which was introduced during the 2005 session and passed the Senate. The Department has requested that the Revenue Laws Study Committee revisit this issue and would encourage the General Assembly to address it during the short session.

The bill would apply the corporate franchise tax to limited liability companies that elect to be taxed as a C Corporation. It also makes conforming changes to G.S. 105-114.1 regarding the attribution of certain LLC assets to controlling corporations for franchise tax purposes.

This bill originated as the result of at least one request for a private letter ruling from a major accounting firm. Based on this request, the Department of Revenue identified another scenario that could result in a corporation's avoidance of paying franchise tax. This scenario would involve a corporation headquartered in North Carolina, but whose parent company is domiciled outside North Carolina. In addition, the parent's only contact with North Carolina is its ownership of the corporation. This corporation, which already files as a C Corporation for federal tax purposes, could convert to an LLC but make an election to continue being taxed as a C Corporation and avoid franchise tax because the parent has no nexus with this State and thus the "constructive ownership" attribution rules do not apply.

Current law provides that an LLC may be disregarded and treated as a division of its parent. The parent company is then considered to own property in this State and therefore has nexus, making it subject to income and franchise tax, and the constructive ownership rules apply for attributing the LLC's assets to the parent's franchise tax calculation. However, when an LLC elects to be taxed as a C Corporation, nexus is not conferred on the parent and the attributes of the LLC do not flow to the parent. Therefore, companies currently operating in this State as C Corporations could convert to an LLC, make an election to file as a C Corporation, as they always have, and eliminate their North Carolina franchise tax obligations.

Under this bill, LLCs that elect to be taxed as a C Corporation would be subject to franchise tax. LLCs that do not elect to be taxed as a C Corporation would be considered "noncorporate LLCs" and would be subject to the attribution rules in G.S. 105-114.1 for franchise tax purposes.

The bill also provides LLCs that elect to be taxed as a C Corporation a nonrefundable credit for the difference between the annual report fee for corporations, which is $20.00, and the annual report fee for limited liability companies, which is $200.

EFFECTIVE DATE: This bill would become effective for taxable years beginning on or after January 1, 2007.

BACKGROUND:

Franchise Tax Generally – 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 NC; or (3) total actual investment in tangible property in NC.

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.

Franchise Tax Loophole History – In 2001, the General Assembly enacted S.L. 2001-327 to close a loophole whereby a corporation, subject to North Carolina franchise tax, could set up a single-member LLC, transfer assets to the LLC in a tax-free transfer, and avoid paying taxes on the transferred assets

since LLCs are not subject to the franchise tax. 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 owned[3] 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.[4]

In 2004, the General Assembly enacted S.L. 2004-74 to address these issues by providing that for purposes of determining ownership of an LLC's assets, any membership interest of a business trust would be attributed to the owners of the beneficial interest in the business trust, according to their interests in the trust, and the trust itself would be disregarded as a separate entity. In addition, the legislation limited the tax to only those assets that a corporation controls, it reduced the minimum threshold of LLC asset ownership from 70% or more to more than 50%, and it exempted small LLCs.

2005-SVxz-12-SMSV

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

[4] 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.

GENERAL ASSEMBLY OF NORTH CAROLINA

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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 25, 2006

TO: Revenue Laws Study Committee

FROM: David Crotts
Fiscal Research Division

RE: Proposal 2005-SVxz-12 (Franchise Tax Loophole Closing)

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:					
EXPENDITURES:					
POSITIONS (cumulative):					

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: The franchise tax is administered by the Department of Revenue. The enactment of the bill is not expected to affect the Department's budget requirements.

EFFECTIVE DATE: Tax years beginning on or after January 1, 2007.

ISSUE BACKGROUND: Under North Carolina law, limited liability companies (LLCs) are not subject to the franchise tax. In 1997 single-member LLCs were authorized in North Carolina. This allowed a corporation the opportunity 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.

After the enactment of the 2002 session change, it was 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". In addition, the 2002 legislation also had the effect of extending the tax to situations that did not involve corporate control of LLC assets.

The 2004 General Assembly attempted to address these issues by providing that for purposes of determining the ownership of an LLC's assets, any membership interest of a business trust would be attributed to the owners of the beneficial interest in the business trust, according to their interests in the trust, and the trust itself would be disregarded as a separate entity. In addition, the 2002 bill limits the tax to only those assets that a corporation controls and exempts small LLC's.

BILL SUMMARY: (1) Applies the corporate franchise tax to limited liability companies (LLCs) that elect to be taxed as a C corporation for federal income tax purposes; (2) provides these corporations are eligible for a nonrefundable credit equal to the difference between the annual report fee for corporations ($20) and the same fee for LLC's ($200); (3) makes conforming changes regarding attribution of certain LLC assets to controlling corporations for franchise tax purposes.

ASSUMPTIONS AND METHODOLOGY: Discussions with the Department of Revenue indicate that the practical effect of the legislation is to address another potential method of avoiding franchise tax liability by corporate structuring arrangements. The concern arose as a result of a request from a major accounting firm for a private letter ruling. The tax planning scenario would involve a corporation headquartered in North Carolina, but whose parent company is domiciled outside the State. In addition, the parent's only contact with North Carolina is its ownership of the corporation. This corporation, which already files as a C-corporation for federal tax purposes, could convert to an LLC but make an election to continue being taxed as a C-corporation and avoid franchise tax because the parent has no nexus (tax situs) with this State. Thus, the "constructive ownership" attribution rules do not apply.

The Department has no data on whether any companies have already established such arrangements. However, the request for a private letter ruling suggests that one or more accounting firms were contemplating the use of such a tax sheltering vehicle. With the passage of time since the legislation was originally proposed, it is possible that the activity level of this tax planning tool has accelerated.

SOURCES OF DATA: Discussions with Department of Revenue

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #11

FRANCHISE TAX BASE CALCULATION

LEGISLATIVE PROPOSAL #11

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO CLARIFY THE TREATMENT OF DEFERRED TAX ASSETS IN THE COMPUTATION OF THE FRANCHISE TAX CAPITAL BASE.

SHORT TITLE: Franchise Tax Base Calculation

SPONSORS: **Hartsell;** Clodfelter, Dalton, Hartsell, Hoyle, Kerr

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BRIEF OVERVIEW: The bill clarifies the treatment of deferred tax assets in the computation of the franchise tax capital base.

FISCAL IMPACT: Negligible fiscal impact.

EFFECTIVE DATE: The bill becomes 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 2005

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BILL DRAFT 2005-RBz-31 [v.7] (02/24)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/19/2006 7:34:52 AM

Short Title: Franchise Tax Base Calculation. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO CLARIFY THE TREATMENT OF DEFERRED TAX ASSETS IN THE COMPUTATION OF THE FRANCHISE TAX CAPITAL BASE.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-122(b) reads as rewritten:

"(b) Determination of Capital Base. -- ~~Every such~~ A corporation taxed under this section shall determine the total amount of its issued and outstanding capital stock, ~~surplus~~ surplus, and undivided ~~profits; no reservation or allocation~~ profits. No reservation or allocation from surplus or undivided profits ~~shall be~~ is allowed ~~other than for~~ except as provided below:

(1) Definite ~~definite~~ and accrued legal ~~liabilities, except as herein provided;~~liabilities.

(2) ~~taxes~~ Taxes accrued, dividends ~~declared~~ declared, and reserves for depreciation of tangible assets as permitted for income tax ~~purposes shall be treated as deductible liabilities. There shall also be treated as a deductible liability reserves for the entire cost~~ purposes.

(3) When including deferred tax liabilities, a corporation may reduce the amount included in its base by netting against that amount deferred tax assets. The reduction may not decrease deferred tax liabilities below zero (0).

(4) Reserves for the cost of any air-cleaning device or sewage or waste treatment plant, including waste lagoons, and pollution abatement equipment purchased or constructed and installed which reduces the amount of air or water pollution resulting from the emission of air contaminants or the discharge of sewage and industrial wastes or other polluting materials or substances into the outdoor atmosphere or streams, lakes, or rivers, upon condition that the corporation claiming

such deductible liability shall furnish to the Secretary a certificate from the Department of Environment and Natural Resources or from a local air pollution control program for air-cleaning devices located in an area where the Environmental Management Commission has certified a local air pollution control program pursuant to G.S. 143-215.112 certifying that the Environmental Management Commission or local air pollution control program has found as a fact that the air-cleaning device, waste treatment plant or pollution abatement equipment purchased or constructed and installed as above described has actually been constructed and installed and that such plant or equipment complies with the requirements of the Environmental Management Commission or local air pollution control program with respect to such devices, plants or equipment, that such device, plant or equipment is being effectively operated in accordance with the terms and conditions set forth in the permit, certificate of approval, or other document of approval issued by the Environmental Management Commission or local air pollution control program and that the primary purpose thereof is to reduce air or water pollution resulting from the emission of air contaminants or the discharge of sewage and waste and not merely incidental to other purposes and functions.

(5) ~~The~~ Reserves for the cost of purchasing and installing equipment or constructing facilities for the purpose of recycling or resource recovering of or from solid waste or for the purpose of reducing the volume of hazardous waste generated shall be treated as deductible for the purposes of this section upon condition that the corporation claiming such deductible liability shall furnish to the Secretary a certificate from the Department of Environment and Natural Resources certifying that the Department of Environment and Natural Resources has found as a fact that the equipment or facility has actually been purchased, installed or constructed, that it is in conformance with all rules and regulations of the Department of Environment and Natural Resources, and the recycling or resource recovering is the primary purpose of the facility or equipment.

(6) ~~The~~ Reserves for the cost of constructing facilities of any private or public utility built for the purpose of providing sewer service to residential and outlying areas shall be treated as deductible for the purposes of this section; the deductible liability allowed by this section shall apply only with respect to such pollution abatement plants or equipment constructed or installed on or after January 1, 1955.

(7) ~~Treasury stock shall not be considered in computing the capital stock, surplus and undivided profits as the basis for franchise tax, but shall be excluded proportionately from said capital stock, surplus and undivided profits as the case may be upon the basis and to the extent of the cost thereof.~~ The cost of treasury stock.

(8) In the case of an international banking facility, the capital base shall be reduced by the excess of the amount as of the end of the taxable year of all assets of an international banking facility which are employed outside the United States over liabilities of the international banking facility owed to foreign persons. For purposes of such reduction, foreign persons shall have the same meaning as defined in G.S. 105-130.5(b)(13)d.

Every corporation doing business in this State which is a parent, subsidiary, or affiliate of another corporation shall add to its capital stock, ~~surplus~~ surplus, and undivided profits all indebtedness owed to a parent, ~~subsidiary~~ subsidiary, or affiliated corporation as a part of its capital used in its business and as a part of the base for franchise tax under this section. ~~The term "indebtedness" as used in this paragraph includes all loans, credits, goods, supplies, or other capital of whatsoever nature furnished by a parent, subsidiary, or affiliated corporation, other than indebtedness endorsed, guaranteed, or otherwise supported by one of these corporations. The terms "parent," "subsidiary," and "affiliate" as used in this paragraph shall have the meaning specified in G.S. 105-130.6.~~ If any part of the capital of the creditor corporation is capital borrowed from a source other than a parent, ~~subsidiary~~ subsidiary, or affiliate, the debtor corporation, which is required under this ~~paragraph~~ subsection to include in its tax base the amount of debt by reason of being a parent, subsidiary, or affiliate of the ~~said~~ creditor corporation, may deduct from the debt ~~thus~~ included a proportionate part determined on the basis of the ratio of ~~such~~ the borrowed capital ~~as above specified~~ of the creditor corporation to the total assets of the ~~said~~ creditor corporation. If ~~Further, in case~~ the creditor corporation ~~as above specified~~ is also taxable under the provisions of this section, ~~such~~ the creditor corporation ~~shall be~~ is allowed to deduct from the total of its capital, ~~surplus~~ surplus, and undivided profits the amount of any debt owed to it by a parent, subsidiary or affiliated corporation to the extent that ~~such~~ the debt has been included in the tax base of ~~said~~ the parent, ~~subsidiary~~ subsidiary, or affiliated debtor corporation reporting for taxation under the provisions of this section.

The following definitions apply in this subsection:

(1) Affiliate. – The same meaning as specified in G.S. 105-130.6.

(2) Indebtedness. – All loans, credits, goods, supplies, or other capital of whatsoever nature furnished by a parent, subsidiary, or affiliated corporation, other than indebtedness endorsed, guaranteed, or otherwise supported by one of these corporations

(3) Parent. – The same meaning as specified in G.S. 105-130.6.

(4) Subsidiary. – The same meaning as specified in G.S. 105-130.6."

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

BILL DRAFT 2005-RBxz-31: Franchise Tax Base Calculation

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	May 2, 2006
Introduced by:		**Summary by:**	Cindy Avrette
Version:	Draft		Committee Counsel

SUMMARY: Draft Proposal 2005-RBz-31 seeks to clarify the treatment of deferred tax assets in the computation of the franchise tax capital base. The bill would become effective when it becomes law.

BILL ANALYSIS: North Carolina imposes a franchise tax at the rate of $1.50 per $1,000 of the total amount of a corporation's capital stock, surplus, and undivided profits (hereinafter referred to as the corporation's capital base). The corporation's capital base may not be less than 55% of the appraised value of all the real and tangible personal property owned by the corporation in the State nor less than its total actual investment in tangible property in the State.

Most public corporations compute their capital base for financial reporting purposes. Public corporations must comply with the requirements of the Financial Accounting Standards Board (FASB) when reporting the results of their operations and financial positions. Under FASB, corporations are required to accrue certain liabilities and the related deferred tax assets which are applicable to those accrued liabilities in order to accurately reflect the financial position of the corporation.

A corporation's determination of its capital base for purposes of the franchise tax is not the same as the calculation of its capital base for financial reporting purposes. The calculation of its capital base for franchise tax purposes is determined by G.S. 105-122(b), not by the requirements of FASB. The statute refers to book value as 'issued and outstanding capital stock, surplus, and undivided profits.' This is similar to net book value with certain adjustments. The principal adjustment is for contingent or deferred liabilities.

Deferred tax assets and deferred tax liabilities are accounts carried on the books of a corporation for financial reporting purposes. They represent timing differences in the recognition of income and deductions for income tax purposes and for financial accounting purposes. Deferred tax liability typically arises where income has been recognized on the corporation's books but not for tax purposes. For example, where a gain is reflected on the books but reported for tax purposes on the installment basis.

- Under FASB, deferred tax liabilities are recognized as liabilities for accounting purposes.
- Deferred liabilities are not recognized for franchise tax purposes because they are not 'definite and accrued'. Therefore, deferred tax liabilities must be added back to a corporation's capital base for franchise tax purposes.
- Frequently, a taxpayer that has a deferred liability will also have a deferred tax asset. The issue is whether the deferred liability that must be added-back can be reduced by the amount of the deferred tax asset. In 1996, the Department of Revenue issued a TAM (technical advice memorandum) that permitted the netting of deferred liability accounts and deferred tax asset accounts. The TAM provided that the deferred tax asset account had to be clearly identified with the deferred tax liability account and the deferred tax asset could not reduce the related deferred liability below zero (0).

The statute, the 1996 TAM, and GAAP differ on how to account for deferred tax assets. The purpose of this bill is to determine how deferred tax assets should be treated for franchise tax purposes and to state that treatment clearly in the statute.

The franchise tax statute begins the calculation of a corporation's franchise tax capital base with the '*total amount of its issued stock, surplus, and undivided profit*'. The statute provides that '*no reservation or allocation from surplus or undivided profits shall be allowed other than for definite and accrued legal liabilities, except as herein provided: taxes accrued, dividends declared and reserves for depreciation of tangible assets as permitted for income tax purposes shall be treated as deductible liabilities.*'

In 1992, FASB Statement No. 109 established financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. The statement resulted in deferred tax assets being separately stated from deferred tax liabilities. When the two accounts were netted, a smaller net tax liability account was added-back to the franchise tax base. When the accounts had to be separately stated, the Department did not permit the netting of the two accounts. This resulted in the add-back of the deferred tax liability unreduced by the amount of the deferred tax asset.

Taxpayers having deferred tax asset accounts contended that they should be allowed to reduce their capital stock bases by the balances in those accounts. Since the asset and liability accounts are reciprocal concepts, they argued that it was inequitable to include a deferred tax liability in the capital stock base without decreasing it by the deferred tax asset.

In response to taxpayer concerns, the Department of Revenue issued TAM-CF-96-1 in August of 1996. The TAM appears to contradict the plain meaning of the statute because it permits the deferred liability accounts to be reduced by deferred tax asset accounts.[1] In explaining the change, the TAM states that a more equitable and consistent position is to recognize that net worth is incorrectly stated when the total amount of a deferred liability is included without a netting adjustment for the deferred tax benefit resulting directly from such liability. The TAM provides that the inclusion of a deferred liability in the computation of the net worth base should permit an offset or adjustment for the deferred tax asset required to be computed under the accounting standards without regard to how the deferred tax asset is reflected on the financial statement.

The FASB change in 1992 concerned the accounting for income taxes. Arguably, the TAM written in 1996 attempted to address the accounting changes precipitated by that FASB change. The wording of the TAM, however, refers to deferred liabilities as a whole instead of just deferred tax liabilities. Any deferred liability may create a corresponding deferred tax asset. Taxpayers contend that the TAM permits them to reduce the amount of any deferred liability required to be added back to its net book value for franchise tax purposes by the amount of a deferred tax asset. Examples of the types of contingent and deferred liabilities that have been reduced include post retirement benefits, loan loss reserves, credit card reserves, and litigation reserves.

This draft proposal would change the law to allow deferred tax liabilities to be reduced by their corresponding deferred tax assets.

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[1] The TAM became effective for tax years ending on or after July 1, 1996.

GENERAL ASSEMBLY OF NORTH CAROLINA

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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 1, 2006

TO: Revenue Laws Study Commission

FROM: Dave Crotts
Fiscal Research Division

RE: Proposal 2005-RBz-31 (v.7):
Franchise Tax Calculation

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:	See "Assumptions and Methodology"				
EXPENDITURES:					

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

EFFECTIVE DATE: When the bill becomes law.

BILL SUMMARY: Since August 1, 1996 the Department of Revenue has been allowing taxpayers, when calculating their franchise tax base, to reduce, but not below zero, a deferred liability by the deferred tax asset amount that resulted when the deferred liability was required under financial accounting standards. The current management of the Department of Revenue feels that the Department did not have the statutory authority to make such a ruling in 1996 and some taxpayers are challenging some of the specifics of the ruling. The proposal attempts to clarify the issue by allowing deferred tax liabilities to be reduced by their corresponding tax assets, but not below zero.

ASSUMPTIONS AND METHODOLOGY: Discussions with the Department of Revenue indicate that the impact of the change will be fairly small.

SOURCES OF DATA: North Carolina Department of Revenue.

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #12

EXPANSION OF ROYALTY REPORTING OPTION

LEGISLATIVE PROPOSAL #12

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO EXPAND THE ROYALTY INCOME REPORTING OPTION TO INCLUDE ADDITIONAL TYPES OF INTANGIBLE PROPERTY.

SHORT TITLE: Expansion of Royalty Reporting Option

SPONSORS: **Luebke**; Carney, Church, Hill, McComas, Wainwright, Wilkins
Hoyle; Clodfelter, Dalton, Hartsell, Kerr, Webster

BRIEF OVERVIEW: This proposal would expand the reporting option available to corporations and their related members with regard to reporting the receipt of royalty payments by including payments for patents and copyrights.

FISCAL IMPACT: This proposal could have a positive impact on General Fund tax revenue but the magnitude of this amount is not known.

EFFECTIVE DATE: For taxable years beginning on or after January 1, 2006.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-SVz-13 [v.7] (02/15)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/19/2006 9:15:55 AM

Short Title: Expansion of Royalty Reporting Option. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO EXPAND THE ROYALTY INCOME REPORTING OPTION TO INCLUDE ADDITIONAL TYPES OF INTANGIBLE PROPERTY.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-130.7A reads as rewritten:

"**§ 105-130.7A. Royalty income reporting option.**

(a) Purpose. – Royalty payments received for the use of ~~trademarks~~ intangible property in this State are income derived from doing business in this State. This section provides taxpayers with an option concerning the method by which these royalties can be reported for taxation when the recipient and the payer are related members. As provided in this section, these royalty payments can be either (i) deducted by the payer and included in the income of the recipient, or (ii) added back to the income of the payer and excluded from the income of the recipient.

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

(1) Component member. – Defined in section 1563(b) of the Code.

(1a) Intangible property. – Copyrights, patents, and trademarks.

(2) North Carolina royalty. – An amount charged that is for, related to, or in connection with the use in this State of ~~a trademark.~~ intangible property. The term includes royalty and technical fees, licensing fees, and other similar charges.

(3) Own. – To own directly, indirectly, beneficially, or constructively. The attribution rules of section 318 of the Code apply in determining ownership under this section.

(4) Related entity. – Any of the following:

a. A stockholder who is an individual, or a member of the stockholder's family enumerated in section 318 of the Code, if the stockholder and the members of the stockholder's family

own in the aggregate at least eighty percent (80%) of the value of the taxpayer's outstanding stock.

b. A stockholder, or a stockholder's partnership, limited liability company, estate, trust, or corporation, if the stockholder and the stockholder's partnerships, limited liability companies, estates, trusts, and corporations own in the aggregate at least fifty percent (50%) of the value of the taxpayer's outstanding stock.

c. A corporation, or a party related to the corporation in a manner that would require an attribution of stock from the corporation to the party or from the party to the corporation under the attribution rules of section 318 of the Code, if the taxpayer owns at least eighty percent (80%) of the value of the corporation's outstanding stock.

(5) Related member. – A person that, with respect to the taxpayer during any part of the taxable year, is one or more of the following:

a. A related entity.

b. A component member.

c. A person to or from whom there would be attribution of stock ownership in accordance with section 1563(e) of the Code if the phrase "5 percent or more" were replaced by "twenty percent (20%) or more" each place it appears in that section.

(6) Royalty payment. – Either of the following:

a. Expenses, losses, and costs paid, accrued, or incurred for North Carolina royalties, to the extent the amounts are allowed as deductions or costs in determining taxable income before operating loss deduction and special deductions for the taxable year under the Code.

b. Amounts directly or indirectly allowed as deductions under section 163 of the Code, to the extent the amounts are paid, accrued, or incurred for a time price differential charged for the late payment of any expenses, losses, or costs described in this subdivision.

(7) Trademark. – A trademark, trade name, service mark, or other similar type of intangible asset.

(8) Use. – Use of ~~a trademark~~ intangible property includes direct or indirect maintenance, management, ownership, sale, exchange, or disposition of the ~~trademark.~~intangible property.

(c) Election. – For the purpose of computing its State net income, a taxpayer must add royalty payments made to, or in connection with transactions with, a related member during the taxable year. This addition is not required for an amount of royalty payments that meets either of the following conditions:

(1) The related member includes the amount as income on a return filed under this Part for the same taxable year that the amount is deducted

by the taxpayer, and the related member does not elect to deduct the amount pursuant to G.S. 105-130.5(b)(20).

(2) The taxpayer can establish that the related member during the same taxable year directly or indirectly paid, accrued, or incurred the amount to a person who is not a related member.

(d) Indirect Transactions. – For the purpose of this section, an indirect transaction or relationship has the same effect as if it were direct."

SECTION 2. This act is effective for taxable years beginning on or after January 1, 2006.

LEGISLATIVE PROPOSAL 2005-SVz-13: Expansion of Royalty Reporting Option

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	April 19, 2006
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft 2005-SVz-13		Committee Counsel

SUMMARY: ***This legislative proposal expands the reporting option available to corporations and their related members with regard to reporting the receipt of royalty payments by including payments for patents and copyrights.***

BACKGROUND[1] & CURRENT LAW: In recent years, intellectual property has become an enormously valuable intangible corporate asset due to the rapid change in science and technology coupled with expanding legal protections and increasing commercial success based on innovation. As intellectual property becomes a more important corporate asset, many companies with large intellectual property portfolios search for ways to maximize revenues, such as licensing those assets. Income derived from licensing intellectual property is subject to federal and state taxation as ordinary income. Given this, many companies have also developed tax strategies to minimize state taxation of royalty income.

Under one such strategy, a company with a large intellectual property portfolio forms a wholly-owned subsidiary to hold its intellectual property assets in a state that does not tax royalty income received from licensing intellectual property assets. The parent company transfers all of its intellectual property assets to the subsidiary in exchange for ownership of stock in the subsidiary. The subsidiary then licenses the intellectual property assets back to the parent company in exchange for royalties. If the parent corporation is late paying these royalties, it also owes the subsidiary late fees. The parent corporation deducts against its state income tax the royalties and late fees it owes the subsidiary. The subsidiary likely pays little or no tax on these receipts to the state in which it was formed because the receipts are either exempt or apportioned away from that state. Moreover, the subsidiary's receipts are paid back to the parent corporation in the form of deductible dividends. As a result of this arrangement, the parent corporation ends up paying little or no state tax on these profits even though it may generate substantial profits from its retail or manufacturing activities in a state. Recognizing this transfer and license-back arrangement as a tax avoidance strategy, many states have enacted laws attempting to reach this income for taxation.

In North Carolina, every C Corporation "doing business" in this State is subject to corporate income and franchise taxes.[2] Some corporations have argued that an out-of-state investment company's receipt of royalty income from the use of trademarks in this State does not constitute "doing business" in North Carolina and, therefore, the investment company is not subject to North Carolina income or franchise tax on the royalties.

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[1] Much of this information is drawn from Xuan-Thao N. Nguyen, "Holding Intellectual Property," 38 State Tax Notes 699 (November 21, 2005).

[2] See G.S. 105-130.3 and G.S. 105-122.

However, in *A&F Trademark, Inc. v. Tolson* the North Carolina Court of Appeals upheld the State's position on the taxation of royalty income received by an out-of-state investment company for the use of trademarks in this State. The Court ruled that the out-of-state taxpayers who hold trademarks used in North Carolina were doing business in North Carolina. Therefore, under current law, an out-of-state holding company receiving royalty payments for the use of trademarks, patents, or copyrights in North Carolina is subject to both North Carolina income and franchise taxes.

In 2001, the General Assembly enacted G.S. 105-130.7A to enhance corporate compliance with taxes on trademark income. This statute did not change what was already considered taxable but merely enhanced compliance with the State tax on income generated from using trademarks and added a reporting option to the income tax statute.

Specifically, G.S. 105-130.7A restates that a company's receipts from royalty payments for the use of trademarks in North Carolina are income from doing business in North Carolina. Then it provides adjustments to assure full and fair accountability of this income in relationship to where it is actually earned. In cases where the recipient of the North Carolina royalty income is unrelated to the payer, the recipient is required to pay tax on the income to North Carolina. In cases where the recipient and the payer are related, they have an option on how the income is reported to North Carolina. Either the payer can deduct the North Carolina royalty payments on its North Carolina return and the recipient can include them on its North Carolina return, or the payer can add them to its North Carolina income and the recipient can deduct them on its North Carolina return.[3]

This provision solves the problem as it relates to trademarks and trade names, but does not address other types of intellectual property, such as patents[4] and copyrights.[5]

BILL ANALYSIS: This legislative proposal would expand the royalty payment reporting option for corporations and their related members to include payments received for use of patents and copyrights.

This proposal does not change or expand what is already taxable in North Carolina. Royalty income received for the use of trademarks, patents, and copyrights in North Carolina *is* taxable and must be reported to North Carolina by an out-of-state corporation receiving this income. However, there is a reporting option currently available to corporations and their related members for royalty payments received for trademark usage that is not available when those payments are for patent or copyright usage.

This proposal would give corporations and their related members that receive royalty payments derived from patent or copyright usage the ability to select which entity, the parent or the holding company, reports the income, just as that option is currently available to those corporations with regard to trademark royalties. That is, the payer has the option of deducting the payments on its North Carolina return and the recipient can include them on its North Carolina return, or the payer can add them to its North Carolina return and the recipient can deduct them on its North Carolina return.

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[3] See *Geoffrey, Inc. v. South Carolina Tax Com'n*, 437 S.E.2d 13 SC, 1993, cert. denied by U.S. Supreme Court, 114 S.Ct. 50 (1993). The South Carolina Supreme Court held that (1) royalty income of a foreign corporation, obtained from trademark licenses issued to an affiliate, could be taxed without violating due process clause and (2) tax could be imposed without violating interstate commerce clause.

[4] A patent for an invention is the grant of a property right to the inventor that gives the inventor the right to exclude others from making, using, offering for sale, selling or importing the invention for a specified period of time.

[5] Copyright is a form of protection provided under federal law to the authors of original works of authorship, including literary, dramatic, musical, artistic, and certain other intellectual works, both published and unpublished.

EFFECTIVE DATE: This act would become effective for taxable years beginning on or after January 1, 2006.

2005-SIz-13

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

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 25, 2006

TO: Revenue Laws

FROM: Dave Crotts
Fiscal Research Division

RE: Draft 2005-SVz-13 (v.6) (Expansion of Royalty Reporting Option)

FISCAL IMPACT

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES:	See "Assumptions and Methodology"				
EXPENDITURES:					

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

EFFECTIVE DATE: Tax years beginning on or after January 1, 2006.

BILL SUMMARY .The 2001 General Assembly enacted legislation that eliminated the tax planning strategy of shifting trademark royalty income to another state in order to avoid the North Carolina income tax. The proposal would extend the 2001 treatment to royalty income patents and copyrights.

ASSUMPTIONS AND METHODOLOGY: A discussion with the Department of Revenue indicates that the enactment of the bill could have a positive impact on General Fund tax revenue but the magnitude of this amount is not known. One factor limiting the impact of the proposal is that fact that in the wake of the **A & F Trademark** case, some affected taxpayers may be in compliance. Another issue

is the fact that the proposal applies to patent and copyright royalty income only. In general, any revenue gain would be smaller than the receipts from the 2001 act affecting trademark income. During the 2001 discussion the estimated fiscal impact from the trademark provision was $20 million per year.

SOURCES OF DATA: North Carolina Department of Revenue.

TECHNICAL CONSIDERATIONS:

LEGISLATIVE RECOMMENDATION #13

ELECTRICITY FRANCHISE TAX DISTRIBUTION

LEGISLATIVE RECOMMENDATION #13

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

CONSIDER A COMMITTEE SUBSTITUTE FOR SENATE BILL 343 THAT WOULD SIMPLIFY THE ELECTRICITY FRANCHISE TAX DISTRIBUTION

SHORT TITLE: Electricity Franchise Tax Distribution (Senate Bill 343, 2nd Edition). The bill is currently in the House Finance Committee.

SPONSORS: Sen. Hoyle

BRIEF OVERVIEW: Senate Bill 343, 2nd edition, finds that the current distribution to cities under G.S. 105-116.1 of part of the franchise tax on electric power companies imposes unnecessary administrative burdens on the cities, the power companies, and the Department of Revenue and results in numerous errors in the distribution. The bill directed the League of Municipalities to recommend a method of distributing this revenue to the cities on the basis of a formula that uses factors such as population and percentage share of prior distributions rather than service inside constantly changing city boundaries. The League's recommendation is contained in Appendix G. The Revenue Laws Study Committee recommends that the General Assembly consider a committee substitute for Senate Bill 343 that embodies the League's recommendation.

FISCAL IMPACT: No impact.

EFFECTIVE DATE: January 1, 2008

A copy of the fiscal analysis memorandum begins on the next page.

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

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 2, 2006

TO: Revenue Laws Study Committee

FROM: Rodney Bizzell
Fiscal Research Division

RE: Electric Utility Franchise Distribution

FISCAL IMPACT

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

	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
REVENUES:					
General Fund		**"See Assumptions and Methodology"**			
Local Governments		**"See Assumptions and Methodology"**			

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue, NC Local Governments

EFFECTIVE DATE: January 1, 2008

BILL SUMMARY:
This bill would change the method by which the municipal share of the electric utility franchise tax is distributed to municipalities. A 3.22% tax rate is applied to gross receipts resulting from the sale of power and light in the state. An amount equal to a tax of 3.09% of revenues derived from within a legally incorporated municipality is distributed to the municipality. This method of distribution requires tracking municipal boundaries to determine the correct distribution amount. This bill provides an alternate distribution methodology that does not require tracking municipal annexations.

ASSUMPTIONS AND METHODOLOGY:
The proposed bill divides the distribution into four parts. The first part uses data from the most recent four distribution quarters, under current law, to calculate a base municipal statewide distribution amount and distribute it quarterly to each city. The second part of the distribution is calculated by using the cumulative growth in the municipal share of the statewide population from a base year as a proxy to create a separate fund to be distributed annually to cities based on their proportionate share of the cumulative absolute population. A third part of the distribution is used to determine the growth in the municipal share of gross revenue resulting from major existing and new commercial/industrial/institutional customers and expansions. This portion of the distribution would be distributed to cities annually based on their proportionate share of the revenues produced by the major new commercial/industrial customers. A final part of the distribution provides extra electric utility franchise tax distributions to municipalities that experience seasonal growth in electricity consumption due to tourism-based changes in population as opposed to changes in permanent population. It is calculated by using the increase in the water consumption in gallons (as a surrogate for electricity) in "seasonal population towns" to create a separate fund to be distributed annually to seasonal population towns as an adjustment factor.

The final calculation details of the formulas for the parts of the distribution would be worked out by League of Municipalities and Department of Revenue staff. By May 1, 2007, the Department of Revenue will provide to the League of Municipalities and appropriate legislative staff the results of test runs of the formulas showing city-by-city distributions to allow for any needed legislative changes before a proposed effective date of January 1, 2008. The distribution change is not expected to result in any significant fiscal impact.

SOURCES OF DATA: NC Department of Revenue, NC League of Municipalities

TECHNICAL CONSIDERATIONS: None

LEGISLATIVE PROPOSAL #14

REVENUE LAWS TECHNICAL AND MOTOR FUEL TAX CHANGES

LEGISLATIVE PROPOSAL #14

A RECOMMENDATION OF THE REVENUE LAWS STUDY COMMITTEE
TO THE 2006 REGULAR SESSION OF THE 2005 GENERAL ASSEMBLY

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES AND TO IMPROVE THE COLLECTION AND ADMINISTRATION OF THE MOTOR FUEL TAX.

SHORT TITLE: Revenue Laws Technical and Motor Fuel Tax Changes

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SPONSORS: **Hartsell;** Clodfelter, Dalton, Hoyle, Kerr, Webster
Luebke; Carney, Church, Hill, McComas, Wainwright, Wilkins

BRIEF OVERVIEW: Makes technical and clarifying changes to the revenue laws and related statutes and makes changes in the motor fuel tax laws to improve collection and administrative efforts.

FISCAL IMPACT:

EFFECTIVE DATE: Except as otherwise noted in the bill, the proposal would become effective when it becomes law.

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

GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 2005

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BILL DRAFT 2005-SVz-10 [v.11] (01/24)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)
4/27/2006 4:33:02 PM

Short Title: Revenue Laws Tech. & Motor Fuel Tax Changes. (Public)

Sponsors: .

Referred to:

A BILL TO BE ENTITLED

AN ACT TO MAKE TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES TO THE REVENUE LAWS AND RELATED STATUTES AND TO IMPROVE THE COLLECTION AND ADMINISTRATION OF THE MOTOR FUEL TAX.

The General Assembly of North Carolina enacts:

SECTION 1. G.S. 105-113.82(a) reads as rewritten:

"**§ 105-113.82. Distribution of part of beer and wine taxes.**

(a) Amount, Method. – The Secretary shall distribute annually the following percentages of the net amount of excise taxes collected on the sale of malt beverages and wine during the preceding 12-month period ending March 31, less the amount of the net proceeds credited to the Department of ~~Agriculture and Consumer Services~~ Commerce under G.S. 105-113.81A, to the counties and cities in which the retail sale of these beverages is authorized in the entire county or city:

(1) Of the tax on malt beverages levied under G.S. 105-113.80(a), twenty-three and three-fourths percent (23¾%);

(2) Of the tax on unfortified wine levied under G.S. 105-113.80(b), sixty-two percent (62%); and

(3) Of the tax on fortified wine levied under G.S. 105-113.80(b), twenty-two percent (22%).

If malt beverages, unfortified wine, or fortified wine may be licensed to be sold at retail in both a county and a city located in the county, both the county and city shall receive a portion of the amount distributed, that portion to be determined on the basis of population. If one of these beverages may be licensed to be sold at retail in a city located in a county in which the sale of the beverage is otherwise prohibited, only the city shall receive a portion of the amount distributed, that portion to be determined on

the basis of population. The amounts distributed under subdivisions (1), (2), and (3) shall be computed separately."

SECTION 2. G.S. 105-122(d) reads as rewritten:

"(d) After determining the proportion of its total capital stock, surplus and undivided profits as set out in subsection (c) of this section, which amount ~~so determined~~ shall ~~in no case~~ not be less than fifty-five percent (55%) of the appraised value as determined for ad valorem taxation of all the real and tangible personal property in this State of each ~~such~~ corporation ~~plus the total appraised value of intangible property returned for taxation of intangible personal property as herein specified~~ nor less than its total actual investment in tangible property in this State, every corporation taxed under this section shall annually pay to the Secretary of Revenue, at the time the report and statement are due, a franchise or privilege ~~tax, which is hereby levied~~ tax at the rate of one dollar and fifty cents ($1.50) per one thousand dollars ($1,000) of the total amount of capital stock, surplus and undivided profits as ~~herein provided.~~ provided in this section. The tax imposed in this section shall ~~in no case~~ not be less than thirty-five dollars ($35.00) and shall be for the privilege of carrying on, doing business, and/or the continuance of articles of incorporation or domestication of each ~~such~~ corporation in this State. Appraised value of tangible property including real estate ~~shall be~~ is the ad valorem valuation for the calendar year next preceding the due date of the franchise tax return. ~~Appraised value of intangible property shall be the total gross valuation required to be reported for intangible tax purposes on April 15 coincident with or next preceding the due date of the franchise tax return.~~ The term "total actual investment in tangible property" as used in this section ~~shall be construed to mean~~ means the total original purchase price or consideration to the reporting taxpayer of its tangible properties, including real estate, in this State plus additions and improvements thereto less reserve for depreciation as permitted for income tax purposes, and also less any indebtedness incurred and existing by virtue of the purchase of any real estate and any permanent improvements made thereon. In computing "total actual investment in tangible personal property" there shall also be deducted reserves for the entire cost of any air-cleaning device or sewage or waste treatment plant, including waste lagoons, and pollution abatement equipment purchased or constructed and installed which reduces the amount of air or water pollution resulting from the emission of air contaminants or the discharge of sewage and industrial wastes or other polluting materials or substances into the outdoor atmosphere or into streams, lakes, or rivers, upon condition that the corporation claiming ~~such~~ this deduction shall furnish to the Secretary a certificate from the Department of Environment and Natural Resources or from a local air pollution control program for air-cleaning devices located in an area where the Environmental Management Commission has certified a local air pollution control program pursuant to G.S. 143-215.112 certifying that said Department or local air pollution control program has found as a fact that the air-cleaning device, waste treatment plant or pollution abatement equipment purchased or constructed and installed as above described has actually been constructed and installed and that ~~such~~ the device, plant or equipment complies with the requirements of the Environmental Management Commission or local air pollution control program with respect to ~~such~~ the devices,

plants or equipment, that ~~such~~ the device, plant or equipment is being effectively operated in accordance with the terms and conditions set forth in the permit, certificate of approval, or other document of approval issued by the Environmental Management Commission or local air pollution control program and that the primary purpose ~~thereof~~ is to reduce air or water pollution resulting from the emission of air contaminants or the discharge of sewage and waste and not merely incidental to other purposes and functions. The cost of constructing facilities of any private or public utility built for the purpose of providing sewer service to residential and outlying areas ~~shall be~~ is treated as deductible for the purposes of this section; the deductible liability allowed by this section shall apply only with respect to ~~such~~ pollution abatement plants or equipment constructed or installed on or after January 1, 1955."

SECTION 3.(a) G.S. 105-130.2 reads as rewritten:

"...

(4a) Gross income. – Defined in section 61 of the Code.

~~(4a)~~(4b) Income year. – The calendar year or the fiscal year upon the basis of which the net income is computed under this Part. If no fiscal year has been established, the income year is the calendar year. In the case of a return made for a fractional part of a year under the provisions of this Part or under rules adopted by the Secretary, the income year is the period for which the return is made.

..."

SECTION 3.(b) G.S. 105-114(b)(4) reads as rewritten:

"(4) Income year. – Defined in G.S. ~~105-130.2(5).~~105-130.2(4b)."

SECTION 4.(a) G.S. 105-130.47(a) reads as rewritten:

"(a) Definitions. – The following definitions apply in this section:

(1) Highly compensated individual. – An individual who receives compensation in excess of one million dollars ($1,000,000) for services with respect to a single production.

(2) Live sporting event. – A scheduled sporting competition, game, or race that is not originated by a production company, but originated solely by an amateur, collegiate, or professional organization, institution, or association for live or tape-delayed television or satellite broadcast. A live sporting event shall not include commercial advertising, an episodic television series, a television pilot, music video, motion picture, or documentary production where any sporting events are presented through archived historical footage or similar footage depicting earlier live sporting events that originated more than thirty days before the time of such usage.

(3) Production company. – Defined in G.S. 105-164.3.

(4) Qualifying expenses. – The sum of the total amount spent in this State for the following by a production company in connection with a production:

a. Goods and services leased or purchased by the production company. For goods with a purchase price of twenty-five

thousand dollars ($25,000) or more, the amount included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.

b. Compensation and wages paid by the production company, other than amounts paid to a highly compensated individual, either directly or indirectly, on which ~~the production company remitted~~ withholding payments are remitted to the Department of Revenue under Article 4A of this Chapter."

SECTION 4.(b) G.S. 105-151.29(a) reads as rewritten:

"(a) Definitions. – The following definitions apply in this section:

(1) Highly compensated individual. – An individual who receives compensation in excess of one million dollars ($1,000,000) for services with respect to a single production.

(2) Live sporting event. – A scheduled sporting competition, game, or race that is not originated by a production company, but originated solely by an amateur, collegiate, or professional organization, institution, or association for live or tape-delayed television or satellite broadcast. A live sporting event shall not include commercial advertising, an episodic television series, a television pilot, music video, motion picture, or documentary production where any sporting events are presented through archived historical footage or similar footage depicting earlier live sporting events that originated more than thirty days before the time of such usage.

(3) Production company. – Defined in G.S. 105-164.3.

(4) Qualifying expenses. – The sum of the total amount spent in this State for the following by a production company in connection with a production:

a. Goods and services leased or purchased by the production company. For goods with a purchase price of twenty-five thousand dollars ($25,000) or more, the amount included in qualifying expenses is the purchase price less the fair market value of the good at the time the production is completed.

b. Compensation and wages paid by the production company, other than amounts paid to a highly compensated individual, either directly or indirectly, on which ~~the production company remitted~~ withholding payments are remitted to the Department of Revenue under Article 4A of this Chapter."

SECTION 4.(c) G.S. 105-259(b) reads as rewritten:

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

~~(32) To provide the report required under G.S. 105-164.14(c) to the Department of Public Instruction and the Fiscal Research Division of the General Assembly.~~

. . .

(36) To furnish to a taxpayer claiming a credit under G.S. 105-130.47 or G.S. 105-151.29 information from a third party to the extent the information was used by the Secretary to adjust the amount of the credit claimed by the taxpayer."

SECTION 5.(a) G.S. 105-164.3(49) reads as rewritten:

"(49) Use. – Means and includes the exercise of any right or power or dominion whatsoever over tangible personal property or over any service subject to tax under this Article by a purchaser thereof and includes, but is not limited to, any withdrawal from storage, distribution, installation, affixation to real or personal property, or exhaustion or consumption of tangible personal property or any service subject to tax under this Article by the owner or purchaser thereof, but does not include the sale of tangible personal property or of any service subject to tax under this Article in the regular course of business."

SECTION 5.(b) G.S. 105-164.16(a) reads as rewritten:

"(a) General. – Sales and use taxes are payable quarterly, monthly, or semimonthly as specified in this section. A return is due quarterly or monthly as specified in this section. A return must be filed with the Secretary on a form prescribed by the Secretary and in the manner required by the Secretary. A return must be signed by the taxpayer or the taxpayer's agent.

A sales tax return must state the taxpayer's gross sales for the reporting period, the amount and type of sales made in the period that are exempt from tax under G.S. 105-164.13 or are elsewhere excluded from tax, the amount of tax due, and any other information required by the Secretary. A use tax return must state the purchase price of tangible personal property or services sourced to this State that ~~was~~ were purchased or received during the reporting period and ~~is~~ are subject to tax under G.S. 105-164.6, the amount of tax due, and any other information required by the Secretary. Returns that do not contain the required information will not be accepted. When an unacceptable return is submitted, the Secretary will require a corrected return to be filed."

SECTION 6. G.S. 105-164.6(c) reads as rewritten:

"(c) Credit. – A credit is allowed against the tax imposed by this section for the following:

(1) The amount of sales or use tax paid on the item to this State. Payment of sales or use tax to this State on an item by a retailer extinguishes the liability of a purchaser for the tax imposed under this section.

(2) The amount of sales or use tax paid on the item to another state. If the amount of tax paid to the other state is less than the amount of tax imposed by this section, the difference is payable to this State. The

credit allowed by this subdivision does not apply to tax paid to a state that does not grant a similar credit for sales or use taxes paid in North Carolina."

SECTION 7. G.S. 105-164.7 reads as rewritten:

"**§ 105-164.7. Sales tax part of purchase price.**

Every retailer subject to the tax levied in G.S. 105-164.4 shall at the time of selling or delivering or taking an order for the sale or delivery of taxable tangible personal property or a taxable service, or collecting the sales price, add to the sales price the amount of tax due. The tax constitutes a part of the purchase price, is a debt from the purchaser to the retailer until paid, and is recoverable at law in the same manner as other debts. The tax must be stated and charged separately from the sales price, shown separately on the retailer's sales records, and paid by the purchaser to the retailer as trustee for and on account of the State. The retailer is liable for the collection of the tax and for its payment to the Secretary. The retailer's failure to charge the tax to or to collect the tax from the purchaser does not affect this liability. It is the intent of this Article that the tax be added to the sales price of tangible personal property and services when sold at retail and be borne and passed on to the customer, instead of being borne by the retailer."

SECTION 8.(a) G.S. 105-164.13(1a) reads as rewritten:

"(1a) Sales of the following to a farmer, as defined in subdivision (1) of this section:

a. A container ~~sold to a farmer, as defined in subdivision (1) of this section,~~ used for a purpose set out in ~~that~~ subdivision (1) of this section or in packaging and transporting the farmer's product for sale.

b. A grain, feed, or soybean storage facility, and parts and accessories attached to the facility."

SECTION 8.(b) G.S. 105-164.13(4e) is repealed.

SECTION 9. G.S. 105-164.14(k) reads as rewritten:

"(k) Reports. – The Department of Revenue shall publish by May 1 of each year the following information itemized by taxpayer for the 12-month period ending the preceding December 31:

(1) The number of taxpayers claiming a refund allowed in subsections (a1), (g), (h), (i), ~~and (j)~~(j), and (*l*) of this section.

(2) The total amount of purchases with respect to which refunds were claimed.

(3) The total cost to the General Fund of the refunds claimed."

SECTION 10. G.S. 105-164.15A reads as rewritten:

"**§ 105-164.15A. Effective date of rate changes for services.**

The effective date of a rate change for a service taxable under this Article is administered as follows:

(1) For a rate increase, the new rate applies to the first billing period that starts on or after the effective date. For a service billed after it is provided, the first billing period starts on the effective date. For a

service billed before it is provided, the first billing period starts on the first day of the month after the effective date.

(2) For a rate decrease, the new rate applies to bills rendered on or after the effective date."

SECTION 11. G.S. 105-187.52 reads as rewritten:

"**§ 105-187.52. Administration.**

(a) Administration. – The privilege taxes imposed by this Article are in addition to the State use tax. Except as otherwise provided in this Article, the collection and administration of these taxes is the same as the State use tax imposed by Article 5 of this Chapter.

(b) Credit. – A credit is allowed against the tax imposed by this Article for the amount of a sales or use tax, privilege or excise tax, or substantially equivalent tax paid to another state. The credit allowed by this subsection does not apply to tax paid to another state that does not grant a similar credit for the privilege tax paid in North Carolina."

SECTION 12.(a) G.S. 105-233 and G.S. 105-234 are repealed.

SECTION 12.(b) G.S. 105-236 reads as rewritten:

"**§ 105-236. ~~Penalties.~~Penalties; situs of violations; penalty disposition.**

(a) Penalties. – ~~Penalties assessed by the Secretary under this Subchapter are assessed as an additional tax. The clear proceeds of any civil penalties levied pursuant to subdivisions (3), (4), (5)a., and (6) of this section shall be remitted to the Civil Penalty and Forfeiture Fund in accordance with G.S. 115C-457.2. Except as otherwise provided by law, and subject to the provisions of G.S. 105-237, the following penalties shall be applicable:~~The following civil penalties and criminal offenses apply:

(1) Penalty for Bad Checks. – When the bank upon which any uncertified check tendered to the Department of Revenue in payment of any obligation due to the Department returns the check because of insufficient funds or the nonexistence of an account of the drawer, the Secretary shall assess a penalty equal to ten percent (10%) of the check, subject to a minimum of one dollar ($1.00) and a maximum of one thousand dollars ($1,000). This penalty does not apply if the Secretary finds that, when the check was presented for payment, the drawer of the check had sufficient funds in an account at a financial institution ~~in this State~~ to pay the check and, by inadvertence, the drawer of the check failed to draw the check on the account that had sufficient funds.

. . .

~~(11) Any violation of Subchapter I, V, or VIII of this Chapter or of Article 3 of Chapter 119 of the General Statutes is considered an act committed in part at the office of the Secretary in Raleigh. The certificate of the Secretary that a tax has not been paid, a return has not been filed, or information has not been supplied, as required by law, is prima facie evidence that the tax has not been paid, the return has not been filed, or the information has not been supplied.~~

(12) Repealed by Session Laws 1991, c. 45, s. 27.

(b) Situs. – Violation of a tax law is considered an act committed in part at the office of the Secretary in Raleigh. The certificate of the Secretary that a tax has not been paid, a return has not been filed, or information has not been supplied, as required by law, is prima facie evidence that the tax has not been paid, the return has not been filed, or the information has not been supplied.

(c) Penalty Disposition. – Civil penalties assessed by the Secretary are assessed as an additional tax. The clear proceeds of civil penalties assesses by the Secretary must be credited to the Civil Penalty and Forfeiture Fund, established in G.S. 115C-457.1."

SECTION 12.(c) G.S. 105-449.48 and G.S. 105-449.127 are repealed.

SECTION 12.(d) G.S. 105-449.49 reads as rewritten:

"**§ 105-449.49. Temporary permits.**

(a) Issuance. – Upon application to the Secretary and payment of a fee of fifty dollars ($50.00), a motor carrier may obtain a temporary permit authorizing the carrier to operate a vehicle in the State for three days without registering the vehicle in accordance with G.S. ~~105-449.47 for not more than three days.~~ 105-449.47. A motor carrier to whom a temporary permit has been issued may elect not to report its operation of the vehicle during the three-day period. Fees collected under this subsection are credited to the Highway Fund.

(b) Refusal. – The Secretary may refuse to issue a temporary permit to any of the following:

(1) A motor carrier whose registration has been withheld or revoked.

(2) A motor carrier who the Secretary determines is evading payment of tax through the successive purchase of temporary permits."

SECTION 13.(a) G.S. 105-449.65(b) reads as rewritten:

"(b) Multiple Activity. – A person who is engaged in more than one activity for which a license is required must have a separate license for each activity, unless this subsection provides otherwise. A person who is licensed as a supplier is considered to have a license as a distributor. A person who is licensed as an occasional importer or a tank wagon importer is not required to obtain a separate license as a distributor unless the importer is also purchasing motor fuel, at the terminal rack, from an elective or permissive supplier who is authorized to collect and remit the tax to the State. A person who is licensed as a distributor is not required to obtain a separate license as an importer if the distributor acquires fuel for import only from an elective supplier or a permissive supplier and is not required to obtain a separate license as an exporter. A person who is licensed as a distributor or a blender ~~is not required to obtain a separate license~~ and who transports fuel is considered to be licensed as a motor fuel ~~transporter if the distributor or blender does not transport motor fuel for others for hire.~~transporter."

SECTION 13.(b) G.S. 105-449.101 reads as rewritten:

"**§ 105-449.101. Motor fuel transporter to file informational return showing deliveries of ~~imported or exported~~ motor fuel.**

(a) Requirement. – A motor fuel transporter ~~that imports motor fuel into this State or exports motor fuel from this State~~ must file a monthly informational return with the Secretary that shows motor fuel ~~received or delivered for import or export~~

transported in this State by the transporter during the month. ~~This requirement does not apply to a distributor that is not required to be licensed as a motor fuel transporter.~~

(b) Content. – The return required by this section is due ~~by the 25th day of the month following the month covered by the return.~~ on the same date as a monthly return due under G.S. 105-449.90. The return must contain the following information and any other information required by the Secretary:

(1) The name and address of each person from whom the transporter received motor fuel outside the State for delivery in the State, the amount of motor fuel received, the date the motor fuel was received, and the destination state of the fuel.

(2) The name and address of each person from whom the transporter received motor fuel in the State for delivery outside the State, the amount of motor fuel delivered, the date the motor fuel was delivered, and the destination state of the fuel.

(3) The name and address of each person from whom the transporter received motor fuel in the State for delivery in the State, the amount of motor fuel received, the date the motor fuel was received, and the destination state of the fuel."

SECTION 14.(a) G.S. 105-449.60 is amended by adding a new subdivision to read:

"**§ 105-449.60. Definitions.**

The following definitions apply in this Article:

...

(10a) Exempt card or code. – A credit card or an access code that enables the person to whom the card or code is issued to buy motor fuel at retail without paying the motor fuel excise tax on the fuel."

SECTION 14.(b) G.S. 105-449.88A reads as rewritten:

"**§ 105-449.88A. Liability for tax due on motor fuel designated as exempt by the use of cards or codes.**

~~(a) Exempt Cards at Rack. – When a licensed distributor or licensed importer removes motor fuel from a terminal by means of an exempt card or exempt access code issued by the supplier, the distributor or importer represents that the fuel removed will be resold to a governmental unit that is exempt from the tax. A supplier may rely on this representation. A licensed distributor or licensed importer that does not resell motor fuel removed from a terminal by means of an exempt card or exempt access code to an exempt governmental unit is liable for any tax due on the fuel.~~

(b) Exempt ~~Cards at Retail.~~ Card or Code. ~~– An "exempt card or code" is a credit card or an access code that enables the person to whom the card or code is issued to buy motor fuel at retail without paying the motor fuel excise tax on the fuel.~~ An entity that issues an exempt card or code has a duty to determine if the person to whom it is issued is exempt from the motor fuel excise tax. An entity that issues an exempt card or code to a person who is not exempt from tax is liable for tax due on motor fuel the person purchases at retail by use of the exempt card or code. If a supplier authorizes another entity to issue an exempt card or code to a person who is not exempt from tax, the

supplier and the entity that issued the card are jointly and severally liable for tax due on motor fuel the person purchases at retail by use of the exempt card or code.

(c) Card Holder. – A person to whom an exempt card or ~~exempt access card~~ code is issued ~~for use at a terminal or at retail~~ is liable for any tax due on fuel purchased with the card or code for a purpose that is not exempt. A person who misuses an exempt card or code by purchasing fuel with the card or code for a purpose that is not exempt is liable for the tax due on the fuel."

SECTION 14.(c) G..S. 105-449.90(c) is repealed.

SECTION 14.(d) G.S. 105-449.93 reads as rewritten:

"**§ 105-449.93. ~~Exempt sale deduction and percentage~~ Percentage discount for licensed distributors and some licensed importers.**

~~(a) Deduction. – A license holder listed below may deduct from the amount of tax otherwise payable to a supplier the amount calculated on motor fuel the license holder received from the supplier and resold to a governmental unit whose purchases of motor fuel are exempt from the tax under G.S. 105-449.88 if, when removing the fuel, the license holder used an access card or code specified by the supplier to notify the supplier of the license holder's intent to resell the fuel in an exempt sale:~~

~~(1) A licensed distributor.~~

~~(2) A licensed importer that removed the motor fuel from a terminal rack of a permissive or an elective supplier.~~

(b) Percentage Discount. – A licensed distributor that pays the tax due a supplier by the date the supplier must pay the tax to the State may deduct from the amount due a discount of one percent (1%) of the amount of tax payable. A licensed importer that removes motor fuel from a terminal rack of a permissive or an elective supplier and that pays the tax due the supplier by the date the supplier must pay the tax to the State may deduct from the amount due a discount of the same amount allowed a licensed distributor. The discount covers the expense of furnishing a bond and losses due to shrinkage or evaporation. A supplier may not directly or indirectly deny this discount to a licensed distributor or licensed importer that pays the tax due the supplier by the date the supplier must pay the tax to the State."

SECTION 14.(e) G.S. 105-449.94 is repealed.

SECTION 14.(f) G.S. 105-449.97(d) reads as rewritten:

"(d) Taxes Paid on Exempt Retail Sales. – When filing a return, a supplier that issues or authorizes the issuance of an exempt card or ~~an exempt access~~ code to a person that enables the person to buy motor fuel ~~at retail~~ without paying tax on the fuel may deduct the amount of excise tax imposed on fuel purchased with the exempt ~~retail~~ card or code. The amount of excise tax imposed on fuel purchased ~~at retail~~ with an exempt ~~retail~~ card or code is the amount that was imposed on the fuel when it was delivered to the retailer of the fuel."

SECTION 14.(g) G.S. 105-449.105A(a) reads as rewritten:

"(a) Refund. – A distributor who sells kerosene to any of the following may obtain a refund for the excise tax the distributor paid on the kerosene, less the amount of any discount allowed on the kerosene under G.S. 105-449.93:

(1) The end user of the kerosene, if the distributor dispenses the kerosene into a storage facility of the end user that contains fuel used only for one of the following purposes and the storage facility is installed in a manner that makes use of the fuel for any other purpose improbable:
a. Heating.
b. Drying crops.
c. A manufacturing process.

(2) A retailer of kerosene, if the distributor dispenses the kerosene into a storage facility that meets both of the following conditions:
a. It is marked with the phrase "Undyed, Untaxed Kerosene, Nontaxable Use Only" or a similar phrase that clearly indicates that the fuel is not to be used to operate a highway vehicle.
b. It either has a dispensing device that is not suitable for use in fueling a highway vehicle or is kept locked by the retailer and must be unlocked by the retailer for each sale of kerosene.

(3) An airport, if the distributor dispenses the kerosene into a storage facility that contains fuel used only for fueling airplanes and that meets at least one of the following conditions:
a. It is marked with the phrase "Undyed, Untaxed Kerosene, Nontaxable Use Only" or a similar phrase that clearly indicates that the fuel is not to be used to operate a highway vehicle.
b. It has a dispensing device that is not suitable for use in fueling a highway vehicle."

SECTION 15.(a) G.S. 105-449.100 reads as rewritten:

"**§ 105-449.100. Terminal operator to file informational return showing changes in amount of motor fuel at the terminal.**

A terminal operator must file a monthly informational return with the Secretary that shows the amount of motor fuel received or removed from the terminal during the month. The return is due ~~by the 25th day of the month following the month covered by the return.~~ on the same date as a monthly return due under G.S. 105-449.90. The return must contain the following information and any other information required by the Secretary:

(1) The number of gallons of motor fuel received in inventory at the terminal during the month and each position holder for the fuel.
(2) The number of gallons of motor fuel removed from inventory at the terminal during the month and, for each removal, the position holder for the fuel and the destination state of the fuel.
(3) The number of gallons of motor fuel gained or lost at the terminal during the month."

SECTION 15.(b) G.S. 105-449.102(a) reads as rewritten:

"(a) Return. – A distributor that exports motor fuel from a bulk plant located in this State must file a monthly return with the Secretary that shows the exports. The return is due ~~by the 25th day of the month following the month covered by the return.~~

on the same date as a monthly return due under G.S. 105-449.90. The return serves as a claim for refund by the distributor for tax paid to this State on the exported motor fuel."

SECTION 15.(c) G.S. 105-449.137(b) reads as rewritten:

"(b) Payment. – The tax imposed by this Article is payable when a return is due. A return is due ~~monthly within 25 days after the end of each month.~~ on the same date as a monthly return due under G.S. 105-449.90. A monthly return covers liabilities that accrue in the calendar month preceding the date the return is due. A return must be filed with the Secretary and must be in the form and contain the information required by the Secretary."

SECTION 15.(d) G.S. 119-18(a) reads as rewritten:

"(a) Tax. – An inspection tax of one fourth of one cent (1/4 of 1¢) per gallon is levied upon all of the fuel listed in this subsection regardless of whether the fuel is exempt from the per-gallon excise tax imposed by Article 36C or 36D of Chapter 105 of the General Statutes. The inspection tax on motor fuel is due and payable to the Secretary of Revenue at the same time that the per gallon excise tax on motor fuel is due and payable under Article 36C of Chapter 105 of the General Statutes. The inspection tax on alternative fuel is due and payable to the Secretary of Revenue at the same time that the excise tax on alternative fuel is due and payable under Article 36D of Chapter 105 of the General Statutes. The inspection tax on kerosene is payable monthly to the Secretary by a supplier that is licensed under Part 2 of Article 36C of Chapter 105 of the General Statutes and by a kerosene supplier. A monthly report is due ~~by the 22nd of each month~~ on the same date as a monthly return due under G.S. 105-449.90 and applies to kerosene sold during the preceding month by a supplier licensed under that Part and to kerosene received during the preceding month by a kerosene supplier. A kerosene terminal operator must file a return in accordance with the provisions of ~~G.S. 105-449.100.~~G.S. 105-449.90.

(1) Motor fuel.

(2) Alternative fuel used to operate a highway vehicle.

(3) Kerosene."

SECTION 16.(a) G.S. 105-449.106(c) reads as rewritten:

"(c) Special Mobile Equipment. – A person who purchases and uses motor fuel to operate special mobile equipment off-highway may receive a quarterly refund, for the excise tax paid during the preceding quarter, at a rate equal to the flat cents-per-gallon rate plus the variable cents-per-gallon rate in effect during the quarter for which the refund is claimed, less the amount of sales and use tax or privilege tax due on the fuel under this Chapter, as determined in accordance with G.S. 105-449.107(c). An application for a refund must be made in accordance with this Part."

SECTION 16.(b) G.S. 105-449.107 reads as rewritten:

"**§ 105-449.107. Annual refunds for off-highway use and use by certain vehicles with power attachments.**

(a) Off-Highway. – A person who purchases and uses motor fuel for a purpose other than to operate a licensed highway vehicle may receive an annual refund for the excise tax the person paid on fuel used during the preceding calendar year. The amount of refund allowed is the amount of the flat cents-per-gallon rate in effect during the year

for which the refund is claimed plus the average of the two variable cents-per-gallon rates in effect during that year, less the amount of sales and use tax or privilege tax due on the fuel under this Chapter. An application for a refund allowed under this section must be made in accordance with this Part.

(b) Certain Vehicles. – A person who purchases and uses motor fuel in one of the vehicles listed below may receive an annual refund for the amount of fuel consumed by the vehicle:

(1) A concrete mixing vehicle.
(2) A solid waste compacting vehicle.
(3) A bulk feed vehicle that delivers feed to poultry or livestock and uses a power takeoff to unload the feed.
(4) A vehicle that delivers lime or fertilizer in bulk to farms and uses a power takeoff to unload the lime or fertilizer.
(5) A tank wagon that delivers alternative fuel, as defined in G.S. 105-449.130, or motor fuel or another type of liquid fuel into storage tanks and uses a power takeoff to make the delivery.
(6) A commercial vehicle that delivers and spreads mulch, soils, composts, sand, sawdust, and similar materials and that uses a power takeoff to unload, blow, and spread the materials.
(7) A commercial vehicle that uses a power takeoff to remove and dispose of septage and for which an annual fee is required to be paid to the Department of Environment and Natural Resources under G.S. 130A-291.1.
(8) A sweeper.

The amount of refund allowed is thirty-three and one-third percent (33 1/3%) of the following: the sum of the flat cents-per-gallon rate in effect during the year for which the refund is claimed and the average of the two variable cents-per-gallon rates in effect during that year, less the amount of sales and use tax or privilege tax due on the fuel under this Chapter. An application for a refund allowed under this section must be made in accordance with this Part. This refund is allowed for the amount of fuel consumed by the vehicle in its mixing, compacting, or unloading operations, as distinguished from propelling the vehicle, which amount is considered to be one-third of the amount of fuel consumed by the vehicle.

(c) Sales Tax Amount. – Article 5 of this Chapter determines the amount of sales and use tax to be deducted under this section from a motor fuel excise tax refund. Article 5F of this Chapter determines the amount of privilege tax to be deducted under this section from a motor fuel excise tax refund. The sales price and the cost price of motor fuel to be used in determining the amount to deduct is the average of the wholesale prices used under G.S. 105-449.80 to determine the excise tax rates in effect for the two six-month periods of the year for which the refund is claimed."

SECTION 17. G.S. 105-449.120(a)(3a) is repealed.

SECTION 18. The caption of G.S. 105-249.2 reads as rewritten:

"§ 105-249.2. **Due date extended and penalties waived for certain military personnel or ~~individuals~~ persons affected by a presidentially declared disaster."**

SECTION 19. The caption of G.S. 143B-437.71 reads as rewritten:

"§ 143B-437.71. **One North Carolina Fund established as a ~~nonreverting account.~~special revenue fund.**"

SECTION 20.(a) G.S. 153A-155(d) reads as rewritten:

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

SECTION 20.(b) G.S. 160A-215(d) reads as rewritten:

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

SECTION 21. G.S. 160A-49(f2) reads as rewritten:

"(f2) Effective Date of Annexation for Certain Property. – Annexation of property subject to annexation under subsection (f1) of this section shall become effective:

(1) Upon the effective date of the annexation ordinance, the property is considered part of the city only (i) for the purpose of establishing city boundaries for additional annexations pursuant to this Article and (ii) for the exercise of city authority pursuant to Article 19 of this Chapter.

(2) For all other purposes, the annexation becomes effective as to each tract of such property or part thereof on the last day of the month in which that tract or part thereof becomes ineligible for classification pursuant to ~~G.S. 105-227.4~~ G.S. 105-277.4 or no longer meets the requirements of subdivision (f1)(2) of this section. Until annexation of a tract or a part of a tract becomes effective pursuant to this subdivision, the tract or part of a tract is not subject to taxation by the city under Article 12 of Chapter 105 of the General Statutes nor is the tract or part of a tract entitled to services provided by the city."

SECTION 22. The introductory language for Section 59.2 of S.L. 2005-435 reads as rewritten:

"**SECTION 59.2.(a)** ~~G.S. 105-114.1(a4)~~ G.S. 105-114(a4) reads as rewritten:"

SECTION 23. The introductory language of Section 4 of S.L. 2005-413 reads as rewritten:

"**SECTION 4.** ~~G.S. 105-129.15(7) reads~~ Subdivisions (6) and (7) of G.S. 105-129.15 read as rewritten:"

SECTION 24. Section 1(a) of S.L. 2005-261 reads as rewritten:

"**SECTION 1.(a)** Authority; Vote. – If the majority of those voting on the question pursuant to this section vote for the levy of the tax, the Monroe City Council may, by ordinance, levy a prepared food and beverages tax of up to one percent (1%) of the sales price of prepared food and beverages sold within the City of Monroe at retail for consumption on or off the premises by a retailer subject to sales tax under G.S. ~~105-164(a)(1).~~105-164.4(a)(1). This tax is in addition to State and local sales tax.

The Monroe City Council may direct the county board of elections to submit to the qualified voters of the city during any election held in 2006 the question of whether to levy a local prepared food and beverages tax of one percent (1%) as provided in this section. The election must be held on a date jointly agreed upon by the board of elections and city council and held in accordance with Chapter 163 of the General Statutes. The question to be used in the voting systems and ballots shall be:

"[ ] FOR [ ] AGAINST

One percent (1%) local prepared food and beverages tax, in addition to the current local sales and use taxes, to be used for the Civic Center Project for the City of Monroe."

SECTION 25. Section 4 is effective for taxable years beginning on or after January 1, 2006. Sections 13, 14, 15, and 17 of this act become effective January 1, 2007, and apply to motor fuel purchased on or after that date. An exempt card or code will not be valid for sales of motor fuel at the terminal rack on or after January 1, 2007. The remainder of this act is effective when it becomes law.

BILL DRAFT 2005-SVz-10: Revenue Laws Technical & Motor Fuels Tax Changes

BILL ANALYSIS

Committee:	Revenue Laws Study Committee	**Date:**	April 27, 2006
Introduced by:		**Summary by:**	Trina Griffin
Version:	Draft		Committee Counsel

SUMMARY: ***This bill draft makes several technical, clarifying, and administrative changes to the revenue laws and related statutes and to the motor fuels tax laws to improve collection and administration.***

Sections 1, 2, 7, 19, 21, 22, 23, and 24 are technical changes. Sections 3, 5, 6, 8, 12, and 18 are clarifying changes. Sections 4, 9, 10, 11, and 20 make administrative changes. Sections 13 through 17 are changes to the motor fuel tax laws designed to improve collection and administrative efforts.

BILL ANALYSIS: This bill draft makes the following changes:

Section	Explanation
1	Corrects a departmental reference since S.L. 2005-380 transferred the NC Grape Growers Council from the Department of Agriculture and Consumer Services to the Department of Commerce.
2	Removes obsolete language and makes other stylistic changes. This statutory subsection makes two obsolete references to including the appraised value of intangible property in the appraised value base. This language became obsolete with the repeal of the intangibles tax effective for tax years beginning on or after January 1, 1995. The Department of Revenue does not require intangible property to be included in the appraised value base.
3(a) & (b)	Defines the term "gross income" in the corporate income tax law by reference to section 61 of the Code, which is the same definition that is currently found in the individual income tax law. Section 20(b) is a conforming change.
4	Section 4 relates to the new film incentives tax credit enacted last year. Subsections (a) and (b) make clarifying changes to the film incentives in both the corporate and individual provisions. First, the term "highly compensated individual" is limited to individuals who are compensated for services and does not include individuals who may sell goods in excess of the one-million-dollar limitation. Second, the exclusion of amounts paid to highly compensated individuals is clarified so that it is clear that the exclusion applies whether the individual is paid directly by the production or by an unrelated third-party. It is not uncommon for a production company to contract with a separate entity for the services of actors or other professionals involved in a production. Third, the statutes are amended so that withholdings must be remitted in order for compensation to qualify as a qualifying expenses, but that withholding does not necessarily have to be performed by the production company. Subsection (c) makes two changes to the confidentiality statute, one of which is related to the film incentives tax credit. It adds a new subdivision (36), which allows the Department of Revenue to provide to a production company claiming a film production

	credit information from a third party to the extent the information was used by the Department to adjust the amount of the credit claimed by the production company. It also repeals subdivision (32), which allows the Department of Revenue to provide to Department of Public Instruction and the Fiscal Research Division reports regarding sales and use tax refunds received by school administrative units. This provision was enacted last year. However, Section 32(b) of S.L. 2005-435 amended the definition of tax information to exclude governmental agency refunds. Therefore, an exception is not needed in the confidentiality statute since the information is no longer confidential tax information.
5(a) & (b)	In 2005, the General Assembly made the use tax applicable to services sourced to this State. Section 21(a) is a conforming change which amends the definition of "use" to include services. Section 21(b) is a conforming change to the statute regarding use tax returns.
6	Corrects an inadvertent omission. In last year's budget bill, there was a rewrite of this statutory section on use tax. A credit should be allowed for both sales and use tax paid to another state, but the revised statute only provides a credit for sales tax paid. There was no intent to change the application of the tax and so, this section adds the phrase "or use" back into the statute.
7	Makes a grammatical change to the statute.
8(a) & (b)	Clarifies that the exemption from sales tax for sales of grain, feed, or soybean storage facilities and accessories only applies to sales made to farmers. This was one of the items previously subject to the 1%, $80 maximum rate of tax. The 1% rate was imposed on sales to farmers of grain, feed, or soybean storage facilities and accessories. Last year, to conform to the Streamlined Agreement, the General Assembly exempted these items from sales tax. However, the new exemption language did not limit the exemption to farmers.
9	Last year, a sales and use tax refund was authorized for the purchase of fuel by interstate passenger air carriers and by motorsports racing team or sanctioning body. Under current law, the Department of Revenue is required annually to publish the number of taxpayers claiming certain sales and use tax refunds. This section would add these categories of refunds to the reporting requirement.
10	Clarifies the effective date for a rate increase with regard to prepayments of service. In 2005, the General Assembly enacted G.S. 105-164.15A, which addresses the effective date for rate increases and decreases to taxable services, but the statute does not specifically address prepayments of service.
11	Provides a credit against the privilege tax for sales and use tax, or a similar type of tax, paid to another state. Currently, there is no specific provision for credits in the newly enacted Article 5F.
12(a) & (b)	Section 12 makes changes to various penalty statutes. **Section 12(a)** repeals two misdemeanor statutes relating to the willful failure to comply with the tax laws and aiding and abetting in the violation of the tax laws. These violations are covered by G.S. 105-236(9) and therefore are unnecessary. Section 12(b) reorganizes the penalties statute and makes some technical and clarifying changes. It divides the former statutory section into three subsections: subsection (a) lists the various penalties available to the Department of Revenue for violations of the

	tax laws; subsection (b) is a recodification of the principle previously set out in subdivision (11), which states that a violation of a tax law is considered an act committed in part at the office of the Secretary in Raleigh; and subsection (c) restates language previously found at the beginning of the statute directing the disposition of the penalty proceeds to the Civil Penalty and Forfeiture Fund. This subsection also deletes an obsolete requirement to avoid the penalty for a bad check, which states that a person had sufficient funds in a bank account "in this State." Since the Department does not follow this requirement, it is being deleted. Section 12(c) repeals G.S. 105-449.127, which provides that civil penalties assessed for violation of the motor fuels tax laws be credited to the Highway Fund. G.S. 105-449.48 provides that fees collected for the issuance of temporary permits for motor carriers and all civil penalties collected for violations of the motor carrier laws be credited to the Highway Fund. **Section 12(d)** repeals this statute and moves the fee disposition language to G.S. 105-449.49. The repeal of these two statutes redirects from the Highway Fund to the Civil Penalty and Forfeiture Fund civil penalty proceeds collected under these two articles as required by *North Carolina School Boards Assn. v. Moore*. In July of 2005, the North Carolina Supreme Court held in *North Carolina School Boards Assn. v. Moore* that the penalties assessed under Chapter 105 are imposed as a monetary payment for a taxpayer's noncompliance with a mandate of the Revenue Act, that they are punitive in nature, and, as such, they are subject to Article IX, Section 7 of the NC Constitution requiring those funds be remitted to the Civil Penalty and Forfeiture Fund for use by the schools.
13(a) & (b)	Section 13 would give the Department the ability to cross match all motor fuel to ensure compliance with the motor fuel tax laws. Under current law, the Department may cross-match information regarding fuel entering the State and fuel leaving the State, but it cannot cross-match information regarding the intrastate movement of motor fuel. The Department has a new fuel tracking system that will better enable it to monitor the movement of fuel. The Department expects the system to be operational by the last quarter of this fiscal year. Section 15 makes the statutory changes necessary to enable the Department to review intrastate movements of fuel by providing that anyone who transports fuel must be licensed as a transporter and that all transporters must file informational returns on all movements of motor fuel. Section 13(a) provides that all people who transport motor fuel will be licensed as a motor fuel transporter. Under current law, a person licensed as a distributor or blender is considered to be licensed as a motor fuel transporter if the person transports the fuel for other for hire. This section would remove the exception for persons who transport their own fuel so that any distributor or blender who transports fuel – whether for hire or for their own use – would also be considered licensed as a transporter. Section 13(b) provides that a transporter must file an informational return showing deliveries of motor fuel. Under current law, only interstate movements of fuel must be reported on a monthly informational return. The change in this section of the bill would

	require such a return for all deliveries of fuel.
14	Section 14 would provide that all motor fuel leaving the terminal rack would be subject to the motor fuel excise tax. The Department requested this change to reduce the areas of evasion and inadvertent duplicate refunds. Under current law, a licensed distributor or importer may remove fuel from a terminal without paying the tax if the person has an exempt card issued by the supplier. This section would remove the ability of distributors and importers to use exempt cards at the terminal rack. Instead, they would be able to obtain a monthly refund on any sales of fuel to exempt entities.[1] This change would conform North Carolina's law to the laws of the surrounding states who do not allow untaxed gasoline or undyed fuel to leave their terminals without the imposition of the tax. Section 14(a) puts the definition of 'exempt card or code' in the definitional statute for the motor fuel article. Section 14(b) repeals the portion of the statute that allows fuel to be removed from the terminal without paying the tax. Section 14(c) removes the deduction a licensed distributor or importer may make for tax exempt fuel taken from the terminal rack because the ability to obtain the fuel without paying the tax is repealed in section 14(b). Section 14(d) repeals the statute requiring a licensed distributor or importer who obtains fuel at the terminal rack with an exempt card to file a quarterly reconciling return. Section 14(e) makes conforming changes. Section 14(f) provides a monthly refund procedure for a distributor who sells diesel fuel to an airport. A refund procedure already exists for sales of motor fuel to the other listed exempt entities.
15	Section 13(b) and section 15 would establish a common due date for all motor fuel tax due and informational returns. Under current law, most of the monthly tax returns are due on the 22nd day of the month following the month covered by the return. Informational returns are due on the 25th day of the month following the month covered by the return. These sections provide that all monthly returns are due on the 22nd day of the month following the month covered by the return.
16	Adds a reference to the privilege tax imposed under Article 5F, which was enacted last year, with regard to refunds of motor fuels tax allowed for nonhighway use of a vehicle. A refund of motor fuels tax allowed for the nonhighway use of a vehicle is to be reduced by the amount of sales and use tax owed based on the method set out in G.S. 105-449.107. Prior to January 1, 2006, the amount of sales tax due was based on either the general State and local rates of tax of the 1% rate imposed on sales of fuel to farmers and manufacturers. Effective January 1, 2006, sales of fuel to farmers and manufacturers are subject to the new 1% privilege tax. Currently, these two statutes refer only to the sales and use taxes levied in Article 5.
17	Section 17 would remove the misdemeanor for taxpayers failing to pay the destination state taxes collected to that state. This provision was put into the law when North Carolina first moved to tax-at-the-rack. Today, all of the surrounding states have destination state tax laws. North Carolina does not collect and remit the taxes to those states, therefore this misdemeanor is no longer needed.
18	Amends the caption of G.S. 105-249.2 by replacing the word "individuals" with the word "persons." This statute provides, in part, that no penalties may be assessed for any period in which the time for filing a federal return or for paying a federal tax is extended

[1] G.S. 105-449.88 exempts the following entities from the motor fuel excise tax if it is sold to them for their use: the federal government, the State, local boards of education, charter schools, community colleges, counties, municipalities, and airports.

	because of a presidentially declared disaster. The relief provided by this statute is applied by the Department of Revenue equally to all tax entities, including businesses, and not just individuals.
19	Amends the caption of the statute to reflect what the statute actually provides. G.S. 143B-437.71(a) states, "The One North Carolina Fund is established as a special revenue fund in the Department of Commerce."
20	Section 20(a) and (b) conform the date an occupancy tax return is due to the date that the occupancy taxes are due.
21	Corrects an incorrect statutory reference.
22	Corrects an incorrect statutory reference.
23	Corrects introductory language from a 2005 session law.
24	Corrects an incorrect statutory reference within a local session law.

EFFECTIVE DATE: Section 4 is effective for taxable years beginning on or after January 1, 2006. Sections 13, 14, 15, and 17 of this act become effective January 1, 2007, and apply to motor fuel purchased on or after that date. An exempt card or code will not be valid for sales of motor fuel at the terminal rack on or after January 1, 2007. The remainder of this act is effective when it becomes law.

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

MEETING AGENDAS

REVENUE LAWS STUDY COMMITTEE

Rep. Paul Luebke Sen. John Kerr

Monday, December 12, 2005
Room 544, Legislative Office Building
1:00 p.m.

I. Welcome and Introductions

II. 2005 Finance Law Changes
Cindy Avrette, Research Division

III. Taxation of Communication Services

- **Past and Current North Carolina Tax Treatment**
  Cindy Avrette, Research Division
- **Convergence of the Industries**
  Brenna Erford, Fiscal Research Division

IV. Expansion of the Sales Tax Base – Maintenance Agreements
Linda Millsaps, Fiscal Research Division

V. Adjournment
Next Meeting: January 11, 2006 at 1:00 pm

REVENUE LAWS STUDY COMMITTEE

Sen. John Kerr Rep. Paul Luebke

Wednesday, January 11, 2006
Room 544, Legislative Office Building
1:00 p.m.

I. Approval of the Minutes from the December 12, 2005, Meeting

II. Taxation of Communication Services

- **Review of Current State Tax Treatment**
  Cindy Avrette, Legal Analyst, Research Division
- **Comments from Interested Parties**
  - *Bruce Yancey, Director of State and Local Taxes, BellSouth*
  - *Alan Ciamporcero, President, Southeast Region Public Affairs, Policy, & Communications, Verizon*
  - *Robert Wells, Executive Director, The Alliance of North Carolina Independent Telephone Companies*
  - *Randy Fraser, Vice President Government Affairs – NC, Time Warner Cable*
  - *Tom Adams, President of the NC Cable Telecommunications Association and President, Raleigh Division, Time Warner Cable*
  - *Ross Lieberman, Director of Government Relations, Echo-Star*
  - *Lee Mandell, Director of Information Technology and Research, NC League of Municipalities*
  - *Paul Meyer, Assistant General Counsel, NC Association of County Commissioners*

III. Adjournment

Next Meeting: February 8, 2006 at 1:00 pm

REVENUE LAWS STUDY COMMITTEE

Sen. John Kerr Rep. Paul Luebke

Wednesday, February 8, 2006
Room 544, Legislative Office Building
1:00 p.m.

I. **Approval of the Minutes from the January 11, 2005, Meeting**

II. **Synopsis of the Institute of Emerging Issues Forum on 'Financing the Future'**

Sabra Faires, Senate Tax Counsel and member of IEI workgroup on 'Bridging the Gap'

III. **Streamlined Sales Tax Update**

Andy Sabol, Director of the Sales & Use Tax Division, Department of Revenue

IV. **Additional Personal Income Tax Filing Option: Draft Proposal, Summary, and Fiscal Memorandum**

Martha Walston, Fiscal Research Division
Linda Millsaps, Fiscal Research Division

V. **IRC Update: Draft Proposal, Summary, and Fiscal Memorandum**
Canaan Huie, Bill Drafting Division
Linda Millsaps, Fiscal Research Division

VI. **Property Tax Changes: Draft Proposal, Summary, and Fiscal Memorandum**

Martha Walston, Fiscal Research Division
Rodney Bizzell, Fiscal Research Division

VII. **Revenue Laws Technical Changes: Draft Proposal and Summary**

Trina Griffin, Research Division

VIII. **2005 Biennial Tax Expenditure Report**

Karl Knapp, Director of the Tax Research Division, Department of Revenue

IX. **Adjournment**

Next Meeting: March 1, 2006, in Room 544 LOB at 1:00 pm

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Wednesday, March 1, 2006
Room 544, Legislative Office Building
1:00 p.m.

I. **Approval of the Minutes from the February 8, 2006, Meeting**

II. **Revenue Laws Technical Changes: Draft Proposal and Summary**

Continuation of the draft from previous meeting – Provisions to improve the collection and administration of the motor fuel tax.

Cindy Avrette, Research Division

III. **Streamlined Sales Tax Definitions: Draft Proposal and Summary**

Sabra Faires, Senate Tax Counsel

IV. **S Corp Income Tax Adjustments: Draft Proposal and Summary**

Trina Griffin, Research Division

V. **Clarify Additional Gross Premiums Tax: Draft Proposal and Summary**

Cindy Avrette, Research Division

VI. **Franchise Tax Loophole Closing: Draft Proposal and Summary**

Trina Griffin, Research Division

VII. **Franchise Tax Base Calculation: Draft Proposal and Summary**

Cindy Avrette, Research Division

VIII. **Expansion of Royalty Reporting Option: Draft Proposal and Summary**

Trina Griffin, Research Division

IX. **Real Estate Investment Trusts**

Cindy Avrette, Research Division

X. **Taxation of Communications Services**

- **Review of Current Tax Treatment** – Cindy Avrette, Research Division
- **Review of Current NC Market** – Brenna Erford, Fiscal Research Division
- **Review of Current Legislation in other States** – Sabra Faires, Senate Tax Counsel

XI. **Adjournment**

Next Meeting: April 5, 2006, in Room 544 LOB at 1:00 pm

REVENUE LAWS STUDY COMMITTEE AGENDA

Sen. John Kerr Rep. Paul Luebke

Wednesday, April 19, 2006
Room 544, Legislative Office Building
1:00 p.m.

I. **Approval of the Minutes from the March 1, 2006, Meeting**

II. **Draft Proposal: Video Services Competition Act**

- **Overview of the Issue and Presentation of Draft Proposal**
  Cindy Avrette, Research Division
  Brenna Erford, Fiscal Research Division
- **Public Comments**

III. **Draft Proposal: Amend Taxation of Logging Machinery**
Trina Griffin, Research Division
Linda Millsaps, Fiscal Research Division

IV. **Draft Proposal: Amend Delinquent Property Tax Collection**
Martha Walston, Fiscal Research Division
Walker Reagan, Research Division

V. **Draft Proposal: Public Service Company Property**
Martha Walston, Fiscal Research Division

VI. **Status Report:**

- **Electricity Franchise Tax Distribution**
- **Real Estate Investment Trust**

VII. **Expansion of Sales Tax Base to include Maintenance Agreements**
Linda Millsaps

VIII. **Corporate Tax Issues, Continued from March 1, 2006, Meeting**

- **Draft Proposal: Franchise Tax Base Calculation**
  Cindy Avrette, Research Division
  David Crotts, Fiscal Research Division
- **Draft Proposal: Clarify Additional Gross Premiums Tax**
  Cindy Avrette, Research Division
  Rodney Bizzell, Fiscal Research Division
- **Draft Proposal: Franchise Tax Loophole Closing**
  Trina Griffin, Research Division
  David Crotts, Fiscal Research Division

- **Draft Proposal: S Corporation Income Tax Adjustments**
  Trina Griffin, Research Division
  David Crotts, Fiscal Research Division

- **Draft Proposal: Expansion of Royalty Reporting Option**
  Trina Griffin, Research Division
  David Crotts, Fiscal Research Division

IX. **Draft Proposal: Property Tax Changes**
(Continuation of draft from February 8, 2006 Meeting)
Martha Walston, Fiscal Research Division

X. **Draft Proposal: Streamlined Sales Tax Changes**
(Continuation of draft from March 1, 2006 Meeting)
Cindy Avrette, Research Division
Linda Millsaps, Fiscal Research Division

XI. **Draft Proposal: Revenue Laws Technical Changes**
(Continuation of draft from previous meetings)
Trina Griffin, Research Division

XII. **Adjournment: Next meeting May 2, *2006, in Room 544 LOB at 1:00 pm***

APPENDIX C

DISPOSITION OF COMMITTEE'S RECOMMENDATIONS TO THE 2005 SESSION OF THE GENERAL ASSEMBLY

STATUS OF BILLS RECOMMENDED BY THE REVENUE LAWS STUDY COMMITTEE – 2005 REGULAR SESSION

SHORT TITLE	SENATE SPONSORS	HOUSE SPONSORS	BILL #	FINAL STATUS*
Increase Disabled Vet Property Tax Exclusion		Brubaker	HB 139	Not enacted
IRC Update	Kerr		SB 146	Original bill not enacted. The provisions were put into SB 622, which was **enacted, S.L. 2005-276** (see Sec. 35).
Motor Fuel Tax Changes		Luebke	HB 105	**Enacted** **SL 2005-435**
Property Tax Changes		Brubaker	HB 116	**Enacted*** **SL 2005-313**
Revenue Laws Technical Changes	Hartsell		SB 159	Original bill not enacted. The provisions were put into HB 105, which was **enacted, S.L. 2005-435** (see Part II.).
Streamlined Sales Tax Changes	Kerr		SB 145	Original bill not enacted. The provisions were put into SB 622, which was **enacted, S.L. 2005-276** (see Sec. 33).

JAC/04-25-2006

* Bills were modified prior to enactment.

APPENDIX D

CABLE FRANCHISE SURVEY
BRENNA ERFORD, FISCAL RESEARCH DIVISION

Summary of Cable Franchise Survey

The following statistics are taken from a survey of 272 North Carolina local governments regarding their franchise fee collections and other nonmonetary contributions received in accordance with their cable franchise agreement or agreements. The survey was conducted by the North Carolina General Assembly Fiscal Research Division. A total of 161 local governments responded to the survey.

Type of Respondent	Number surveyed	Number responded	Percent
Municipalities	172	109	63.4%
Counties	100	52	52.0%

The municipality-to-county ratio in the following survey data is:

Type of respondent	Number of respondents	Percent of total
Cities or towns	109	67.7%
Counties	52	32.3%
Total	161	100%

The purpose of this document is to summarize the survey's findings. The survey requested actual franchise fee collections for fiscal years 2004 and 2005. This data is reported separately in Appendix A.

Franchise Agreements & Fees

- One hundred and fourteen survey respondents (70.8%) negotiated their current franchise agreement or agreements independent of other local governments.[1]
- The majority of responding local governments (75.8%) assess franchise fees at the rate of 5% of gross revenues. (Please see Appendix B for detail on the assessment of franchise fees.)

Network Infrastructure and Other Equipment

- Twenty respondents (12.4%) indicated they receive some network infrastructure from their cable operator or operators.[2]
- Twenty-one respondents (13.1%) indicated they receive equipment for PEG programming from their cable operator or operators. In addition, four respondents (2.5%) indicated they receive some computer hardware or software related to PEG

[1] 24.2% of survey respondents negotiated their current franchise agreement or agreements in partnership with other local governments (5% did not respond to this question).

[2] 57.8% indicated that they do not receive any network infrastructure from their cable operator (29.8% did not respond)

programming. Four respondents (2.5%) also indicated they receive a PEG studio from their cable operator.[3]

- Eleven respondents (6.8%) indicated they receive some other form of capital from their cable operators.

Public, Educational, and Governmental (PEG) Channels

- More than half (50.9%) of respondents indicated they receive PEG channels from their cable operator.[4]
- The number of channels provided by cable operators ranged from 1 to 6 per local government. The chart below shows that the majority of local governments receiving PEG channels are allotted 3 or less by their cable operator.

Number of PEG channels provided	Number of responding local governments	Percent of total
1	44	57.9%
2	12	15.8%
3	11	14.5%
4	5	6.6%
5	1	1.3%
6	3	3.9%
Total	***76***	***100%***

- Twenty-eight survey respondents indicated how many of their allotted PEG channels are currently in use. Their responses ranged from all in use (100%) to none (0%). Unfortunately, too few respondents offered data on how many PEGs are currently in use to generalize these findings to North Carolina local governments in general.[5]

Broadband Internet Service

- Only seven respondents (4.3%) indicated they receive broadband internet service from their cable operator as part of their franchise agreement. Most of those who receive service indicated that it is provided in the public schools.[6]

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[3] 55% of respondents indicated they do not receive any PEG-related equipment from their cable operator (31.9% did not respond). 42.2% of respondents indicated they do not receive computer hardware or software (55.3% did not respond), and 41.6% indicated they do not receive a PEG studio (55.9% did not respond).

[4] 29.2% indicated they do not receive PEG channels (19.9% did not respond).

[5] Twenty-seven local governments indicated how many of their allotted PEG channels are in use, but eight of the 27 are urban centers that have both a higher number of PEG channels than their less urban counterparts and also tend to utilize them differently. For example, the city of Raleigh has been allocated 5 PEG channels, but currently only uses 3, or 60%. In contrast, the cities of Elkin and Davidson each receive 1 PEG channel, which they indicated is used (100%). Using averages regardless of population size would result in overestimation of PEG use by urban areas and underestimation of their use in more rural areas.

[6] A few (less than five) respondents indicated they receive a "VPN discount" equal to 20% off the retail price of broadband service. These responses were not included in the broadband totals for the survey since they were understood to constitute something other than the provision of broadband service *free of charge*.

Basic Cable Service

- Seventy-one respondents (44.1%) receive basic cable service free of charge in some or all government-owned buildings.[7] Of those local governments that receive basic cable service:
    - Forty-one respondents (25.5%) receive free basic cable service in all government-owned buildings[8]
    - Fifty-six respondents (34.8%) receive free basic cable service in all administrative buildings[9]
    - Forty-six respondents (28.6%) receive free basic cable service in all public schools[10]
    - Thirty-six respondents (22.4%) receive free basic cable service in all public libraries[11]

Competition

- Although this survey was not designed to study competition within the cable industry in North Carolina, respondents were asked to indicate if they held more than one current cable franchise agreement with separate operators.
    - Twenty-four local governments surveyed (14.9% of respondents) hold cable franchise agreements with more than one cable operator in their area
    - One hundred and thirty-two local government surveyed (82.0%) hold only one cable franchise with one cable operator
    - Five local governments (3.1%) did not respond to the question
- Respondents were also asked to estimate what percent of households in their franchise area are able to obtain cable television service from more than one cable operator. Out of the twenty-four local governments with multiple franchises, twenty (or 83.3%) responded to this question.
    - Of those twenty local governments, eleven (or 45.8%) indicated that the multiple cable operators in their area do not serve the same areas, so in effect the "overlap" of cable operators' service areas was 0.0%.
    - The remaining thirteen local governments (or 54.2%) indicated that 1.0% to 60.0% of households in their area have access to service from more than one cable operator.

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[7] 26.7% do not receive basic cable service free of charge (29.2% did not respond).
[8] 74.5% did not respond.
[9] For purposes of this survey, "administrative buildings" include city halls, town administrative buildings, public utilities facilities, and police and fire departments (65.2% did not respond).
[10] 71.4% did not respond
[11] 77.6% did not respond

APPENDIX E

STREAMLINED SALES TAX UPDATE
ANDY SABOL, DIRECTOR OF SALES AND USE TAX
DEPARTMENT OF REVENUE

STREAMLINED SALES TAX UPDATE
February 2006

The Streamlined Sales Tax Project began in March 2000 as an effort by states, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. The goal of the representatives working on this Project is to achieve sufficient uniformity and simplification so as to encourage sellers without nexus in states to voluntarily collect sales or use tax in participating states. Currently, forty-three states and the District of Columbia have by legislative or executive action authorized participation in Project.

In November 2002, the Streamlined Sales and Use Tax Agreement was approved by the states. The Agreement contains the uniformity and simplification provisions developed by the Project. The Agreement has been amended several times over the last three years to adopt items that the Project participants continued to address. The Agreement itself was to become effective when at least ten (10) states representing twenty percent (20%) of the population of all states that impose a sales tax were determined to be in compliance with the provisions of the Agreement.

Over the last few years, states, including North Carolina, have enacted provisions to bring themselves into compliance with the Agreement. 2005 was a significant year in that in July 2005, eighteen states representing over twenty-eight percent (28%) of the population of states imposing sales tax were determined to be in substantial compliance with the Streamlined Agreement and became either full or associate member states. Full member states are states that were determined presently to be in substantial compliance with the provisions of the Streamlined Agreement. Associate member states are states that have taken action to amend their laws to come into compliance but have future effective dates. On October 1, 2005, the Streamlined Sales Tax Governing Board, Inc., consisting of representatives of the member states, came into existence. The Governing Board will oversee administration of the Agreement including matters such as interpretations of the Agreement, admittance of new members, and oversight of contracts and technology.

Since 2001, legislation has been enacted in each session to bring North Carolina laws into compliance with the provisions of the Streamlined Agreement and North Carolina was admitted as a full member state. There are currently thirteen full member states and six associate member states as Nevada was admitted as a member state as of January 1, 2006. As the states continue to address matters brought before them, there will be future amendments to the Agreement that will require amendments to our law. With most amendments states are being given at least two legislative sessions to address the issues and our Department has been working with General Assembly staff on changes to the Agreement made in April 2005 that will need to be enacted by January 1, 2008 in order for our State to remain in compliance. We look forward to continuing to work with members and staff and want to express our appreciation for all that has been accomplished to date.

The Governing Board is overseeing the implementation of several technology initiatives that will ease the burden of sellers for collection and remittance of sales and use tax. On October 1, 2005, a central registration system was activated on the Governing Board's website. This allows a multistate seller to complete a single electronic registration form and become registered to collect sales and use tax in all the member states. The member states download the registration information and incorporate the data into their own registration systems. To date, 479 sellers have registered through the central site with 27 of these being new sellers signifying that they will collect tax in North Carolina and with 67 being sellers already registered and collecting tax. Over $110,000 has been collected from the new sellers since activation of the system. In addition to these new sellers, we have estimated that we are collecting over $1.5 million annually from several sellers that came forward prior to the formation of the Governing Board who indicated that the reason for beginning to voluntarily collect tax was the progress that the states had made through the Streamlined Project efforts.

Another major initiative is the finalizing of contracts with third party service providers that will perform the administrative sales tax collection and remittance functions for sellers. Under this model, states have agreed to compensate the service providers for the services that they provide to sellers thus significantly easing the burden of collecting tax in states in which a seller is not located. The member states have been working for months on reviewing the tax computation software developed by the service providers and other functions necessary for the proper collection and remittance of tax. Four firms are currently being evaluated and it is hoped that the Governing Board will enter into contracts with at least two of the firms over the next few months. Once a service provider is available, it is anticipated the number of voluntary sellers will significantly increase.

All forty-three participating states and the District of Columbia, along with local government representatives, continue to work on remaining issues undertaken by the Streamlined Project through a State and Local Advisory Council. Private industry representatives have also formed an advisory body as recognized in the Streamlined Agreement. These bodies will be consulted and assigned projects by the Governing Board as new issues are brought forward, as deemed appropriate. Only the states that compose the Governing Board have the authority to vote on amendments to the Streamlined Agreement and entry of new members. It is anticipated that at least two more states, Vermont and Washington, will petition for membership in 2006 and that more states will choose to give serious consideration to making law changes necessary to become members now that the Agreement is effective and sellers are coming forward.

Members of our Department continue to represent the State and are delegates to the State and Local Advisory Council and the Governing Board. Our staff will continue to work with the appropriate parties to explain any new measures that come forth and to help formulate any legislation necessary to keep North Carolina in compliance. Federal legislation has once again been introduced in Congress that would require remote sellers to collect tax in those states that have adopted the uniformity and simplification provisions of the Streamlined Agreement. If this legislation is eventually enacted, our State should find itself in position to benefit accordingly.

Thank you for the opportunity to present this update. My staff and I will be glad to provide any additional information. 2005 was an important year in this process although there continues to be important work ahead. Once again, the support of members of the General Assembly and their staff have given is appreciated and we look forward to future discussions.

Submitted by: Andy Sabol, Director
Sales and Use Tax Division
North Carolina Department of Revenue

APPENDIX F

STATEWIDE SURVEY REGARDING SALES TAX ON SERVICE CONTRACTS, LINDA MILLSAPS, FISCAL RESEARCH DIVISION

Service Contracts Statewide Survey Results

Revenue Laws Study Committee

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Methodology

- Met with NCCBI Tax Committee, NCCBI Staff, North Carolina Retail Merchants.
- Additional requests to:
  - NC Bankers Association
  - NC Auto Dealers Association
  - NC Technology Association

- Surveys returned directly to Fiscal Research.

Major Retailers

- **While few responses, those who did reply appear representative of their respective industries.**
- **Average potential liability (per chain):**

	Purchases	State Tax	Local Tax	Total Tax
2004	2,600,489	117,022	65,012	182,034
2005	4,096,381	184,337	102,410	286,747
2006	4,962,622	223,318	124,065	347,383

Banking Institutions

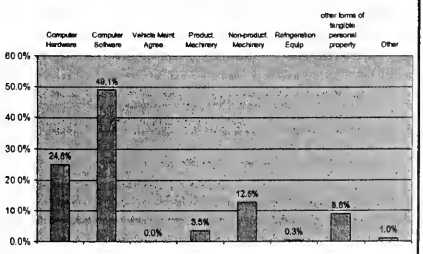
- Overall 25 respondents (24%)
- Represent full spectrum of banks, from the state's largest banks to those who are less than 1% of total statewide assets.
- Total assets and deposits represented unknown, but significant.

Banks – Nature of Agreements

(All responding banks)

	Comp. Hardware	Comp. Softw.	Vehicle	Prod Mach	Non Prod Mach	Refrig	Other TPP	Other
2004	23.5%	50.0%	0.0%	1.9%	15.0%	0.3%	8.6%	0.9%
2005	25.2%	51.1%	1.3%	3.5%	9.8%	0.2%	8.8%	1.1%
2006	24.8%	49.1%	0.0%	3.5%	12.6%	0.3%	8.8%	1.0%

2006 Bank Contract Distribution



Banks – Expected Future Agreement Growth

Decline	0%
Stay the same	14%
Increase less than 10%	33%
Increase 10% - 25%	48%
Increase more than 25%	5%

Smaller Bank Respondents

- Average Deposits: 425.0 million
- Average Assets: 524.4 million

Potentially Taxable Purchases	$190,868
State Liability	$8,589
Local Liability	$4,772
Total Tax	$13,361

Large Bank Statistics

	Average			
	Base	State Tax	Local Tax	Total Tax
2005	42,181,538	1,898,169	1,054,538	2,952,708
2006	42,559,068	1,915,158	1,063,977	2,979,135

Motor Vehicles

- No specific survey responses
- Association produced an estimate
- New car estimate in line with previous Fiscal Research estimate
  - $236.3 million base
    - $10.6 million state tax
    - $5.9 million local tax
- Used Car Estimate
  - $486.0 million base
    - $21.9 million state tax
    - $12.2 million local tax

Overall

- Major Retailers (per chain)
  - $223,318 state
  - $124,065 local
- Regional and Community Banks
  - $8,589 state
  - $4,772 local
- Large Banks (per bank)
  - $1.9 million state
  - $1.1 million local
- Auto Dealers (total)
  - $32.5 million state
  - $18.1 million local
- Technology Companies
  - Unknown, but exemption for custom software and downloads will substantially limit fiscal impact.

APPENDIX G

RECOMMENDATION FOR ELECTRICITY FRANCHISE TAX DISTRIBUTION FORMULA, LEAGUE OF MUNICIPALITIES

Electric Utility Franchise Tax Distribution Issues and Proposed Process

Assumptions and Goals:

1. Electric utilities should only have to report total statewide gross receipts and major customer information to DoR. Utilities would no longer be required to track annexations except for large industrial/commercial/Institutional billing meters. Utilities would only need to provide an annual report to the state providing commercial/industrial/Institutional large billing meter revenue by municipality. Utilities would not need to provide any other detail on a monthly or quarterly basis other than total revenues subject to gross receipts tax and related gross receipts tax payment on the those revenues.
2. Data to make annual adjustments should be readily available and timely
3. Population-based data (natural growth, mergers, incorporations & un-incorporations, and annexations) and other sources (ones that do not involve utility companies calculating gross receipts from "service inside constantly changing city boundaries") should be the only data DoR needs to make annual adjustments
4. The proportion of the statewide electric utility franchise tax revenues that goes to municipalities should continue to grow, as it does under current law
5. Individual cities should be able to get additional electric utility tax revenues based on their growth, without penalizing municipalities without growth, as they can under current law
6. Calculated negative distribution amounts are not allowed and will be rounded up to zero.
7. The current criteria for determining whether municipalities are eligible to receive electric utility tax revenues will remain in place

Overview of Process:

The distribution process has four parts, creating four separate pots of money that are distributed through four different formulas.

The first pot uses data from the most recent four distribution quarters, under current law, to calculate a base municipal statewide distribution amount and distribute it quarterly to each city.

A second, "municipal share growth," pot is calculated by using the cumulative growth in the municipal share of the statewide population from a base year as a proxy to create a separate fund to be distributed annually to cities based on their proportionate share of the cumulative absolute population growth from the same base year.

A third pot is calculated by using gross revenue data from electric utilities about major existing and new commercial/industrial/institutional customers and expansions (those meeting a pre-determined threshold size of annual electricity consumption) to create a separate fund to be distributed to cities annually based on their proportionate share of the revenues produced by the major new commercial/industrial customers.

A final pot provides extra electric utility franchise tax distributions to municipalities that experience seasonal growth in electricity consumption due to tourism-based changes in population as opposed to changes in permanent population. It is calculated by using the increase in the water consumption in gallons (as a surrogate for electricity) in "seasonal population towns" to create a separate fund to be distributed annually to seasonal population towns as an adjustment factor.

The final calculation details of the formulas for the four pots of funds would be worked out by League of Municipalities and DoR staff. By May 1, 2007, DoR will provide to the League of Municipalities and appropriate legislative staff the results of test runs of the formulas showing city-by-city distributions to allow for any needed legislative changes before a proposed effective date of January 1, 2008. Reasonable one-time, re-programming costs for DoR could be deducted from the first new quarterly distribution in the same manner as the continuing costs of collection.

Proposed Process and Issues

Pot 1, Base Municipal Statewide Distribution:

1. *Municipal base share of total statewide Electric Utility Franchise Tax collections* (use the municipal collection percentage for the most recent year available [currently estimated to be about 58%] to calculate the base municipal share each quarter; this percentage will remain fixed)
2. *Individual municipality share of base distribution* (use each municipality's past proportional share of each quarterly distribution, averaged over the last 3 years, after adjustment for holdback and hold harmless but before adjustment for cost of collection and error corrections, and then apply those percentages to the base municipal share amount each quarter; these percentages will remain fixed)

Pot 2, Municipal Share Growth Distribution:

1. *Growth in municipal share of total statewide electric utility tax collections* (use the cumulative percentage growth in the certified municipal proportion of the statewide population from the most recent base year [the municipal population proportion has grown from 49.75% in 1996 to 52.25% in 2003 = 5.03%] as a proxy to calculate quarterly municipal share growth percentages [the municipal share proportion has grown from 53.11% in FY97-98 to 57.92% in FY04-05 = 9.06%], which are then applied to the base municipal collection percentage to calculate the percent of the quarterly total statewide electric utility tax collections going into the municipal share growth pot [58% * 5.03% = 2.92%])
2. *Growth in individual municipality electric utility tax collections from the impact of natural population growth and annexations on each municipality's share of the distribution* (use cumulative absolute growth in certified individual municipal populations from the base year annually to distribute, only to growing municipalities, the pot of money created by the adjustment by calculating individual municipality population growth as a percentage of statewide municipal population growth)

Pot 3, Major Customer Growth Distribution:

1. *Growth in individual municipality electric utility tax collections from the impact of growth in electricity use by major commercial/industrial customers on each municipality* (utilities would provide annual information to the state that would show large commercial/industrial/ institutional billing meter revenue by municipality to create a separate fund, calculated by multiplying annual growth by city by 3.09%,). A commercial/industrial/institutional billing meter is considered to be large if the annual electric revenue for financial reporting purposes from the billing meter is more than $200,000 for the year.

1. [For purposes of implementation and reporting of utility gross receipts tax proceeds for major electric customers, "customer" shall be defined as an individual electric billing meter with actual annual revenue in excess of $200,000 in the prior calendar year. Revenue shall consider all tariff charges, but shall exclude any applicable sales taxes or other miscellaneous charges such as outdoor lighting, additional facilities, non-regulated services or other fees that might be included on the electric bill. "Customer" shall include any industrial or commercial entity located on a single premise receiving an electric bill that is not classified as Public Administration by the Standard Industrial Classification Manual published by the United States Government. A billing meter revenue could include multiple meters all serving a single corporate entity on a single premise that are simultaneous metered and totalized and billed through a single rate schedule. This definition would also exclude multiple unmetered locations, such as traffic signals or outdoor street lighting, that are consolidated and billed in a single mailing.]

2. Distribute annually to those cities with major electric customers, based on the taxes generated by each city's increased revenues produced by the growth in electricity used by major new commercial/industrial/institutional customers

Pot 4, Seasonal Population Towns Growth Distribution:

1. *Growth in individual seasonal population town electric utility tax collections from the impact of future increases in non-resident populations on each seasonal population town's share of the distribution* (use an index of relevant and readily available data (e.g., taxable real property per capita, tourism expenditures per capita, population, occupancy tax) to identify seasonal population towns in the base year. [This index is forthcoming from the League of Municipalities.] Update the list of seasonal population towns with new data every five years.
2. Calculate seasonal population towns' aggregate share of the total municipal distribution in the base year to establish a percentage which will be used in following years to create a seasonal population towns' distribution base. Recalculate this percentage every five years.
3. The rate of cumulative change in seasonal population towns' water consumption (based on annual water consumption data supplied by each seasonal population town) is used as a proxy for change in electricity consumption. The rate of change in seasonal population towns' water consumption is applied to the seasonal population towns' distribution base to establish the seasonal population towns' distribution amount. This distribution amount is allocated annually to the individual seasonal

population towns relative to their contribution to the cumulative change in water consumption.

Other Adjustments and Issues:

1. *Holdback amounts* (currently fixed at $19,308,392/year; subtract off the top of the base municipal share amount in equal quarterly totals, before distribution calculations)
2. *Cost of collection* (currently $75,000/year; subtract off the top of the base municipal share amount in equal quarterly amounts, before distribution calculations)
3. *Hold harmless amounts* (currently fixed at $265,066/year for 24 cities; adjusted for by using quarterly post-hold harmless adjustment distribution percentages)
4. *Error corrections* (adjusted for by using quarterly pre-error correction adjustment distribution percentages)
5. *New incorporations, mergers, & un-incorporations that have no franchise tax distribution history* (follow current procedures for handling new incorporations, etc., within the telecommunications tax)
6. *Unified city/county governments that have no franchise tax distribution history [e.g., Currituck County]* (follow current procedures for handling new incorporations within the telecommunications tax)
7. *Towns with current $0 distributions* (If a local act that provides alternative electric utility tax revenues to a city is repealed or if any other circumstances that prevent a city from currently getting electric utility franchise tax revenues change, then follow current procedures for handling new incorporations within the telecommunications tax; possibly affects 11 small towns)

Pros:

1. Eliminates the need for electric utilities to calculate gross receipts from "service inside constantly changing city boundaries" except for easily identified major customers
2. Eliminates distribution errors due to utility or municipality reporting mistakes, thereby reducing the administrative burden on DoR for error correction and the negative impact on cities
3. Provides for all municipalities to share in the natural growth of electric franchise tax
4. Provides for recurring increases in overall municipal share of statewide electric utility franchise tax revenues
5. Captures population and non-population growth in electric utility taxes.
6. Provides for growing municipalities to realize additional utility tax revenues <u>without</u> penalizing non-growing municipalities, since the funding for the growth comes from the State share of tax collections
7. Reduces the variability of revenues to individual municipalities; while the economy and the weather will still be major factors determining electric franchise tax revenues, they now will only affect the statewide municipal amount, and not the distribution to <u>individual</u> cities and towns; this softens the blow to individual municipalities that would otherwise absorb the <u>full</u> impact of a localized loss of electric gross receipts

Cons:

1. While providing a reasonable approximation, this process does not exactly adjust individual municipal shares of overall municipal statewide electric utility franchise tax revenues for the impact of electric gross receipts growth specifically through commercial and industrial customers, abnormally large annexations, or growth in seasonal visitors/residents but not year-round population
2. Certified municipal population estimates are sometimes inaccurate; however, they are the current basis for the distribution Powell Bill, sales tax, and beer and wine revenues
3. While the overall trend is towards an increasing proportion of statewide population to be municipal, there will be some years in which the growth will be negative

Statewide Distribution Examples for All Four Pots of Utility Tax Revenues

Pot 1: Base Municipal Share of Total Statewide Collections Based on Past Distributions

Year	State Total Collections (1)	Municipal Share % (2)	Municipal Share $ (3)	Holdback and Cost (4)	Municipal Distribution (5)
FY04-05 (base)	$259,926,056	57.92%	$150,549,172	$19,383,392	$131,165,780
FY05-06 (est)	$267,723,838	57.92%	$155,065,647	$19,383,392	$135,682,255
FY06-07 (est)	$270,401,076	57.92%	$156,616,303	$19,383,392	$137,232,911
FY07-08 (est)	$275,809,098	57.92%	$159,748,629	$19,383,392	$140,365,237
FY08-09 (est)	$273,051,007	57.92%	$158,151,143	$19,383,392	$138,767,751
FY09-10 (est)	$289,434,067	57.92%	$167,640,212	$19,383,392	$148,256,820
	(Formulas: 1x2=3; 3-4=5)				

Pot 2: Additional Municipal Share of Total Statewide Collections Based on Cumulative Population Growth

Year	State Total Collections (1)	Municipal Share % (2)	Cumulative Population Growth (3)	Municipal Growth Share % (4)	Municipal Growth Distribution (5)
FY04-05 (base)	$259,926,056	57.92%	0.00%	0.00%	$0
FY05-06 (est)	$267,723,838	57.92%	1.32%	0.77%	$2,052,804
FY06-07 (est)	$270,401,076	57.92%	3.88%	2.25%	$6,071,376
FY07-08 (est)	$275,809,098	57.92%	4.29%	2.48%	$6,850,334
FY08-09 (est)	$273,051,007	57.92%	5.79%	3.35%	$9,158,883
FY09-10 (est)	$289,434,067	57.92%	4.91%	2.84%	$8,225,445
	(Formulas: 2x3=4; 1x4=5)				

Pot 3: Additional Municipal Share Based on Major Municipal Commercial/Industrial Customer Growth

Year	Statewide Major Municipal Customer Sales (+$200k/Yr)	Annual (5%) Major Municipal Customer Sales Growth (1)	Municipal Electric Tax Rate (2)	Municipal Growth Distribution (3)
FY04-05 (base)	$823,418,660	$0	3.09%	$0
FY05-06 (est)	$864,589,593	$41,170,933	3.09%	$1,272,182
FY06-07 (est)	$907,819,073	$43,229,480	3.09%	$1,335,791
FY07-08 (est)	$953,210,026	$45,390,954	3.09%	$1,402,580
FY08-09 (est)	$1,000,870,528	$47,660,501	3.09%	$1,472,709
FY09-10 (est)	$1,050,914,054	$50,043,526	3.09%	$1,546,345
	(Formula: 1x2=3)			

Pot 4: Additional Municipal Share Based on Seasonal Population Growth

Year	Statewide Municipal Distribution (1)	Seasonal Population Share (2)	Seasonal Population Distribution Base (3)	Calculated Seasonal Population Δ H20 Consumption (4)	Seasonal Population Growth Distribution (5)
FY04-05 (base)	$131,165,780	4.76%	$6,243,491	n/a	n/a
FY05-06 (est)	$135,682,255	4.76%	$6,458,475	3.10%	$200,213
FY06-07 (est)	$137,232,911	4.76%	$6,532,287	2.70%	$176,372
FY07-08 (est)	$140,365,237	4.76%	$6,681,385	3.20%	$213,804
FY08-09 (est)	$138,767,751	4.76%	$6,605,345	2.50%	$165,134
FY09-10 (est)	$148,256,820	4.76%	$7,057,025	3.30%	$232,882
	(Formulas: 1x2=3; 3x4=5)				