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State Taxation

The major state tax changes are found in S.L. 2003-284 (H 397), the 2003 appropriations act. They include continuation of the increased rates of the individual income tax and the sales tax and various amendments to the sales tax.

Highway Use Tax

In 1989, the General Assembly enacted the North Carolina Highway Use Tax (G.S. Chapter 105, Article 5A) to provide a major source of revenue for the Highway Trust Fund. The tax rate is 3 percent of the retail value of a motor vehicle for which a certificate of title is issued, and the Division of Motor Vehicles collects the tax.

Under G.S. 105-187.5, a retailer who leases or rents motor vehicles may elect not to pay the highway use tax on a vehicle purchased for lease or rental. Instead, the retailer may elect to pay an alternate gross receipts tax at the rate of 8 percent on the gross receipts of short-term leases or rentals and 3 percent on the gross receipts of long-term rentals. Although the gross receipts tax is imposed on the retailer, it is added to the lease or rental price of the vehicle and is ultimately paid by the person who leases or rents the vehicle. The gross receipts tax is collected by the Department of Revenue. The tax levied at 8 percent is credited to the General Fund, and the tax levied at 3 percent is credited to the Highway Trust Fund.

S.L. 2003-5 (S 235) allows a retailer who leases motor vehicles and who elected to pay the highway use tax on the retail value of the vehicles at the time the retailer obtained a certificate of title for those vehicles to collect the alternate gross receipts tax. In order to collect the gross receipts tax on these vehicles, a retailer must have submitted a written request to the Division of Motor Vehicles and the Department of Revenue by July 1, 2003. The retailer was required to specifically identify the vehicles to which the election applied and the date upon which the retailer would begin collecting the additional taxes and to provide any additional information needed to collect the tax. If a retailer elected to pay the gross receipts tax under this act, that election is irrevocable and does not relieve the taxpayer of liability for any tax previously imposed.

Typical practice throughout the rental car industry is for the highway use tax to be paid on the receipts of the rentals. In most instances, states that impose a tax on the leasing of vehicles impose a gross receipts tax. In North Carolina, however, at least one rental car retailer elected to pay the

highway use tax at the time the retailer obtained the certificates of title for its fleet. To be consistent with other companies in the industry and with standard practice among the various states in which the retailer leases its motor vehicles, the retailer requested authorization to collect the gross receipts tax on its rentals.

Internal Revenue Code Update

S.L. 2003-25 (H 320) updates the reference to the Internal Revenue Code used in defining and determining certain state tax provisions by changing the reference date from May 1, 2002, to January 1, 2003. Part 37-A of S.L. 2003-284 updates the reference date again, to June 1, 2003 (see State and Federal Tax Law Conformity, below, for more details). Updating the Internal Revenue Code reference date makes recent amendments to the Code applicable to the state to the extent that state law previously tracked federal law.

Tax Changes in the 2003 Budget Act

S.L. 2003-284 makes numerous changes in state tax laws, as summarized below.

Local Government Hold-Harmless Payments

Part 37 of S.L. 2003-284 changes from September 15 to August 15 the date that sales tax hold-harmless payments are made to local governments each year. It also provides that the payments will be made in 2003 and 2004 only, but includes language showing intent for the payments to continue through 2012. The Governor's budget would have eliminated the hold-harmless payments beginning in 2003.

In 2001, the General Assembly gave local governments the authority to increase their local sales tax by 0.5 percent, effective upon the repeal of the state's additional 0.5 percent sales tax on July 1, 2003. Also effective July 1, 2003, the state's reimbursements to local governments were repealed, and the state was directed to provide hold-harmless payments to those local governments whose potential gain from the half cent local sales tax increase would be less than their loss from the repealed state reimbursements. State reimbursements were for losses due to the repeal of the property tax on inventories and on poultry and livestock, the repeal of the intangibles tax, the "homestead exclusion" from property tax, and the repeal of local sales and use taxes on food purchased with food stamps.

In 2002, the General Assembly accelerated the repeal of the state reimbursements from July 1, 2003, to July 1, 2002, and accelerated the effective date that local governments could begin levying the additional half cent local tax from July 1, 2003, to December 1, 2002. Part 37 of S.L. 2003-284 also provides that the estimates used to calculate the hold-harmless payments must be updated to reflect legislative changes.

State and Federal Tax Law Conformity

Part 37 of S.L. 2003-284 makes three changes relating to conformity of state tax laws to federal tax laws. These provisions were not in the House or Senate budgets.

Section 37A.1 updates to June 1, 2003, the date used in defining and determining certain state tax provisions. In May 2003, Congress enacted the Jobs and Growth Tax Relief Reconciliation Act of 2003. That act contained two tax changes that affect federal taxable income, which is the starting point for determining state taxable income, and it became effective for the 2003 tax year. The two changes were an increase in the bonus depreciation allowance first enacted after the September 11, 2001, terrorist attacks and an increase in the amount that can be expensed under

section 179 of the Internal Revenue Code.¹ Section 37A.1 of S.L. 2003-284 conforms to both of these provisions. Sections 37A.2 and 37A.3 of the act provide for a bonus depreciation add-back for the 2004 taxable year to offset the second-year losses from the depreciation and expensing provisions.

Sections 37A.4 and 37A.5 delay until July 1, 2005, the phaseout and elimination of the state estate tax that would otherwise occur due to the phaseout and elimination of the federal credit for state death taxes. North Carolina repealed its inheritance tax in 1998, effective for deaths occurring on or after January 1, 1999. It replaced the inheritance tax with an estate tax that is equivalent to the federal state death tax credit allowed on a federal estate tax return. This type of state estate tax is known as a “pick-up” tax because it picks up for the state the amount of federal estate tax that would otherwise be paid to the federal government. In 2001, Congress increased the exclusion amount for the federal estate tax and phased out the state death tax credit over four years by reducing it 25 percent in 2002, 50 percent in 2003, and 75 percent in 2004, and by repealing it entirely in 2005. In 2002, the General Assembly enacted legislation not to conform to the phaseout of the state death tax credit. In other words, the amount of the state estate tax is tied to the federal credit as it existed in 2001 rather than as it currently exists. The 2002 legislation was set to sunset for estates of decedents dying on or after January 1, 2004. Part 37 extends the sunset to July 1, 2005, meaning that the estate tax will continue to be based on the federal credit as it existed in 2001. This part became effective when the act was signed into law by the Governor on June 30, 2003.

State Sales Tax Rate

Part 38 of S.L. 2003-284 delays the sunset of the 0.5 percent increase in the state sales tax from July 1, 2003, to July 1, 2005. In the 2001 appropriations act, the General Assembly increased the state sales tax by 0.5 percent, from 4 percent to 4.5 percent, effective October 16, 2001. This state sales tax increase was to sunset July 1, 2003. Before 2001, the state sales tax rate had last been increased in 1991, from 3 percent to 4 percent.

Upper Income Tax Rate

Part 39 of S.L. 2003-284 delays the sunset of the upper-income individual income tax bracket from January 1, 2004, to January 1, 2006. In 2001, the General Assembly added a new tax bracket that imposed an additional 0.5 percent income tax (a total rate of 8.25 percent) on certain North Carolina taxable income for three years. Under prior North Carolina law, tax was imposed at the following rates on individuals' North Carolina taxable income.

Tax Rate	Married Filing Jointly	Heads of Household	Single Filers	Married Filing Separately
6.0%	Up to \$21,250	Up to \$17,000	Up to \$12,750	Up to \$10,625
7.0%	Over \$21,250 and up to \$100,000	Over \$17,000 and up to \$80,000	Over \$12,750 and up to \$60,000	Over \$10,625 and up to \$50,000
7.75%	Over \$100,000	Over \$80,000	Over \$60,000	Over \$50,000

1. Section 179 of the Code allows a taxpayer to treat the cost of certain property as an expense that is not chargeable to a capital account. This allows the taxpayer to take a deduction for the property in the year in which it is placed into service rather than depreciating the property over a number of years.

The 2001 law created a fourth tax bracket for North Carolina taxable income as follows.

Tax Rate	Married Filing Jointly	Heads of Household	Single Filers	Married Filing Separately
8.25%	Over \$200,000	Over \$160,000	Over \$120,000	Over \$100,000

This change was estimated to affect approximately 2 percent of North Carolina taxpayers. The provision extending the tax rate for two more years was recommended by the Governor.

Child Tax Credit

Part 39-B of S.L. 2003-284 conforms the state tax credit for children to the federal definition of whether a dependent child is eligible for the federal tax credit for dependent children. The effect of this change is to limit the credit to dependent children under seventeen years of age. The federal credit is limited to dependent children under age seventeen, but the North Carolina credit previously applied to seventeen-year-olds as well as to children over seventeen up to age twenty-three if they were in college. This legislation was part of a provision in the Senate budget that also would have delayed the scheduled increase in the credit. The change is effective beginning with the 2003 tax year.

Insurance Tax Rates on Article 65 Corporations

Before 2004, HMOs and nonprofit medical service corporations, such as Blue Cross/Blue Shield and Delta Dental Corporation, paid a gross premiums tax of 1 percent. Other insurance providers pay a gross premiums tax of 1.9 percent on most insurance contracts. Companies that pay a gross premiums tax are automatically exempt from corporate income and franchise taxes. Part 43 of S.L. 2003-284 increases the gross premiums tax rate on medical service corporations from 1 percent to 1.9 percent, effective January 1, 2004. The tax rate for HMOs (including HMOs directly operated by medical service corporations) remains at 1 percent.

Part 43 also provides that for the 2004 and 2005 tax years only, medical service corporations will make the following estimated payments of the tax: 50 percent on April 15 and 50 percent on June 15. For subsequent tax years, the general law on installment payments of gross premiums tax will apply. This change accelerates the timing of the tax payment to move the revenue gain to an earlier fiscal year.

Part 43 provides a conditional sunset of the increased tax rate. It requires the Commissioner of Insurance to make a certification to the Department of Revenue and the Revisor of Statutes when there are no longer any medical service corporations that offer anything other than dental service plans. Beginning with the first taxable year after that certification is made, Part 43 will expire and the gross premiums tax rate applied to medical service corporations will revert to 1 percent. The effect of this provision would be to reduce the rate on medical service corporations if Blue Cross/Blue Shield completes its conversion to for-profit status. In July 2003, Blue Cross/Blue Shield announced its intention not to pursue conversion at this time.

The insurance gross premiums taxes are taxes based on the amount of insurance premiums that are paid, or, in the case of certain self-insurers, would have been paid during the year. They presently consist of the following:

- A 1.9 percent tax on most insurance contracts
- A 1 percent tax on HMOs and on nonprofit medical service companies, such as Blue Cross/Blue Shield and Delta Dental, that provide hospital, medical, and dental service plans
- A 2.5 percent tax on workers' compensation premiums and workers' compensation self-insurers

- An additional 1.33 percent tax on premiums for fire and lightning coverage of property other than motor vehicles and boats
- An additional 0.5 percent tax on premiums for fire and lightning coverage of property within a fire district

Use Tax Line Item

Part 44 of S.L. 2003-284 extends for two years the law that provides that consumer use tax is payable on the individual income tax return. The law would otherwise sunset for the 2003 taxable year.

North Carolina levies state and local sales and use taxes. The sales tax applies to purchases made in this state. It is collected by the retailer and remitted to the state. The use tax complements the sales tax by taxing transactions that are not subject to the sales tax because of movement in interstate commerce. The use tax is imposed on the purchaser, and the responsibility for remitting the use tax to the Department of Revenue is also on the purchaser. In 1997, the General Assembly established an annual filing period for the payment of use taxes owed by consumers on mail-order and other out-of-state purchases. This change relieved consumers of the duty to file either monthly or quarterly returns.

In 1999, the General Assembly further simplified use tax collection by providing that the use tax will be declared on taxpayers' income tax returns. An individual who owes use tax on nonbusiness purchases and who must remit a state income tax return must pay the use tax with the income tax return. The income tax return has space on it to indicate the amount of use tax owed. Placing the use tax on the individual income tax return, as opposed to a separate use tax return being sent to the taxpayer with the income tax return, is intended to increase taxpayers' awareness of their responsibility to pay the tax. In 2000, the General Assembly placed a 2003 sunset on this provision, anticipating that as a result of the Streamlined Sales and Use Tax Agreement, use tax collection would be handled by retailers by that time. The 2003 sunset date may have been overly optimistic; Part 44 extends it for two more years.

Streamlined Sales and Use Tax Agreement

In November 2002, the states involved in implementing the Streamlined Sales and Use Tax Project approved a final version of an historic multistate agreement designed to simplify and modernize sales and use tax collection and administration. The multistate agreement is known as the Streamlined Sales and Use Tax Agreement (the Agreement).²

To participate in the Agreement, a state must amend or modify its sales and use tax law to conform to the simplifications and uniformity in the Agreement. Part 45 of S.L. 2003-284 makes changes to the sales and use tax statutes to bring North Carolina into conformity with the Agreement. The Agreement becomes effective when at least ten states, representing at least 20 percent of the total population of all states imposing a state sales tax, have petitioned for membership and have been found to be in compliance with the requirements of the Agreement. A certificate of compliance will document each state's compliance with the provisions of the Agreement. As of July 7, 2003, nineteen states, with more than 20 percent of the total population of all states, had enacted legislation to implement provisions of the Agreement.

One objective of the Streamlined Sales and Use Tax Project is to encourage remote vendors to voluntarily collect use tax owed to the states, thereby increasing the states' collections. In a study issued in September 2001, Bruce and Fox of the University of Tennessee, Knoxville, estimated the state and local government revenue loss from sales made via the Internet at \$7 billion in 2001, increasing to \$24.2 billion by 2006. According to that estimate, North Carolina is currently losing \$200 to \$300 million a year in uncollected use tax revenues.

2. Currently, forty states and the District of Columbia are involved in the Streamlined Sales and Use Tax Project. In November 2002, thirty-five states and the District of Columbia were involved in the Streamlined Sales and Use Tax Project.

A second objective of the project is to convince Congress or the U.S. Supreme Court to grant collection authority over remote sales to the states that conform their sales tax laws to the uniform provisions in the Agreement, on the premise that the simplifications in the Agreement eliminate the burdens on interstate commerce that have been the justification for denying states that authority. If federal legislation is enacted granting states this authority, it is likely to be linked with proposals to extend the Internet Tax Freedom Act moratorium, which expired on November 1, 2003.

Uniform local sales tax base. Under the Agreement, all local jurisdictions in a state must have a common tax base. The base for the most recent 0.5 percent local sales tax and the 0.5 percent Mecklenburg local transit tax does not include food, while the other local sales and use taxes do. To conform to the Agreement, the base must be consistent. The state is allowed to tax food at a rate different from its general rate of tax. Effective October 1, 2003, section 45.6A of Part 45 finesses the nonuniform local base by stating that the local sales tax on food will be administered as if the local tax on food were zero and the state had a 2 percent tax on food. The state will collect and distribute the 2 percent local tax on food. This change brings North Carolina into compliance with the Agreement without changing the amount of local tax collected. Under S.L. 2003-284, the distribution with respect to food tax proceeds would have to be in proportion to other local sales tax proceeds rather than being based on the actual county of collection. This would have resulted in a shift of revenue in favor of counties that are retail centers. However, Part 45 of S.L. 2003-284 is amended by Section 27 of S.L. 2003-416. Under that act, half of the proceeds of the food tax will be distributed based on county population, with the remaining half being distributed based on the proportion of sales taxes on food collected within the county under Article 39 of Chapter 105 of the General Statutes in the 1997–1998 fiscal year in relation to the total collections under that Article.

Candy, soft drinks, and prepared food. Under the Agreement, if there is a uniform definition for a type of product, a state may not exempt only part of the items included in that definition. Candy, soft drinks, and prepared foods have uniform definitions in the Agreement. Under previous law, North Carolina exempted those items as food only if they were purchased for home consumption. To conform to the Agreement, the products must be treated consistently whether or not they are intended for home consumption. Part 45 of S.L. 2003-284 removes soft drinks and prepared foods from the exemption for food, effective July 15, 2003. The legislation offsets the impact of this change by extending to soft drinks sold in vending machines the 50 percent sales tax reduction currently allowed on other products sold in vending machines, effective January 1, 2004. It also exempts all candy as if it were food, effective January 1, 2004.

Definitions. The Agreement mandates that a state that uses any of the terms defined in the Agreement in its sales and use tax laws must define the terms in substantially the same language as that in the Agreement. To conform to the Agreement, Part 45 modifies and defines the following terms: *computer, computer software, custom computer software, prewritten computer software, delivered electronically, load and leave, direct mail, drug, durable medical equipment, durable medical supplies, electronic, lease or rental, mobility enhancing equipment, over-the-counter drug, prepared food, prescription, prosthetic device, and tangible personal property*. This provision became effective July 15, 2003.

Modifications to prewritten software. As discussed above, the Agreement mandates that a state must either tax or exempt all products within a given uniform definition. Previously, North Carolina taxed prewritten computer software that had not been modified and it exempted both custom computer software and prewritten computer software that had been modified. To conform to the Agreement, the state will tax the prewritten portion of modified computer software and it will exempt the modifications to it if the charges for the modifications are separately stated. Through the use of defined terms, computer software that is delivered electronically or by load and leave will remain exempt from tax. This provision became effective July 15, 2003.

Mobility enhancing equipment. To ensure consistent treatment of products within a uniform definition, Part 45 of S.L. 2003-284 provides that mobility enhancing equipment must be sold by prescription to be exempt from tax. Under previous law, a few items that come within this defined term, such as crutches, did not need to be sold by prescription to be exempt. However,

to preserve the previous tax treatment as much as possible, this part requires mobility enhancing equipment to be sold by prescription in order to be exempt, since previous law required most items in this category to be sold by prescription in order to be exempt. This provision became effective July 15, 2003.

Uniform sourcing principles. North Carolina adopted many of the uniform sourcing principles in 2001. Part 45 codifies additional sourcing principles for periodic rental payments. The codified principles reflect previous practice. This provision became effective July 15, 2003.

Uniform returns, remittances, and notices. North Carolina adopted many of the uniform provisions governing returns, remittances, and notices in 2001. Part 45 adds a few more provisions:

- The collection period for a seller that collects less than \$1,000 in state sales tax during a calendar year cannot occur more often than annually. This provision became effective October 1, 2003.
- Monthly returns are due by the twentieth day of the month rather than the fifteenth day of the month. This provision became effective October 1, 2003.
- Catalog sellers must be given at least 120 days' notice of tax changes and tax rate changes. This provision became effective July 15, 2003.

Sales tax holiday. The Agreement sets forth certain conditions for sales tax holidays after December 31, 2003. One of these conditions is that the tax-exempt items must be specifically defined in the Agreement. North Carolina's sales tax holiday exempts printers, printer supplies, educational computer software, and school supplies. None of these items is defined in the Agreement. The implementing states are currently working on a definition of *school supplies*. Effective October 1, 2003, S.L. 2003-284 removes printers, printer supplies, and educational computer software from the exemption. The act also extends the exemption to layaway sales.

Multiple rates, caps, and thresholds. In addition to implementing the sales and use tax modifications made by Part 45 of S.L. 2003-284, North Carolina will need to address the issue of multiple rates, caps, and thresholds in the near future. The Agreement mandates the elimination, after December 31, 2005, of most caps and thresholds. It also mandates a single tax rate per taxing jurisdiction after December 31, 2005. North Carolina currently has a 1 percent tax rate on certain items and a 1 percent rate with an \$80 cap on other items. It has a 3 percent rate with a \$1,500 cap on mobile classrooms and offices. The state also has a different rate on telecommunications, satellite TV, and spirituous liquor, and it has a \$1,500 threshold for the sales tax applicable to funeral expenses.

Tobacco and Alcohol Discounts

Part 45A of S.L. 2003-284 eliminates tax reductions previously allowed to distributors and wholesalers who pay excise taxes on cigarettes, other tobacco products, wine, beer, and spirituous liquor. These discounts were equal to 4 percent of the tax due. The discounts for cigarettes and tobacco products were intended to cover expenses incurred in preparing tax reports and the expense of furnishing a bond. The discounts for alcoholic beverages were intended to cover these expenses as well as losses due to spoilage or breakage.

An amendment to H 1303 would have partially restored these discounts. On July 19, 2003, the Senate passed an amendment that would have reinstated the discounts at a rate of 2 percent rather than 4 percent. That bill passed the Senate and was sent to the House for concurrence. The House adjourned without voting on concurrence.

Revenue Administrative Changes

S.L. 2003-349 (S 236) makes the following miscellaneous changes.

Dividends Received Deduction for RICs and REITs

Part 1 of S.L. 2003-349 (S 236) repeals the dividend deduction provisions that previously applied to regulated investment companies (RICs) and real estate investment trusts (REITs), effective beginning with the 2003 tax year. The effect of the repeal is to conform to the federal dividend deduction for RICs and to the federal disallowance of any dividend deduction for REITs.

The federal dividends received deduction³ is meant to reduce the negative effects of the double tax on C corporation profits distributed as dividends to corporate shareholders. Subject to certain exceptions and limitations, corporations may deduct 70 percent of the dividends received from another domestic corporation if the receiving corporation owns less than 20 percent of the distributing corporation. The deduction rises to 80 percent of dividends if the corporation owns 20 percent or more of the corporation paying the dividends, and to 100 percent if the corporations are affiliated under the Internal Revenue Code.

Certain investment companies, including mutual funds, may elect to be taxed as RICs. There are several conditions that must be satisfied in order for a company to qualify for the election, including: (1) 90 percent of the corporation's gross income must be derived from dividends, interest, and gains on the sale of stock or securities and (2) the corporation's investments must be diversified as prescribed by Section 851 of the Internal Revenue Code. A qualified RIC is taxed only on its undistributed income and is treated as a partial conduit for the income it earns. The fundamental premise of conduit treatment is that the RIC's income should be taxed only once, at the shareholder level. Dividends received from RICs are eligible for the federal deduction, subject to additional limitations.⁴

A REIT is a corporation or trust that uses the pooled capital of many investors to purchase and manage real estate. REITs are traded on major exchanges just like stocks and are granted special tax considerations. A REIT pays yields in the form of dividends. It is required to pay out at least 90 percent of its income to shareholders and it deducts the amount paid out, so there is no taxation at the REIT level. The shareholders pay tax on the dividends they receive.

Under prior law, G.S. 105-130.7 provided that dividends received by a corporation from a RIC or a REIT were deductible to the extent that income received by that corporation from a RIC or a REIT would not be taxable by North Carolina. Section 1.1 of S.L. 2003-349 repeals G.S. 105-130.7.⁵ In 2001, the General Assembly adopted the federal approach to the corporate dividends received deduction by repealing G.S. 105-130.7(b) and G.S. 105-130.5(a)(7), which had provided corporations with an income tax deduction for dividends received by their subsidiaries. Adopting the federal approach simplified tax administration and compliance because the taxpayer is required to make fewer adjustments to taxable income in order to calculate state net income. The repeal under Section 1.1 of S.L. 2003-349 is consistent with this philosophy.

Dividends received from a RIC qualify for the federal dividends received deduction. Therefore, despite the repeal of G.S. 105-130.7, dividends received from RICs will continue to be deductible. The repeal of G.S. 105-130.7 also ensures that dividends received from a RIC are subject to the same rules concerning attribution of expenses as dividends received from other corporations.

Dividends from REITs do not qualify for the federal dividends received deduction. Therefore, under past state law, dividends from REITs were taxed more favorably for state tax purposes than under federal law. The repeal of G.S. 105-130.7 ensures that the state treatment of dividends from REITs is the same as under federal law.

3. 26 U.S.C. § 243 (2002).

4. Capital gain dividends received from a regulated investment company do not qualify for the deduction.

5. The repeal of G.S. 105-130.5(b)(3) and the changes in Sections 1.2 and 1.3 of the act are conforming changes.

Reporting of Sales of Seized Property

If any tax levied by the state and payable to the Department of Revenue has not been paid within thirty days after the taxpayer was given notice of final assessment of the tax, the department is authorized to collect the tax through the levy upon and sale of the taxpayer's real or personal property. The department may direct the sheriff to levy upon and sell property or it may levy upon the property itself through one of its employees.

Most personal property seized by the Department of Revenue is taken for the payment of unauthorized substance taxes. When the department's employees levy upon the property without the use of the sheriff, the actual sale of the property is conducted by the Department of Administration's State Surplus Property section in accordance with the same notice and bidding procedures that apply to surplus property. The State Surplus Property section provides public information related to bids and sales of seized property both on-line and in written format.

The laws in Article 29B of Chapter 1 of the General Statutes, which apply when the sheriff conducts the levy and sale of property, also apply when the Department of Revenue conducts the levy and sale of property. Among those provisions is G.S. 1-339.63, which states that the sheriff must file a report of sale with the clerk of superior court. Because the Department of Revenue is subject to the same laws governing execution sales, it construed this provision to mean that the department must file a report of all sales of seized property with the clerk of superior court.

Because the Department of Administration makes a report of all property sold through the surplus property sales, the Department of Revenue did not see a need to file a report of sale with the clerk of court as well. Therefore, Section 2 of S.L. 2003-349 amends G.S. 105-242 to provide that the Department of Revenue is not required to file a report of sale of seized property with the clerk of superior court as long as the sale is otherwise publicly reported. This change became effective when the act was signed into law by the Governor on July 27, 2003. In addition to improving efficiency by avoiding duplicative reporting, this change should also reduce costs, several clerks of court having begun charging a fee for filing these reports.

Authority to Use Collection Agencies to Collect In-State Tax Debts

Part 3 of S.L. 2003-349 extends for two years the Department of Revenue's authority to use private collection agencies to collect in-state tax debts. The Department of Revenue has permanent authority to use private collection agencies to collect out-of-state tax debts. The authority to outsource in-state debts was scheduled to expire on October 1, 2003; this act extends it to October 1, 2005. A tax debt is the amount of tax, interest, and penalties due for which a final notice of assessment has been mailed to the taxpayer after the taxpayer no longer has the right to contest the debt.

In 1999, the General Assembly authorized the Department of Revenue to initiate a pilot program whereby the department would contract for the collection of tax debts owed by nonresidents and foreign entities. In September 2000, the Department of Revenue, in conjunction with the Office of the State Auditor, began outsourcing some of its out-of-state tax debts. Between September 2000 and May 2001, it collected in excess of \$12 million in out-of-state receivables by using a combination of outsourcing and in-house collection techniques.

In 2001, the Department of Revenue was authorized to outsource out-of-state tax debts permanently and to outsource in-state tax debts for two years. When outsourcing tax debts, the department is required to notify the taxpayer prior to submitting the debt to a collection agency. The taxpayer has thirty days after the notice is sent to pay the tax debt. If the debt remains unpaid at the end of the thirty days, then the debt may be outsourced to a collection agency. The collection agencies that contract to collect tax debts are prohibited from revealing confidential tax information. If a contractor reveals tax information, the contractor is subject to a misdemeanor penalty, its contract is terminated, and it is barred from contracting again for five years.

Division of Motor Vehicles Tax Secrecy Change

Under the tax secrecy law [G.S. 105-259(b)], an officer, employee, or agent of the state who has access to tax information in the course of service or employment by the state may not disclose the information to any other person except for the purposes expressly authorized by statute. One of the authorized purposes is to exchange information with the Division of Motor Vehicles of the Department of Transportation when the information is needed to fulfill a duty imposed on the Department of Revenue or the Division of Motor Vehicles.

In 2002, the General Assembly enacted legislation⁶ that transferred to the Department of Crime Control and Public Safety the personnel and functions of the Department of Transportation Division of Motor Vehicles Enforcement Section for the regulation and enforcement of commercial motor vehicles, oversize and overweight vehicles, motor carrier safety, and mobile and manufactured housing. The transfer became effective January 1, 2003. In order to preserve the secrecy provision in existing law, Section 4 of S.L. 2003-349 replaces the phrase "Division of Motor Vehicles of the Department of Transportation" with the phrase "Division of the State Highway Patrol of the Department of Crime Control and Public Safety" because the State Highway Patrol will be performing the functions of the prior Division of Motor Vehicles Enforcement Section.

Local Sales Tax Distributions

Pursuant to G.S. 105-472, the Secretary of Revenue makes distributions of local sales and use tax proceeds to cities and counties. In 2001, the General Assembly accelerated these distributions from quarterly to monthly, effective July 1, 2003. Part 5 of S.L. 2003-349 provides that each monthly distribution will include tax proceeds for which a return has been filed. Proceeds received the month before the related return is expected to be filed will be held until the month the return is filed. Because the return contains information necessary for determining the distribution formula, distributing some taxes before the related return is filed would result in misallocation of the tax proceeds. Part 5 became effective July 1, 2003.

As of January 1, 2002, the threshold for taxpayers required to make semimonthly payments of sales and use tax was lowered from \$20,000 to \$10,000, substantially increasing the total amount of revenues received semimonthly for processing by the Department of Revenue. For semimonthly filers, sales and use tax revenues collected between the first and fifteenth of the month must be paid by the twenty-fifth of the same month, and sales and use tax revenues collected during the remainder of the month must be paid by the tenth of the following month. The return for the two semimonthly periods is due ten days later, on the twentieth of the month. Consequently, for revenues received for the first half of each month, the return indicating where the funds should be distributed will not be received until the following month.

Part 5 of S.L. 2003-349 amends the local government sales and use tax distribution statute by stating that amounts collected by electronic funds transfer payments are included in the distribution for the month in which the return that applies to the payment is due. Semimonthly taxpayers are required to pay by electronic funds transfer. This amendment ensures that the Department of Revenue will distribute local sales and use tax proceeds only after the department has the necessary information provided on semimonthly returns.

Procedure for Hold-Harmless Calculation

In 2001, the General Assembly authorized all counties of the state to levy a third one-half cent sales tax.⁷ The same legislation also provided local governments an annual hold-harmless distribution from the state's General Fund to ensure that none of them would lose money when the

6. S.L. 2002-190, as amended by Section 31.5 of S.L. 2002-159.

7. Effective July 1, 2004, all 100 counties will have adopted the local option third one-half cent sales tax authorized by Section 34.14 of S.L. 2001-424.

local government reimbursements are repealed.⁸ The hold-harmless distribution provides that if a county's or city's estimated proceeds from the third half cent tax would be less than the amount it would have gotten under the repealed reimbursements, it will receive a payment equal to the difference. If a county's or city's estimated gain from the third half cent tax exceeds its repealed reimbursement amount, it does not receive a hold-harmless payment from the state. The hold-harmless payment would be the same even if a county had not levied the new tax.

Under prior law, G.S. 105-521(b) directed both the Office of State Budget and Management (OSBM) and the Fiscal Research Division of the General Assembly to submit to the Secretary of Revenue and the General Assembly, by May 1 of each year, a projection of the estimated amount that local governments would be expected to receive from the levy of the third one-half cent local sales and use tax during the upcoming fiscal year. By September 15 of each year, the Secretary of Revenue is required to calculate, based on the projections, the hold-harmless distribution amounts, if any, and to distribute the funds. If the secretary does not use the lower of the two projections when making the calculation, the secretary must report the reasons for this decision to the Joint Legislative Commission on Governmental Operations within sixty days after receiving the projections.

Part 6 of S.L. 2003-349 requires the Department of Revenue, rather than the OSBM, to provide the estimate. The data needed to make the projections are housed within the Department of Revenue. Making this change simplifies the process by eliminating the need for the OSBM to obtain the data from the Department of Revenue and then make the necessary projection.

Filing Fee for Annual Reports

G.S. 55-1-22 sets out the fees for filing certain documents with the Secretary of State, including documents such as corporations' articles of incorporation, articles of dissolution, designation of a registered agent, and so forth. Included on the list is a \$20.00 fee for filing an annual report. Each corporation authorized to do business in this state is required to file an annual report, which, unlike the other documents in G.S. 55-1-22, must be delivered to the Secretary of Revenue.⁹ The annual report contains the name of the corporation, its address, the name and address of its registered agent, the names and addresses of its principal officers, and a brief description of the nature of its business. Annual reports are due by the due date for filing the corporation's income and franchise tax return. As a practical matter, the annual reports are typically attached to the return along with a check for the filing fee.

Part 7 of S.L. 2003-349 amends G.S. 55-1-22 by adding a new subsection stating that the annual report fee of \$20.00 is nonrefundable. This change became effective when the act was signed into law by the Governor on July 27, 2003. The purpose of this change is to codify the Department of Revenue's existing policy that annual report fees are not refundable. G.S. 55-1-22 does not address whether or under what circumstances the filing fees are refundable. However, it is the policy and practice of the Secretary of State to issue refunds for those fees if requested and depending upon the circumstances. Specifically, if the Secretary of State's office has not begun to process or review the document for which the refund is requested, then it will usually refund the filing fee at the filer's request, regardless of whether the fee has been deposited. The Department of Revenue's policy with regard to the annual report is that the fee is nonrefundable.

8. The 2003 General Assembly limited this distribution to two years, 2003 and 2004, but stated the intent that it would continue through 2012. Part 37 of S.L. 2003-284.

9. Nonprofit corporations are exempt from this requirement and insurance companies are required to deliver their annual reports to the Secretary of State.

Eligibility for Research and Development Credit

The William S. Lee Quality Jobs and Business Expansion Tax Credits, in Article 3A of Chapter 105 of the General Statutes, are allowed only to certain types of businesses.¹⁰ For most of the eligible business types, the law specifies that the taxpayer's primary business must be the designated business. For a few of the business types, including computer services, the law requires only that the taxpayer's primary activity at an establishment be the designated business. In addition, to qualify for the credits, the jobs, investment, or activity must be used in the designated business or activity.

One of the credits under Article 3A is for research and development. Generally, a taxpayer that claims a federal income tax credit for increasing research activities under Section 41 of the Internal Revenue Code is allowed a state credit as well for the eligible research activities conducted in North Carolina. The amount of the credit varies, depending upon which type of federal credit is claimed.¹¹ Under the Department of Revenue's interpretation of Article 3A, to satisfy the eligible business requirements, the jobs, investment, and activity must be located at an establishment where the primary activity is an eligible business or eligible activity.

The question of whether a taxpayer's qualified research expenditures must have occurred on the premises of an establishment that performed an eligible industry activity has arisen. Under the Department of Revenue's past interpretation of the law, the answer was yes. Part 8 of S.L. 2003-349 purports to clarify the original intent of the General Assembly that research and development activities need not be on the same premises as an eligible activity. It extends this clarification to the legislature's recent relaxation of the eligible business requirements surrounding computer services. The act provides that if the primary activity of an establishment of the taxpayer in this state is computer services, then the taxpayer's qualified research expenditures in this state are considered to be used in computer services. For all other taxpayers, the expenditures are considered to be used in the primary business of the taxpayer. These changes are retroactive to the years the related provisions were effective, 2001 and 1996, respectively.

Study of Impact of Consolidated Returns

Whenever study committees discuss tax modernization, an issue that arises is the state's corporate income tax structure. The corporate tax structure has remained substantially unchanged for years. In the course of these discussions, the Fiscal Research Division of the General Assembly and the Tax Research Division of the Department of Revenue have been asked what the fiscal consequences would be if the state allowed consolidated corporate income tax returns. Currently, neither division has enough information to form a credible estimate.

Part 9 of S.L. 2003-349 directs the Revenue Laws Study Committee to establish a study group composed of tax professionals and representatives of the Department of Revenue to gather appropriate data that will allow the department to estimate the fiscal impact of consolidated returns. Part 9 becomes effective with the 2003 tax year and expires in two years.

Motor Fuel Tax Changes

Part 10 of S.L. 2003-349 makes several changes to the motor fuel tax laws, effective January 1, 2004. It provides the Department of Revenue with greater enforcement capabilities; it protects the state's interest with a shorter temporary permit for motor carriers and a higher bond requirement for distributors; and it makes the motor fuel statutes more equitable by extending the inspection tax to dyed diesel fuel. It also makes several technical and administrative changes.

10. Central office or aircraft facility; air courier services or data processing; manufacturing, warehousing, or wholesale trade; computer services or electronic mail order house; customer service center; or warehousing at an establishment.

11. The credit amount is 5 percent of the state's apportioned share if the taxpayer claims the credit under section 41(a) of the Internal Revenue Code or 25 percent if the taxpayer claims the alternative incremental credit under section 41(c)(4) of the Code.

Enforcement. This part strengthens the Division of Motor Fuel's enforcement capabilities in the following ways:

- Sections 10.3 and 10.4 require a taxpayer that imports motor fuel from an out-of-state terminal into North Carolina to be licensed as a distributor. Past statutes made the distributor's license optional. If the product was being imported, the taxpayer was required to register as a licensed importer, but none of the importer categories fit a taxpayer obtaining tax-paid fuel from an out-of-state terminal. For example, an importer's license requires the taxpayer to file a return on a monthly basis, but a taxpayer obtaining fuel from an out-of-state terminal would not owe tax directly to the Department of Revenue. The Department of Revenue determined that a distributor's license, which allows the taxpayer to import and export the product but does not require periodic returns, was more appropriate. The Department had implemented this change administratively; Sections 10.3 and 10.4 change the statutes accordingly.
- Section 10.5 removes the requirement that an applicant for licensure as a distributor or importer notify the Department of Revenue of any states to which it plans to export or from which it plans to import motor fuel, because there is no means for tracking this information.
- Section 10.7 enables the Department of Revenue to deny a motor fuel license to a taxpayer that fails to file a return or pay any tax debt due under Chapter 105 or 119 of the General Statutes.
- Section 10.10 clarifies the Department of Revenue's authority to investigate illegal use of non-tax-paid fuel for highway purposes. One way the department investigates alleged violations is through undercover operations in which an agent drives a state-owned truck to a retailer and asks to have it filled with dyed (non-tax-paid) fuel. It would be a violation for the retailer to permit the purchase of non-tax-paid fuel for highway use. Technically, however, the fuel in this situation is not taxable, because G.S. 105-449.88 exempts motor fuel sold to the state for its use. This section specifies that it is not a valid defense to a violation of the motor fuel tax statutes that the state is exempt from motor fuel tax.
- Sections 10.12 through 10.14 require kerosene terminal operators to be licensed and to file reports. Currently, jet fuel and kerosene are delivered from the pipeline directly to airports. This method of delivery bypasses the motor fuels terminals and thereby bypasses the record-keeping requirements that help ensure that the Department of Revenue can uniformly enforce the tax statutes. Kerosene terminal operators are currently subject to tax. The Internal Revenue Service licenses these terminals and the terminal operators must report deliveries to the airports. Sections 10.12 through 10.14 do not subject the airports to greater tax liability but rather require them to be licensed and to file reports so that the Department of Revenue can identify the taxpayers and ensure that they are paying the requisite amount of tax. As a result, the state should soon begin collecting inspection tax revenue that was otherwise falling through the cracks.
- Section 10.16 provides a licensed kerosene distributor the same deferred payments and discounts that a licensed motor fuel distributor receives. These sections also reorganize and modernize the language of the kerosene licensing statutes.

Temporary permits. Section 10.1 reduces from twenty days to three days the maximum amount of time that a motor carrier can operate in the state using a temporary permit (rather than obtaining a license). A licensed motor carrier pays tax based on the number of miles driven in the state. The cost of a temporary permit is \$50. It would take approximately 1,000 miles to exceed the \$50 temporary permit fee in taxes. A motor carrier can drive far more than 1,000 miles in twenty days and thus could get many "free" miles by obtaining a temporary permit. Three days is a better approximation of the time in which a motor carrier would use \$50 worth of miles. The Department of Revenue surveyed numerous states and determined that, of the twenty-six states where permit information was available, seven states issued three-day permits, five states issued permits for between four and seven days, five states issued ten-day permits, one state issued a

thirteen-day permit, and one state issued a twenty-day permit. Seven states did not issue temporary permits. Section 10.1 could increase Highway Fund revenues by increasing the number of permits issued or the number of permanent licenses issued. No estimate is available for the permit volume.

Bond cap. Section 10.6 of S.L. 2003-349 increases the cap on the bond amount of motor fuel licensees to \$500,000. The most recent bond cap amount, \$250,000, was last adjusted in January 1991. The Department of Revenue believes the maximum bond amount should be increased to \$1 million. Since 1991, licensees' tax liabilities have increased to a point where 28 percent of the current licensees have a monthly tax liability of more than \$250,000 18.3 percent have a liability of more than \$500,000, 13.17 percent have a liability of more than \$750,000, and 8.48 percent have a liability of more than \$1 million. In the last six months there have been four bankruptcy cases, two of which exceeded the taxpayer's bond amount. In one of these cases, the potential loss to the state is in excess of \$1 million after payment from the surety company. A survey of the surrounding states shows that South Carolina, West Virginia, Kentucky, and Louisiana do not have caps; Florida has a \$100,000 cap; Virginia has a \$300,000 cap; Georgia has a \$150,000 cap; and Maryland has a \$500,000 cap.

Inspection tax. Section 10.15 imposes the inspection tax on dyed diesel. The Department of Revenue estimates that this change will yield an additional \$1.2 million in inspection tax revenues per year. The inspection tax is currently imposed on all other fuel types at the rate of one-fourth of one cent per gallon,¹² including dyed kerosene, which, like dyed diesel, is used for heating and other non-highway purposes. The department conducts monthly on-road investigations for the misuse of dyed fuels, including dyed diesel. Each sample of fuel withdrawn must be tested by the Department of Agriculture for evidence of dye in the fuel.

Technical and administrative changes. Part 10 of S.L. 2003-349 makes the following technical and administrative changes:

- Section 10.2 clarifies that the definition of a *tank wagon* includes vehicles designed to carry at least 1,000 gallons of motor fuel. The past definition appeared to exclude those vehicles that can carry a total of more than 1,000 gallons but have individual tanks that are less than 1,000 gallons each.
- Section 10.8 conforms the statutes with the legislative change made last session to exempt local governments from the motor fuel tax.
- Section 10.9 removes the requirement that shipping documents must be machine printed by the operator of a bulk plant. This requirement was imposed inadvertently when the statutes were reorganized. Bulk plant operators do not have the necessary equipment to provide machine-printed documents, nor does the Department of Revenue need them to do so. The act does not change the requirement that terminal operators must machine print shipping documents.

Storage facilities for dyed kerosene. Section 10.11 of S.L. 2003-349 clarifies that storage facilities for dyed kerosene must be clearly marked for nontax use only, just like the storage facilities for dyed diesel fuel. It also provides that the dispensing device for dyed fuel must be clearly marked as nontax use only.

Bad Debt Charge-Offs

Retailers pay sales tax on their gross sales. If accounts of purchasers are found to be worthless and are charged off for income tax purposes, then the retailer may deduct those sales from its gross sales. Municipalities that sell electricity are considered to be retailers, and they pay state sales tax on their gross sales of electricity. The practice of the Department of Revenue has been to allow the municipalities to charge off their bad debts as other retailers are allowed to do. However, municipalities did not technically meet the conditions of the statute because they do not

12. The inspection tax is imposed regardless of whether the fuel is exempt from the per-gallon excise tax. The proceeds of the tax are applied first to the cost of administering the Motor Fuels Tax Division. The remainder is credited to the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund and the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund.

pay federal income tax. Part 11 of S.L. 2003-349 conforms the statute to the Department of Revenue's practice by clarifying that municipalities that sell electricity may deduct worthless accounts from their gross sales for sales tax purposes. Accounts are determined to be worthless in the same way that they would be under the Internal Revenue Code if municipalities were taxed. As under current law, the accounts that are collected afterward must be added back to gross sales.

Psychiatric Hospital Financing

The North Carolina Constitution¹³ and the North Carolina General Statutes restrict the General Assembly's authority to issue debt. Except in limited circumstances,¹⁴ the General Assembly does not have the power to authorize the issuance of bonds secured by a pledge of the faith and credit of the state without a referendum approved by a majority of the voters in an election. These bonds are referred to as general obligation bonds because the general taxing power of the state secures the bonds. Article 5 of Chapter 159 of the General Statutes authorizes the state to use revenue bonds to finance a project without voter approval, but authorization by specific legislation is required under G.S. 159-88(c). Revenue bonds involve the pledge of nontax revenues related to the project, such as parking fees for parking decks and water and sewer charges for water and sewer projects. In recent years, the state has used security interest indebtedness as a financing tool on a project-by-project basis.¹⁵ S.L. 2003-314 (H 684), as amended by S.L. 2003-284, provides the procedural and regulatory provisions needed to carry out security interest indebtedness. As with revenue bonds, authorization to use security interest indebtedness must be given by the General Assembly through specific legislation under G.S. 142-83, as mandated by this act.

Security interest indebtedness is commonly referred to as "certificates of participation." The act employs the term "special indebtedness" to cover the three forms that this type of debt can take: installment-purchase (with or without certificates of participation), lease-purchase (with or without certificates of participation), and limited obligation bonds. In each case, the debt is nonvoted. The particular form to be used for a given project¹⁶ will depend on its size, the nature of the property and the improvement, and other circumstances. Based on these circumstances, one form or another of security interest debt may be the least expensive and the most practical for the state to utilize.

Under security interest indebtedness, the debt is secured by a lien on or security interest in all or any part of the capital facilities to be financed, including all or part of any land on which improvements are to be constructed. If the project is a renovation, the entire existing facility as well as the improvement could serve as security. The value of the property securing the debt may

13. Article V, section 3, of the North Carolina Constitution.

14. The North Carolina Constitution allows the General Assembly to issue nonvoted general obligation bonds in an amount not to exceed two-thirds of the amount by which it reduced its outstanding general obligation debt in the preceding biennium. Other constitutional exceptions for nonvoted general obligation debt include: to fund or refund an existing debt; to supply an unforeseen deficiency in revenue; to borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 percent of the taxes due; to suppress riots or insurrections or to repel invasions; and to meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor.

15. S.L. 2000-143 authorized installment contract financing for a \$13.5 million office building and wildlife education center for the Wildlife Commission and a \$4 million Eastern Wildlife Education Center. S.L. 2001-84 authorized the state to enter into lease-purchase contracts to finance three prisons. S.L. 2002-161 authorized installment-financing contracts for guaranteed energy savings contracts for state buildings.

16. S.L. 2003-314 specifically defines the capital expenditures that may be financed as any combination of buildings, utilities, structures, and other facilities and property developments, including streets, landscaping, equipment, and furnishing in connection with a building project; additions, renovations, and improvements to existing facilities; land acquisition; infrastructure; and furniture, equipment, vehicles, machinery, and similar items.

exceed the amount of the debt, and the financing of several capital projects may be jointly secured by liens on some or all of the capital facilities being financed.

Because the property serves as the security for the indebtedness, there is no pledge of the state's faith and credit or taxing power. Thus, voter approval is not necessary for the borrowing. If the state defaults on its repayments, no deficiency judgment can be rendered against the state, but the capital facilities that serve as security can be disposed of to generate funds to satisfy the debt. The state could choose not to appropriate funds to repay the debt, but such a decision would have negative consequences for the state's credit rating.

Before special indebtedness can be issued or incurred, the State Treasurer must certify that debt financing may be desirable for a specific project presented to it by the Department of Administration. Next, the Council of State must give preliminary approval. If preliminary approval is obtained, the Council of State must give final approval, setting out details such as the maximum amount to be financed, the maximum maturity, and the maximum interest rates. The maximum maturity may not exceed forty years. The State Treasurer must approve the financing, finding that the amount to be borrowed is adequate and not excessive and will not require an excessive increase in any state revenues to provide for repayment and that the special indebtedness can be incurred or issued on terms favorable to the state. Finally, the State Treasurer must report to the Joint Legislative Commission on Governmental Operations at least five days before any special indebtedness is issued or incurred.

Once it is determined that special indebtedness can be issued or incurred, the funds can be borrowed from a single entity in an installment-purchase or lease-purchase contract; generated by the issuance of limited obligation bonds; or borrowed under an installment-financing contract by the sale of certificates of participation. A certificate of participation represents the holder's undivided interest in the right to receive the installment payments to be made by the state. If certificates of participation are issued, a nonprofit corporation will act as a straw person to facilitate the financing.

S.L. 2003-314 not only provides the statutory framework for special indebtedness as a financing tool of the state; it also provides the specific legislative authorization for up to \$110 million of this type of indebtedness to be used for a new psychiatric hospital to be located in Butner. The new facility will consist of approximately 450,000 square feet and contain 432 beds. The indebtedness for this project cannot be incurred prior to July 1, 2004.

The new psychiatric hospital to be built in Butner will replace the current John Umstead Hospital in Butner and Dorothea Dix Hospital in Raleigh. These two psychiatric hospitals are outdated facilities that need extensive repairs and renovations. Even with significant repairs and renovations, according to the Secretary of Health and Human Services the hospitals would still be unable to support the latest mental health treatments. The secretary contends that replacing the two hospitals with one regional facility will save an estimated \$40.9 million a year by reducing costs. S.L. 2003-314 directs that any nonrecurring savings in state appropriations realized from the closure of the two current facilities that are in excess of the cost of operating and maintaining the new hospital shall be credited to the Trust Fund for Mental Health, Developmental Disabilities, and Substance Abuse Services and Bridge Funding Needs. The act also directs that any recurring savings realized from the closure of the existing two hospitals shall be used for the payment of debt service on financing contract indebtedness for the construction of the new hospital. The act provides that the State Treasurer may require one or more reports evidencing (1) the savings expected to be realized from the closure of existing psychiatric hospitals that are to be replaced by the project and (2) the feasibility of the financing of the project.

The act also makes the following changes:

- Requires DHHS to maintain research programs currently being conducted at Dorothea Dix Hospital and John Umstead Hospital by the UNC Medical School and the UNC Chapel Hill Psychology Department.
- Authorizes the county chosen as the site for the hospital to acquire the land by eminent domain and to convey the land to the state.
- Creates a study commission to consider the potential disposition of the state-owned real property encompassing the Dorothea Dix Hospital campus. The Dorothea Dix Hospital Property Study Commission must make recommendations to the Joint Legislative Commission on Governmental Operations on the options for sale of the property before any part of the property may be sold to a nongovernmental entity.

Manufactured Housing

S.L. 2003-400 (H 1006) makes numerous changes in the statutes dealing with manufactured housing. The changes regarding definitions and consumer protection are discussed in Chapter 13, “Land Use, Community Planning, Code Enforcement, and Transportation,” and the changes affecting the property tax are discussed in Chapter 15, “Local Taxes and Tax Collection.” Reviewed here are the changes that affect state taxes.

Under the law before January 1, 2004, the sales and use tax treatment of modular homes depends upon the type of frame of the modular home. According to industry representatives, there are two types of modular homes. “On-frame” modular homes are built on a steel chassis and are typically delivered to the homesite by means of wheels and axles attached to the steel frames. On-frame modular homes are taxed at the same sales and use tax rate as manufactured homes: 2 percent, with a maximum tax of \$300 per section. The tax derived from these sales goes to the General Fund. “Off-frame” modular homes are typically delivered to the site on a flatbed truck or other carrier. Off-frame modular homes are taxed at the general sales tax rate of 7 percent (4.5 percent state and 2.5 percent local), with the tax applying to the cost of the materials used by the seller to create the home.

Section 15 of S.L. 2003-400 removes this tax distinction and taxes the sales price of both types of modular homes at a rate of 2.5 percent with no cap.¹⁷ To offset the loss of local sales tax revenue, Section 16 of the act requires that 20 percent of the taxes collected on modular homes must go to counties and be distributed with local sales tax revenue that is not attributable to a particular county. Section 14 of the act defines a *modular home*, for sales and use tax purposes, as a factory-built structure that is designed to be used as a dwelling, is manufactured in accordance with the specifications for modular homes under the North Carolina State Residential Building Code, and bears a seal or label issued by the Department of Insurance. The act defines a *modular homebuilder* as a person who furnishes for consideration a modular home to a purchaser who will occupy the modular home. The purchaser can be a person who will lease or rent the unit as real property. Section 13 of the act amends the definition of *manufactured home* by deleting the reference to modular homes.

Wine Shipper Permits

In the 1930s, at the end of Prohibition, North Carolina adopted laws to regulate the importation of wine and other alcoholic beverages. The state’s ABC system is three tiered: out-of-state wine producers may sell their products in North Carolina only to licensed wholesalers, the wholesalers may in turn sell the products to other wholesalers or to licensed retailers, and only licensed retailers may sell the products to consumers.

17. Manufactured homes will continue to be taxed at 2 percent with a \$300 cap.

In 1981, the General Assembly enacted an exception to this three-tiered structure. Under the exception, North Carolina wineries were allowed to sell and ship wine directly to North Carolina consumers. The exception did not extend to out-of-state wineries. In 2002, a federal district court held in *Beskind v. Easley*¹⁸ that this exemption violated the Commerce Clause of the United States Constitution because it clearly favored in-state economic interests over out-of-state interests. The court further held that North Carolina's regulatory interests protected under the Twenty-First Amendment did not outweigh the federal government's interest in regulating interstate commerce in this instance. That court ordered the state not to enforce the ban on out-of-state shipments and to collect the excise tax due on the wine shipped from out of state. North Carolina appealed this decision to the federal court of appeals. That court upheld the ruling that the exemption violates the Commerce Clause but allowed the General Assembly to fashion an appropriate remedy.¹⁹ In essence, the General Assembly was left with the choice of repealing the exemption for in-state wineries or allowing shipments from out-of-state wineries on the same basis as for in-state wineries.

S.L. 2003-402 (S 668) establishes a structure through which out-of-state wineries, as well as in-state wineries, may ship wine directly to consumers in North Carolina. Under this act, any winery that holds a federal basic wine manufacturer permit may apply for a North Carolina wine shipper permit for a fee of \$100. The annual renewal fee is \$25.²⁰ The permit authorizes the shipment of brands of wine identified in the permit application. The wine shipper permittee may amend the brands identified in the permit at any time. The wine shipper permittee is required to notify any wholesale permittee that had been authorized to distribute those brands in this state of its application to become a wine shipper permittee. If the wine shipper permittee ships more than one thousand cases²¹ of wine to addresses in the state during a calendar year, the permittee is required to appoint a North Carolina wholesaler if any North Carolina wholesaler wishes to sell the products.²² A winery is not required to obtain a wine shippers permit to ship to addresses in North Carolina wine that was bought on the premises of the winery.

A wine shipper permittee may ship up to two cases of wine per month to any person in North Carolina to whom alcoholic beverages may be sold. Shipment of wine may be made by common carrier only. The common carrier is required to have the recipient demonstrate that he or she is over the age of twenty-one and sign an acknowledgment of receipt. The common carrier must refuse delivery when the recipient appears to be below twenty-one years of age and fails to provide sufficient identification.

S.L. 2003-402 also establishes a mechanism for collecting the excise²³ and use²⁴ taxes due on the wine. Under prior law, the direct shipment of wine escaped the imposition of the state excise tax²⁵ because the tax was payable by the resident wholesaler or importer. Although the consumer was liable for the use tax due on the purchase of the wine, the winery shipping the wine had no affirmative duty to collect and remit the tax if it did not have nexus in this state. Under the new act, a wine shipper is required to pay the excise tax due on the wine and to collect the use tax due on the wine. Under the Twenty-First Amendment to the United States Constitution, the state has

18. 197 F. Supp. 2d 464 (W.D.N.C. 2002).

19. *Beskind v. Easley*, 325 F.3d 506 (4th Cir. 2003).

20. G.S. 18B-903 provides that ABC permits are valid for one year, May 1 to April 30, and that the renewal fee is 25 percent of the original application fee.

21. A case is defined as any combination of packages that contains not more than nine liters of wine. Wine purchased by a resident of the state at the premises of the wine shipper permittee and shipped to an address in the state is not included in calculating the total of one thousand cases.

22. The wine shipper permittee does not have to appoint the wholesaler that originally contacted it to serve as its appointee.

23. The excise tax on unfortified wine is 21¢ and the excise tax on fortified wine is 24¢.

24. Wine is subject to a 4.5 percent state sales and use tax and a 2.5 percent local sales and use tax in every county but Mecklenburg County; in Mecklenburg County, the local sales and use tax is 3 percent.

25. Although the state collects the excise tax, the state shares the revenues with the counties and cities in which the retail sale of wine is authorized in the entire county or city: these local governments receive 62 percent of the excise tax collected on unfortified wine and 22 percent of the tax collected on fortified wine.

more authority to regulate alcoholic beverages than it generally has to regulate interstate commerce; thus, it is not as difficult to establish nexus when the product to be taxed is an alcoholic beverage. Because the state will require the out-of-state wineries to obtain a permit to ship to North Carolina addresses, the state will have sufficient nexus with the winery to force the collection of the taxes.

Employment Security Commission Surtax Delay

Unemployment insurance taxes or contributions are paid by employers on a quarterly basis and deposited into the Unemployment Insurance Fund. Pursuant to G.S. 96-6, the Unemployment Insurance Fund is administered by the Employment Security Commission and disbursed by the State Treasurer under the direction of the commission. Three separate accounts are maintained within the Unemployment Insurance Fund: a clearing account, an unemployment trust fund account, and a benefit account. The moneys payable to the fund are initially deposited in the clearing account. After any refunds payable from the fund pursuant to G.S. 96-10(f) are deducted, the money is deposited with the Secretary of the Treasury of the United States to the credit of this state's account in the unemployment trust fund.²⁶ Funds in the state's account earn interest that is also credited to the account. As money in the state's account is needed to pay benefits, it is transferred to the state and credited to the benefits account of the state Unemployment Insurance Fund to be used to pay benefits to people who lose their jobs through no fault of their own. Federal law prohibits transfer of or payment of refunds from money in the unemployment trust fund account.

There is also an Employment Security Commission Reserve Fund, created in the state treasury and used by the commission to bolster the Unemployment Insurance Fund. The moneys in the reserve fund consist of proceeds from the 20 percent surtax on contributions due.²⁷ This surtax was suspended in 1992, but the surtax is automatically triggered when the balance of the reserve fund falls below \$163 million. Also, under G.S. 96-9(b)(3)d5, the regular unemployment insurance tax or contribution rate of an employer is reduced by 50 percent for any year in which the balance in the Unemployment Insurance Fund equals or exceeds \$800 million. After a number of years of paying the contributions at the 50 percent rate, employers began paying at the full rate in 2003. The tax will remain at the full rate until the Unemployment Insurance Fund again reaches \$800 million, thereby triggering the half rate.

S.L. 2003-405 (H 1241) states that the 20 percent surtax will not be imposed as long as the Unemployment Insurance Fund balance is at or below \$500 million. When the contributions replenish the fund balance to \$500 million, the 20 percent surtax will be triggered to start replenishing the reserve fund. When the reserve fund reaches \$163 million, the surtax will trigger back off. The intended effect is that the 20 percent surtax, originally scheduled to go into effect January 1, 2004, due to the balance in the Reserve Fund being under \$163 million, will not be imposed during the 2004 calendar year.

26. G.S. 96-10(f) provides for the refund of contributions if a court determines that the contributions were invalid, excessive, or contrary to the provisions of Chapter 96 of the General Statutes.

27. G.S. 96-5(f) provides that the moneys in the Employment Security Reserve Fund may be used by the Commission for loans to the Unemployment Insurance Fund, as security for loans from the federal Unemployment Insurance Trust Fund, and to pay any interest required on advances under Title XII of the Social Security Act.

Qualified Business Credit/Ports Credit

S.L. 2003-414 (H 1294) makes several important changes to the Qualified Business Tax Credits and the State Ports Tax Credit.

Qualified Business Tax Credits

The qualified business investment tax credit is allowed for an individual taxpayer who purchases the equity securities or subordinated debt of a qualified business venture or a qualified grantee business directly from that business. The credit is equal to 25 percent of the amount invested and may not exceed \$50,000 per individual in a single taxable year. An individual investor may also claim the allocable share of credits obtained by “pass-through entities” of which the investor is an owner. Pass-through entities include limited partnerships, general partnerships, S corporations, and limited liability companies. The credit may not be taken in the year the investment is made. Instead, the credit is taken in the year following the calendar year in which the investment was made, but only if the taxpayer filed an application with the Secretary of Revenue. Any unused credit may be carried forward for the next five years. The total amount of credits allowed to all taxpayers for investments made in a calendar year may not exceed \$6 million. The Secretary of Revenue calculates the total amount of tax credits claimed from applications filed with the Secretary of Revenue. If the amount exceeds the cap, then the secretary allows a portion of the tax credits claimed by allocating the total of \$6 million in tax credits in proportion to the size of the credit claimed by each taxpayer. In general, a taxpayer forfeits the credit if the taxpayer transfers the securities within one year or the qualified business redeems the securities purchased by the taxpayer within five years after the investment was made.

Qualified business investment tax credit sunset. The qualified business investment tax credit was enacted in August 1987 to promote economic development for North Carolina businesses. The original credits applied to both corporations and individual taxpayers, and there was a \$12 million cap on the total amount of all tax credits. In response to a 1996 United States Supreme Court decision in *Fulton Corp. v. Faulkner*²⁸ that raised the issue of whether the credits unconstitutionally discriminated against out-of-state businesses, the General Assembly reduced the \$12 million cap to \$6 million, removed the requirement that the qualified businesses be headquartered or operating in North Carolina, and limited the credit to individuals and small pass-through entities. The latter change was based on the theory that these investors are not likely to invest outside a fifty-mile radius of their homes.

S.L. 2003-414 extends the sunset on the qualified business investment tax credit from January 1, 2004, until January 1, 2007. The credit was originally set to expire for investments made on or after January 1, 1999. In 1998, the credit was extended for four additional years, until January 1, 2003. Then, in 2002, it was extended for one additional year, until 2004.

One of the purposes of the sunset is to allow the credit to expire if the state determines that it is being allowed for investments in non-North Carolina businesses. Because the Constitution does not allow the credit to be restricted to North Carolina businesses, there is the possibility that North Carolina tax dollars may actually be subsidizing investments in out-of-state corporations. The Secretary of State’s office is required to publish a periodic list of businesses that have registered as qualified businesses. The most recent version of this list indicates that most registered businesses are North Carolina businesses.

Types of qualified businesses. Under current law, in order to be a business in which investments are eligible for a credit, the business must be either a qualified business venture or a qualified grantee business. Both types of businesses must be registered with the Secretary of State. The definition of *qualified business venture* includes several general requirements related to the line of business, gross revenues of the business, and the organization date of the business. A *qualified grantee business* is one that has received a grant or other funding in at least one of the three previous years from one of several types of entities that are generally described in the statute.

28. 516 U.S. 325 (1996).

Those descriptions encompass the following entities, which, before 2002, were specifically named in the statute: the North Carolina Biotechnology Center, MCNC, and the Kenan Institute for Engineering, Technology, and Science.

S.L. 2003-414 further expands one of these descriptions—which currently applies to nonprofits organized to stimulate microelectronics and communications industries—to apply as well to nonprofits and their affiliates organized to conduct research and development in or stimulate the development of technologies. This language is designed to bring in a new entity called MCNC-Research and Development Institute, which is a nonprofit corporation formed to enhance economic development in North Carolina through applied research and technology development and commercialization of those technologies. The new language also covers the MCNC Enterprise Fund, which is owned 50 percent by MCNC and 50 percent by MCNC-RDI.

Additional type of qualified business. S.L. 2003-414 adds a third category of qualified business: a *qualified licensee business*. These businesses must have no more than \$1 million in gross revenues annually and must be performing under a contract with a UNC system institution or a doctoral research university to commercialize technology developed by the institution or university.

State Ports Tax Credit

The State Ports tax credit is allowed to a taxpayer that loads or unloads waterborne cargo from an ocean carrier at one of the state-owned port terminals at Wilmington and Morehead City. The credit is allowed against the taxpayer's income tax. The taxpayer may be either an individual (G.S. 105-151.22) or a corporation (G.S. 105-130.41). The amount of the tax credit is equal to the amount of wharfage, handling, and throughput charges paid to the North Carolina State Ports Authority in the taxable year that exceeds the average amount of charges paid to the Authority for the current tax year and the two previous tax years. The credit is limited to 50 percent of the tax imposed on the taxpayer for the taxable year. Any excess credit may be carried forward and applied to the taxpayer's income tax liability for the next five years. The maximum cumulative credit that one taxpayer may claim is \$2 million.

In 1992, the General Assembly enacted the State Ports tax credit to encourage exporters to use the two state-owned port terminals in Wilmington and Morehead City. When enacted, the credit applied to amounts paid by a taxpayer on any cargo exported at either port. In 1994, the General Assembly expanded the credit to include all amounts assessed on exported cargo, regardless of who paid the shipping costs. In 1995, the General Assembly expanded the credit to include some imports by allowing a credit for break-bulk cargo and container cargo imported at either Wilmington or Morehead City and for bulk cargo imported at Morehead City. It did not allow a credit for bulk cargo imported at Wilmington. In addition, the credit for bulk exports was then limited to bulk exports at only the Morehead City terminal. In 1996, the General Assembly expanded the State Ports tax credit to include the importing and exporting at either terminal of one specific type of bulk cargo: forest products. All imports and exports of bulk cargo at the Morehead City terminal were already covered, so the effect of this change was to allow a credit for forest product imports and exports at the Wilmington terminal. In 1997, the General Assembly extended the sunset of the State Ports tax credit from February 28, 1998, to the taxable year ending on or before February 28, 2001, and increased the maximum cumulative credit from \$1 million to \$2 million per taxpayer. In 2001, the General Assembly extended the sunset to January 1, 2003, and in 2002, extended it to January 1, 2004.

Although not defined by the relevant statutes, the various types of cargo differ as follows:

- Bulk cargo is a type of commodity that is loose and usually stockpiled. Typically, bulk cargo is considered material that is picked up in scoops and is not in a bag or some other type of binding. Examples of this type of commodity include cement, coal, fertilizer, fishmeal (used for making pet food), grain, salt, sand (used for golf courses and during ice storms), soybean meal, and wood chips.

- Break-bulk cargo consists of commodities that are packaged and stored on pallets or in cases that must be handled and stacked onto a ship by hand, crane, etc. Break-bulk cargo also includes machinery. Some examples of break-bulk cargo are cotton, lumber, paper, and rubber.
- Container cargo consists of commodities that are packaged in a metal trailer box that can be locked onto a tractor-trailer chassis and then detached and put on a ship without any other handling. Some examples of container cargo include clothing, electronics, frozen poultry, furniture, housewares, meat, seafood, and tobacco.

S.L. 2003-414 extends the sunset on the tax credit for North Carolina State Ports Authority wharfage, handling, and throughput charges for five years (from January 1, 2004, to January 1, 2009). When first enacted, this credit was effective for taxable years beginning on or after March 1, 1992, and ending on or before February 28, 1996. The sunset has been extended five times.

Historic Preservation Credit

North Carolina allows an income tax credit²⁹ to taxpayers that qualify for the federal historic rehabilitation tax credit.³⁰ The amount of the credit is equal to 20 percent of the expenses of rehabilitating an income-producing historic structure.³¹ A pass-through entity may qualify for the rehabilitation credit and pass the credit on to its owners.³²

For most state tax credits, a pass-through entity is required to allocate the credit among its owners in the same proportion that other items, such as the federal rehabilitation credit, are allocated under the Internal Revenue Code. Under the Code, tax credits are allocated among S corporation shareholders in accordance with their pro rata share of the corporation, which is determined on the basis of stock ownership,³³ and tax credits are allocated among partners in a partnership in accordance with the partnership agreement.³⁴ However, in 1999, the General Assembly amended the law to provide for the separate sale of the historic tax credit for income-producing property by allowing a pass-through entity to allocate the tax credit among its owners at its discretion. The allocation of the credit allows the tax credit to be utilized more fully since it can be redistributed to North Carolina investors with state income tax liability. Each year that an allocated credit is claimed, the pass-through entity and its owners must include a statement with their tax return that shows both the allocation made and the allocation that would otherwise have been required under G.S. 105-131.8 and G.S. 105-269.15. This change in the law would have expired for taxable years beginning on or after January 1, 2002. S.L. 2001-476 extended the provision for two years and S.L. 2003-415 (S 119) extends it for four more years, until January 1, 2008.

To further maximize the use of the state historic rehabilitation tax credit for income-producing property, S.L. 2003-415 increases the amount of the credit that a pass-through entity may allocate among its owners. Prior law provided that the credit could be allocated to an owner of the

29. G.S. 105-129.35. The credit may not be taken for the tax year the property is placed in service but must be taken in installments over five years after the historic structure is placed in service. Any unused portion of a credit may be carried forward for a five-year period.

30. The federal tax credit is only available for rehabilitating income-producing historic structures. The federal credit amount is equal to 20 percent of the rehabilitation expenses.

31. North Carolina also allows an income tax credit of 30 percent of the expenses of rehabilitating an historic structure that is not income producing and thus not eligible for the federal income tax credit.

32. A pass-through entity is an entity—such as a partnership, a limited liability company, or a Subchapter S corporation—that is treated as owned by individuals or other entities under federal tax law and the income, losses, and credits of which are reported by the owners on their state income tax returns.

33. State law provides that the tax credit allowed a shareholder in a Subchapter S corporation is based on the percentage of stock held by the shareholder in the corporation. G.S. 105-131.8.

34. State law provides that the tax credit allowed a partner is based on the partnership agreement, which must have substantial economic effect, meaning that the allocation agreement must reflect the economic interest of the partners in the partnership and cannot be based solely on tax consequences. G.S. 105-269.15.

pass-through entity as long as the amount of the credit allocated to the owner did not exceed the owner's adjusted basis in the entity,³⁵ as determined under the Code. This act provides that the owner's adjusted basis must be at least 40 percent of the credit allocated to that owner. The General Assembly enacted a similar change in the low-income housing tax credit in 2002.³⁶

During the finance committee deliberations, the Department of Revenue was asked to report on the amount of income-producing historic rehabilitation tax credits taken in tax years 2000 and 2001. Although the department could extrapolate from outside data the amount of tax credits taxpayers were eligible for each year, it could not determine the percentage of tax credits actually claimed each year. The department's Tax Research Division responded that it could only determine the number of corporate taxpayers that claimed the historic rehabilitation credit because the agency's computer system does not contain information on the individuals that claim the credit. The computer system does not capture data on individual historic rehabilitation credits because the credit is one of a number of credits combined on Form D-400TC as a miscellaneous credit. To remedy this data problem, S.L. 2003-415 directs the Department of Revenue to change the income tax forms to provide separate lines for each tax credit claimed by a taxpayer, effective for tax years beginning on or after January 1, 2003. This change will provide valuable information to legislative and executive branch analysts charged with evaluating and estimating the General Fund revenue loss of tax credits.

State Government Sales Tax Exemption/School Cooperative Refund

State Government Sales Tax Exemption

Currently, all major state agencies except the Department of Transportation³⁷ are subject to state and local sales taxes. However, the state receives a quarterly refund of the local sales taxes paid by its agencies,³⁸ with the proceeds of the refund going to the General Fund.

The current refund process is time-consuming for the Office of the State Controller, the agencies, and the Department of Revenue. To relieve the agencies of this burden, the Office of the State Controller recommended changing the refund process to a sales and use tax exemption for state agencies.³⁹ The term *state agency* is currently defined for sales and use tax purposes as a unit of the executive, legislative, or judicial branch of state government, such as a department, commission, board, council, or the University of North Carolina. The term does not include local boards of education⁴⁰ or local boards of trustees for the Community College System.

S.L. 2003-431 (S 100) changes the current refund process to an exemption for state agencies. To qualify for the exemption, items must be purchased by a state agency and the purchase must meet one of the following conditions:

- The items are purchased pursuant to a state agency purchase order that contains the exemption number of the agency and a description of the items purchased.

35. The adjusted basis is determined at the end of the taxable year in which the historic structure is placed in service.

36. S.L. 2002-87.

37. The Department of Transportation is exempt from state and local sales and use tax.

38. Each state agency is supposed to file with the Secretary of Revenue a written application for a refund of the local sales taxes paid by it. The application is due within fifteen days after the end of each calendar quarter. G.S. 105-164.14(e).

39. Refunds for purchases by the North Carolina Low-Level Radioactive Waste Management Authority, the North Carolina Hazardous Waste Management Commission, the constituent institutions of the University of North Carolina paid for with contract and grant funds, and The University of North Carolina Hospitals at Chapel Hill are made on an annual basis and are refunded directly to the state agency. At the suggestion of the Office of State Budget and Management, the act does not change the refund status of these purchases.

40. Local school administrative units are allowed an annual refund of state and local sales taxes paid.

- The items purchased are paid for by a state-issued check, electronic deposit, credit card, procurement card, or credit account of a state agency and the agency provides to or has on file with the retailer the agency's exemption number.

The act incorporates all of the various payment and purchase mechanisms where accounting system controls are in place to verify purchases and prevent possible misuse of the agency's sales tax exemption by its employees. The only type of direct purchase not included within this exemption is employee expense reimbursements.

The sales tax exemption applies only to direct purchases of tangible personal property. State agencies will continue to apply for refunds of local taxes paid on indirect purchases of building materials, supplies, fixtures, and equipment that become part of a structure owned or leased by the state.

A state agency will be liable for items purchased with its exemption number even if it does not use those items. The liability will include not only the tax that should have been paid on the items purchased but also interest calculated from the date the tax should have been paid.

To be eligible for the sales and use tax exemption, a state agency must apply to the Department of Revenue for a sales tax exemption number. The part of S.L. 2003-431 that provides for this application process becomes effective January 1, 2004, in order to allow state government agencies to begin the process of obtaining their exemption numbers from the Department of Revenue. The section of the act granting the exemption becomes effective July 1, 2004, and applies to sales made on or after that date.

S.L. 2003-431 also provides that the Office of State Budget and Management must reduce each state agency's certified budget for fiscal years 2003–2004 and 2004–2005 by an appropriate amount to reflect the tax savings generated by the sales and use tax exemption allowed under this act.

Sales Tax Refund for School Board Cooperatives

Under Chapter 160A of the General Statutes, units of local government⁴¹ may enter into contracts or agreements with each other in order to execute any undertaking. Since 1996, several boards of education in the eastern part of the state have participated in an agreement under the authority of Part 1 of Chapter 160A in order to operate a cooperative program known as the Southeast Cooperative Utilizing Resources Efficiently (SECURE). The purpose of SECURE is to coordinate the acquisition of food service–related materials, supplies, equipment, and services. The school districts in SECURE at present are Wayne, Pitt, Greene, Lenoir, Onslow, Sampson, New Hanover, Guilford, and Cumberland counties.

Local school boards are allowed to seek an annual refund of state and local sales and use taxes. Since SECURE enables several local school boards to join together to increase their buying power, it applied for a sales tax refund on behalf of the school boards. However, the Department of Revenue found that it was not included in the list of entities entitled to a refund because SECURE is not a local board of education and it is not a charitable nonprofit organization.

S.L. 2003-431 allows SECURE—and any other joint agency created by interlocal agreement among local school administrative units to jointly purchase food service–related materials, supplies, and equipment on their behalf—to qualify for an annual refund of state and

41. G.S. 160A-460 includes a local board of education within its definition of *unit of local government*.

local sales and use taxes paid by the agency. The refund request must be made in writing and must include any information and documentation required by the secretary. This section of the act became effective for taxes paid on and after July 1, 2003.

Cindy Avrette

Trina Griffin

Martha H. Harris

Canaan Huie

Mary Shuping

Martha Walston