

# North Carolina

## 2004 Tax Law Changes

North Carolina Department of Revenue  
Tax Administration

## PREFACE

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

- (1) Changes made by prior General Assemblies that take effect for tax year 2004. Each change enacted by a prior General Assembly is also discussed in the Department's Tax Law Change document for the year the change was enacted.
- (2) Changes made by the 2004 General Assembly, regardless of when they take effect.

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

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

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## ESTATE TAX

**G.S. 105-32.2(b) – Estate Tax Changes:** In 2002, the General Assembly amended this subsection to provide that the North Carolina estate tax is equal to the state death tax credit for federal purposes before the phase-out of the federal credit. The amendment was scheduled to sunset effective for estates of decedents dying on or after January 1, 2004. The 2003 General Assembly further amended this subsection to delay the sunset to July 1, 2005. The 2003 General Assembly also amended G.S. 105-32.2(b) to reflect the decoupling from the Internal Revenue Code with respect to both the phase-out and termination provisions of Code section 2011.

The 2004 General Assembly amended this subsection to clarify that the estate tax changes enacted in 2002 and 2003 have a uniform sunset date of July 1, 2005. This subsection was also amended to provide that the North Carolina estate tax is calculated without regard to the deduction for state death taxes allowed under section 2058 of the Code. Code section 2058 replaces the state death tax credit with a deduction for state death taxes for decedents dying after December 31, 2004. This amendment also expires July 1, 2005.

As a result of these amendments, the North Carolina estate tax liability will continue to be equal to the 2001 state death tax credit for estates of decedents dying before July 1, 2005. If no further legislation is enacted, the North Carolina estate tax will effectively be repealed beginning with the estates of decedents dying on or after July 1, 2005.

(Effective August 2, 2004; SB1145, ss.1 and 4, S.L. 04-170.)

## GROSS RECEIPTS AMUSEMENT TAX

**G.S. 105-40 – Exemptions From the Tax:** This section was amended to add two new subdivisions to provide two more exemptions from the gross receipts amusement tax. Subdivision (6a) exempts from the tax a youth athletic contest with an admission price that does not exceed \$10.00 sponsored by a person that is exempt from income tax. A youth athletic contest is defined as a contest in which each participating athlete is less than 20 years of age. Subdivision (7a) exempts from the tax all exhibitions, performances, and entertainments promoted and managed by a nonprofit arts organization that is exempt from income tax under G.S. 105-130.11(a)(3). This exemption does not apply to athletic events.

(Effective July 1, 2004; HB 1303, s. 1, S.L. 04-84.)

## TOBACCO PRODUCTS LICENSE AND EXCISE TAXES

**G.S. 105-113.5 – Technical Change:** This section was rewritten to delete subdivisions (1) and (2) which exempted from tax sample packs of cigarettes containing five or fewer cigarettes distributed without charge and packages of cigarettes given without charge by the cigarette's manufacturer to its factory workers. These exemptions are obsolete.

(Effective August 2, 2004; SB 1145, s. 5, S.L. 04-170.)

**G.S. 105-113.21 – Reinstatement of Cigarette Tax Discount:** Subsection (a) of this section was reenacted to reinstate a discount to cigarette distributors who both timely file the monthly cigarette tax report and timely pay the cigarette tax due. The discount is 2%. The discount under prior law was 4% and had been repealed effective for reporting periods beginning on or after August 1, 2003. Subsection (b) was rewritten to include language regarding the discount to conform with the reinstatement of the discount in subsection (a).

(Effective for reporting periods beginning on or after August 1, 2004; HB 1303, s. 2(a), S.L. 04-84.)

**G.S. 105-113.35(c) – Conforming Change:** This subsection was amended to include language regarding the discount against the tax on other tobacco products to conform with the changes to G.S. 105-113.39 that reinstated the discount.

(Effective for reporting periods beginning on or after August 1, 2004; HB 1303, s. 2(b), S.L. 04-84.)

**G.S. 105-113.39 – Reinstatement of Discount Against Tax on Other Tobacco Products:** This section was reenacted to reinstate a discount to wholesale dealers or retail dealers who both timely file the monthly tax on other tobacco products report and timely pay the tax due. The discount is 2%. The discount under prior law was 4% and had been repealed effective for reporting periods beginning on or after August 1, 2003.

(Effective for reporting periods beginning on or after August 1, 2004; HB 1303, s. 2(c), S.L. 04-84.)

## ALCOHOLIC BEVERAGE LICENSE AND EXCISE TAXES

**G.S. 105-113.68(a)(2) – Technical Change:** Subdivision (a)(2), which defined "ABC law," was repealed. The definition was no longer needed because the only reference to "ABC law" in Article 2C had been deleted in 2003.

(Effective August 2, 2004; SB 1145, s. 6, S.L. 04-170.)

**G.S. 105-113.68(a)(5) – Definition of Fortified Wine:** This subdivision was rewritten to redefine “fortified wine.” Under prior law, wine was considered fortified wine if any amount of brandy had been added. As rewritten, wine is not defined as fortified unless it has alcoholic content of more than 16%. The maximum alcoholic content remains 24%.

(Effective October 1, 2004; SB 74, s. 3, S.L. 04-135.)

**G.S. 105-113.68(a)(12) – Definition of Unfortified Wine:** This subdivision was rewritten to redefine “unfortified wine.” Under prior law, unfortified wine could not have had any brandy added to it. As rewritten, unfortified wine can have brandy added to it as long as the final product does not have alcoholic content of more than 16%.

(Effective October 1, 2004; SB 74, s. 3, S.L. 04-135.)

**G.S. 105-113.82(e) – Conforming Change:** This subsection was rewritten to conform to the name change of the State Planning Officer to the State Budget Officer.

(Effective August 17, 2004; HB 281, s. 5(d), S.L. 04-203.)

**G.S. 105-113.83(b) – Technical Change:** This subsection was rewritten to correct a grammatical error.

(Effective August 2, 2004; SB 1145, s. 7, S.L. 04-170.)

**G.S. 105-113.85 – Reinstatement of Alcoholic Beverage Tax Discount:** This section was reenacted to reinstate a discount to wholesalers or importers who both timely file the monthly alcoholic beverage tax report and timely pay the tax due. The discount is 2%. The discount under prior law was 4% and had been repealed effective for reporting periods beginning on or after August 1, 2003.

(Effective for reporting periods beginning on or after August 1, 2004; HB 1303, s. 2(d), S.L. 04-84.)

## FRANCHISE TAX

**G.S. 105-114.1 – Closing Additional Franchise Tax Loophole and Limiting Application of Law to Avoid Unintended Results:** The 2001 General Assembly enacted subsection (c) of G.S. 105-114 (HB 1157, s. 2, S.L. 01-327) in an attempt to close an unintended loophole that allowed corporations to reduce the franchise tax by transferring assets to a controlled limited liability company

(LLC). The new subsection required a corporation that was a member of a limited liability company (LLC) and was entitled to receive at least 70% of the LLC's assets upon dissolution to include the LLC's assets in the corporation's investment in tangible property franchise tax base. The member corporation's investment in the LLC was excludible from the computation. The new subsection also provided that a taxpayer that underpaid the franchise tax due under this subsection because of fraud with intent to evade tax was guilty of a Class H felony. The General Assembly's stated purpose for the new subsection was to apply the franchise tax equally to assets held by corporations and assets held by corporate-affiliated limited liability companies.

The 2002 General Assembly determined that some taxpayers found a way around the 2001 loophole closing provision by manipulating ownership of the assets. One method was to place a controlled partnership between the corporation and the LLC. To close this loophole, G.S. 105-114(c) was recodified as G.S. 105-114.1 (SB 1115, s. 30G.2.(b), S.L. 02-126.). New G.S. 105-114.1 was amended to require the LLC's income, assets, liabilities, or equity to be attributed to a corporation if the corporation and its related members together owned indirectly seventy percent (70%) or more of the LLC's assets. A person owned indirectly assets of an LLC if the LLC's governing law provided that seventy percent (70%) or more of its assets, after payments to creditors, would be distributed to the person upon dissolution. The LLC's assets were attributed only to the related members that were corporations. None of the LLC's assets were attributed to the related members that were not corporations. Instead, the amount that would be attributed to that member was also attributed to the corporate members.

The 2004 General Assembly determined that another potential loophole existed by placing a business trust between the corporation and the LLC. The General Assembly also determined that the prior legislation had caused unintended results. This section was amended to close the loophole and to remove provisions that could result in franchise tax on assets that were not indirectly owned by corporations. In addition, the General Assembly reduced the percentage ownership required for attribution.

Subsection (a) was rewritten to delete all existing definitions except "governing law," add new definitions, and renumber "governing law" so the definitions are alphabetical in order. Subdivision (1) defines "affiliated group" by cross-referencing section 1504 of the Internal Revenue Code. Subdivision (2) defines "capital interest" as the right under an LLC's governing law to receive a percentage of the company's assets upon dissolution after payments to creditors. Subdivision (3) defines "entity" as a person that is not a human being. The definition of "governing law" was not changed but was renumbered as subdivision (4). The definitions for "owned indirectly" and "principal corporation" (subdivisions (2) and (3) of the prior law) were repealed.

The General Assembly made two substantive and one clarifying change to subsection (b). The first substantive change to subdivision (b) rewrites the subsection to no longer require a corporation to include all related members, including individual shareholders, in determining whether the corporation owned 70% of the LLC's assets. As rewritten, the 70% ownership test is limited to the corporation or an affiliated group of corporations. If a corporation or affiliated group of corporations owns 70% or more of the capital interests in an LLC, the corporation or group of corporations must include the same percentage of the LLC's assets in its three franchise tax bases.

The second substantive change to subsection (b) changes the test for when attribution is required. Under prior law, including the first substantive changes to subsection (b) explained above, attribution was required if the corporation or affiliated group of corporations owned 70% or more of the LLC's assets. Effective January 1, 2005, that percentage is reduced from 70% to 50%.

The clarifying change to subsection (b) clarifies that the attribution to the three bases is equal to the same percentage of (1) the LLC's capital stock, surplus, and undivided profits, (2) 55% of the LLC's appraised ad valorem tax value of property, and (3) the LLC's actual investment in tangible property in this State.

Subsection (c) as rewritten addresses constructive ownership when a partnership, trust, LLC, or other entity is placed between a corporation and an LLC. Ownership of the capital interests in an LLC is determined under the constructive ownership rules for partnerships, estates, and trusts in Code section 318(a)(2)(A) and (B), modified as follows:

- (1) the term "capital interest" is substituted for "stock" where that term appears in the referenced Code section.
- (2) an LLC and any noncorporate entity other than a partnership, estate, or trust is treated as a partnership.
- (3) the operating rule of section 318(a)(5) applies without regard to section 318(a)(5)(C).

*Example:* A partnership owns 100% of the capital interests of an LLC. Corporation A is a 50% owner of the partnership. Corporation A constructively owns 50% of the capital interests in the LLC.

Subsection (d) as rewritten provides that a corporation may exclude its investment in the LLC from its computation of the capital stock base if the corporation is required to include a percentage of the LLC's assets in its franchise tax bases under subsection (b). This provision was previously included in subdivision (b)(2).



Subdivision (e) as rewritten addresses how the members of an affiliated group determine the percentage of the LLC's assets to be included in each member's franchise tax bases. If all members of the group are doing business in North Carolina, then each member includes the percentage of the LLC's assets equal to the member's percentage ownership in the LLC. If some of the members of the group are not doing business in North Carolina, then the percentage of the LLC's assets owned by the group are allocated among the members that are doing business in North Carolina. The percentage attributed to each member doing business in North Carolina is determined by multiplying the percentage of the LLC owned by the entire group by a fraction. The numerator of the fraction is the member's percentage ownership of the LLC and the denominator is the total percentage of the LLC owned by all members doing business in North Carolina.

*Example:* An affiliated group of corporations owns 100% of the capital interests in an LLC. The group consists of three corporations. Corporation A is doing business in North Carolina and owns 50% of the LLC. Corporation B is doing business in North Carolina and owns 10% of the LLC. Corporation C is not doing business in North Carolina and owns 40% of the LLC. The percentage of the LLC's assets required to be included in Corporation A's and Corporation B's franchise tax bases is determined as follows:

Corporation A:  $100\% \times 50\% / (50\% + 10\%) = 83.33\%$

Corporation B:  $100\% \times 10\% / (50\% + 10\%) = 16.67\%$

Subsection (f) provides an exception to the requirement for a corporation to attribute a percentage of an LLC's assets to its franchise tax bases. If the total book value of the LLC's assets never exceeded \$150,000 during its taxable year, no attribution is required.

Subsection (g) addresses timing to prevent a corporation from shifting assets back and forth between itself and an LLC to avoid franchise tax. Ownership of the capital interests in an LLC is determined as of the last day of the LLC's taxable year. The attribution of the LLC's assets under subsection (b) and the exclusion of the corporation's investment in the LLC under subsection (d) are made to the corporation's next following franchise tax return. However, if the corporation and LLC have engaged in a pattern of transferring assets between them so that each did not own the assets on the last day of its taxable year, the ownership of the capital interest in the LLC must be determined as of the last day of the corporation's taxable year.

The penalty provisions previously codified as subsection (d) are recodified as subsection (h).

(Most changes to G.S. 105-114.1, including first substantive change to G.S. 105-114.1(b) effective retroactively to January 1, 2003, and applies to taxes due on or after that date; SB 51, s. 1, S.L. 04-74; second substantive change to subsection

(b) effective January 1, 2005, and applies to taxes due on or after that date; SB 51, s. 2, S.L. 04-74; clarifying change to subsection (b) effective August 2, 2004; SB 1145, s. 8.1, 04-170.)

## **TAX INCENTIVES FOR NEW AND EXPANDING BUSINESSES**

### **G.S. 105-129.2 – Definitions of Eligible Major Industry and Interstate Air**

**Courier:** This section was amended to add new subdivision (8a) to define an eligible major industry and new subdivision (12a) to define an interstate air courier. A taxpayer is an eligible major industry if the taxpayer is primarily engaged in bioprocessing or pharmaceutical and medicine manufacturing, as defined in G.S. 105-164.14(j)(3), and the taxpayer has been certified by the Secretary of Commerce as planning to invest at least one hundred million dollars of private funds to acquire, construct, and equip a facility in this State to engage in one or more of those industries. An interstate air courier is defined by a cross-reference to G.S. 105-164.3.

(Definition of an eligible major industry effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.1, S.L. 03-435 [second extra session]; definition of an interstate air courier effective August 2, 2004; SB 1145, s. 9, S.L. 04-170.)

**G.S. 105-129.2A – Sunset for Eligible Major Industries Extended:** This section was amended by adding a new subsection (a2) to create an exception to the sunset of the Article 3A credits for a taxpayer that qualifies as an eligible major industry on or before January 1, 2006. In that case, the Article 3A credits expire for business activities that occur on or after January 1, 2010, instead of the general sunset date of January 1, 2006, found in G.S. 105-129.2A(a).

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.2, S.L. 03-435 [second extra session].)

**G.S. 105-129.3(b) – Tier Designation Statistical Period:** This subsection was rewritten to revise the time period used by the Department of Commerce for statistical purposes in determining tier designations for purposes of the Article 3A tax credits. As revised, the Department of Commerce will use the last twelve months instead of the last three years.

(Effective August 17, 2004 and applies to designations made on or after that date; SB 1244, s. 10, S.L. 04-202.)

**G.S. 105-129.3(b1) – Conforming Change:** This subsection was rewritten to conform to the name change of the State Planning Officer to the State Budget Officer.

(Effective August 17, 2004; HB 281, s. 5(e), S.L. 04-203.)

**G.S. 105-129.3A(a) – Conforming Change:** This subsection was rewritten to conform to the name change of the State Planning Officer to the State Budget Officer.

(Effective August 17, 2004; HB 281, s. 5(f), S.L. 04-203.)

**G.S. 105-129.4(b1) – Time Period for Large Investment Extended for Eligible Major Industries:** This subsection was amended to allow eligible major industries seven years to make the necessary investment in real property, machinery and equipment, or central office property to qualify for the large investment enhancements. This seven-year period is the same as for interstate air couriers. All other businesses have two years to make the necessary investment.

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.3, S.L. 03-435 [second extra session].)

**G.S. 105-129.4(b2) – Clarifying Change:** This subsection was rewritten to clarify that the requirement for a taxpayer to provide health insurance for its employees to qualify for the Article 3A tax credits begins when jobs are created or when qualifying investment is made and continues throughout the period of time the taxpayer claims installments or carryforwards of the credits.

(Effective August 2, 2004; SB 1145, s. 10, S.L. 04-170.)

**G.S. 105-129.4(b6) – Clarifying Change:** This subsection was rewritten to clarify that the provision prohibiting a taxpayer from claiming an Article 3A tax credit if the taxpayer has an overdue tax debt applies equally to tax credits that are claimed in full in one year and to tax credits that are claimed in installments.

(Effective August 2, 2004; SB 1145, s. 11, S.L. 04-170.)

**G.S. 105-129.4(d) – Forfeiture of Eligible Major Industry Enhancements:** This subsection was amended to provide that a taxpayer forfeits the eligible major industry enhancements, including a delayed sunset of the Article 3A credits and an extended time to make sufficient investments to qualify for the large investment enhancements, if the taxpayer fails to timely make the required level of investment under G.S. 105-129.2(8a).

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.4, S.L. 03-435 [second extra session].)

**G.S. 105-129.5(c) – Time Period for Sufficient Investment to Qualify for Longer Carryforward Period Extended for Eligible Major Industries:** This subsection was amended to allow eligible major industries seven years to make the necessary investment in real property, machinery and equipment, or central

office property to qualify to carry forward any unused credits for ten years. This seven-year period to make the necessary investment is the same as for interstate air couriers. All other businesses have two years to make the necessary investment.

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.5, S.L. 03-435 [second extra session].)

**G.S. 105-129.6(b) – Change to Due Date for Report:** This subsection was rewritten to change the date the Department of Revenue is required to publish the report on Article 3A credits from March 1 to April 1. This change was enacted in identical form in two separate bills.

(Effective August 17, 2004; HB 281, s. 40, S.L. 04-203; effective August 2, 2004; SB 1145, s. 12, S.L. 04-170.)

**G.S. 105-129.8 – Stylistic and Substantive Changes:** This section was rewritten to make stylistic changes and two substantive changes. The stylistic changes divided subsection (a) into four subsections – (a), (a1), (a2), and (a3). The provisions regarding eligibility for the credit and the amount of the credit remain in subsection (a). The provisions regarding where a position is located were moved to new subsection (a1). The provisions regarding claiming the credit in installments were moved to new subsection (a2). The provisions regarding transferred jobs were moved to new subsection (a3). The first substantive change adds a provision to new subsection (a1) to define how a taxpayer determines the number of new jobs filled during the taxable year. To determine the number of new jobs filled, the taxpayer subtracts the highest number of full-time employees the taxpayer had in the State at any time during the twelve-month period preceding the beginning of the taxable year from the number of full-time employees the taxpayer has in the State at the end of the taxable year. The second substantive change rewrote subsection (d) to allow eligible major industries seven years to create at least twenty new jobs to qualify to use the county's tier designation at the time a letter of commitment is signed with the Department of Commerce. This seven-year period is the same as for interstate air couriers. All other businesses have two years to create the additional jobs.

(Stylistic changes and first substantive change effective for taxable years beginning on or after January 1, 2004; SB 1145, s. 43(a), S.L. 04-170; second substantive change effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.6, S.L. 03-435 [second extra session].)

**G.S. 105-129.9(d) – Clarifying Change:** This subsection was rewritten to clarify that the expiration of the machinery and equipment tax credit applies equally to property that is disposed of, taken out of service, or moved out of state.

(Effective August 2, 2004; SB 1145, s. 13, S.L. 04-170.)

**G.S. 105-129.9(e) – Time Period to Place Specific Machinery and Equipment in Service Under Letter of Commitment Extended for Eligible Major Industries:**

This subsection was amended to allow eligible major industries seven years to place specific machinery and equipment in service to qualify to use the county's tier designation at the time a letter of commitment is signed with the Department of Commerce. This seven-year period is the same as for interstate air couriers. All other businesses have two years to create the additional jobs.

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.7, S.L. 03-435 [second extra session].)

**G.S. 105-129.10 – Credit for Research and Development Allowed to Targeted Businesses; Sunset:** This section was rewritten by adding a new subsection (d) to provide that the two research and development tax credits allowed under this section and the research and development tax credit allowed under new Article 3F are exclusive. A taxpayer may elect to take only one of the three credits with respect to its research activities in a taxable year.

The credits for research and development in Article 3A sunset effective for taxable years beginning on or after January 1, 2006.

(Prohibition from taking more than one of the credits allowed under G.S. 105-129.10 and the credit allowed under G.S. 105-129.55 effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.1, S.L. 04-124; sunset effective for taxable years beginning on or after January 1, 2006; HB 1414, s. 32D.4, S.L. 04-124.)

## **BUSINESS AND ENERGY TAX CREDITS**

**G.S. 105-129.15 – Definitions:** This section was rewritten to add a new subdivision (8) to define "renewable fuel." The term includes either of the following:

- (a) Biodiesel, as defined in G.S. 105-449.60.
- (b) Ethanol either unmixed or in mixtures with gasoline that are seventy percent (70%) or more ethanol by volume.

(Effective for taxable years beginning on or after January 1, 2005; HB 1636, s. 1, S.L. 04-153.)

**G.S. 105-129.16D – Credit for Constructing Renewable Fuel Facilities:** Article 3B of Chapter 105 was rewritten by adding this new section to provide tax credits for constructing renewable fuel facilities. There are two types of credits included in this section, a dispensing credit and a production credit. By being

enacted as part of Article 3B, these credits are subject to the general provisions of G.S. 105-129.17, G.S. 105-129.18, and G.S. 105-129.19, including the election of against which tax the credit will be claimed, the cap on the amount of credit that can be claimed in a taxable year, the substantiation requirements, and the requirement for the Department of Revenue to report the credits claimed to the Revenue Laws Study Committee and to the Fiscal Research Division of the General Assembly.

Subsection (a) provides a dispensing credit to a taxpayer that constructs and installs and places in service in this State a qualified commercial facility for dispensing renewable fuel. A facility is qualified if the equipment used to store or dispense renewable fuel is labeled for this purpose and is clearly identified as associated with renewable fuel.

The credit is equal to 15% of the cost to the taxpayer of constructing and installing the part of the dispensing facility, including pumps, storage tanks, and related equipment, that is directly and exclusively used for dispensing or storing renewable fuel. The tax credit is claimed in three equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the portion of a facility that is directly and exclusively used for dispensing or storing renewable fuel is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim carryforwards of any prior years' installments.

Subdivision (b) provides a production credit to a taxpayer that constructs and places in service in this State a commercial facility for processing renewable fuel. The credit is equal to 25% of the cost to the taxpayer of constructing and equipping the facility. The tax credit is claimed in seven equal installments beginning with the taxable year in which the facility is placed in service. If, in one of the years during which an installment of the credit is to be claimed, the facility is disposed of or taken out of service, the credit expires and the taxpayer may not take any remaining installments of the credit; however, the taxpayer may continue to claim carryforwards of any prior years' installments.

Subsection (c) provides that a taxpayer that claims any other tax credit allowed under Chapter 105 with respect to the costs of constructing and installing a renewable energy facility may not take the credit allowed in this section with respect to the same costs.

Subsection (d) provides that the credit allowed in this section sunsets for facilities placed in service on or after January 1, 2008.

(Effective for taxable years beginning on or after January 1, 2005; HB 1636, s. 1, S.L. 04-153.)

## HISTORIC REHABILITATION TAX CREDITS

**G.S. 105-129.35(c)(4) – Technical Change:** This subdivision was rewritten to correct an erroneous cross-reference in the definition of “State Historic Preservation Officer.”

(Effective August 2, 2004; SB 1145, s. 14, S.L. 04-170.)

## LOW-INCOME HOUSING TAX CREDITS

**G.S. 105-129.42 – Reference Changes:** Subsections (b) and (c) of this section were rewritten to change the references to “eligible basis, as determined pursuant to section 42(d) of the Code” to “qualified basis, as determined pursuant to section 42 of the Code.” “Qualified basis” is the most appropriate reference for determining the credit allowed for North Carolina tax purposes.

(Effective July 17, 2004; HB 1430, s. 4.2, S.L. 04-110.)

**G.S. 105-129.45 – Sunset Extended:** This section was rewritten to extend the sunset of Article 3E, which provides for low-income housing tax credits, from January 1, 2006 to January 1, 2010. The sunset now applies to developments to which federal credits are allocated on or after January 1, 2010.

(Effective July 17, 2004; HB 1430, s. 4.1, S.L. 04-110.)

## RESEARCH AND DEVELOPMENT TAX CREDIT

**New Article 3F – Research and Development Tax Credit:** This new Article was enacted to provide a research and development tax credit that is available to more taxpayers than the research and development tax credits in G.S. 105-129.10 of Article 3A. The tax credits in Article 3A are limited to taxpayers that are in eligible businesses while the tax credit in Article 3F is available to a taxpayer regardless of its type of business.

**G.S. 105-129.50 – Definitions:** This section sets out the definitions that apply to Article 3F. Definitions are provided for the terms “North Carolina university research expenses,” “period of measurement,” “qualified North Carolina research expenses,” “receipts,” “related person,” “research university,” and “small business.” In addition to the specific definitions, the definitions in section 41 of the Internal Revenue Code also apply to Article 3F.

Subdivisions (1) through (3) are reserved for future additional definitions.

Subdivision (4) defines “North Carolina university research expenses” as any amount the taxpayer paid or incurred to a research university for qualified research performed in this State or basic research performed in this State.

Subdivision (5) defines “period of measurement” by cross-referencing the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13CFR121.104), the period of measurement is used to determine the entity’s annual receipts and is determined by how long an entity has been in business. If the entity has been in business for less than three years, the annual receipts for the period of measurement are the receipts for the period of time for which the entity has been in business divided by the number of weeks in business and multiplied by 52. If the entity has been in business for three full fiscal years and has not filed a short-period income tax return for any of those three years, the annual receipts for the period of measurement are the total receipts over the last three years divided by three. If one of the three years’ returns is a short-period return, the annual receipts for the period of measurement are the receipts for the short year and the two full years divided by the total number of weeks in the short year and two full years multiplied by 52.

Subdivision (6) defines “qualified North Carolina research expenses” as qualified research expenses, other than North Carolina university research expenses, for research performed in this State.

Subdivision (7) defines “receipts” by cross-referencing the Small Business Size Regulations of the federal Small Business Administration. Pursuant to those regulations (13CFR121.104), receipts means total income, gross income plus cost of goods sold as reported for federal income tax purposes, less net capital gains or losses and taxes collected for and remitted to a taxing authority to the extent included in gross or total income, proceeds from transactions between the entity and its domestic or foreign affiliates if also excluded from gross or total income on a federal consolidated return, and amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

Subdivision (8) defines “related person” by cross-referencing G.S. 105-163.010, which in turn defines the term by cross-referencing sections 267(b) or 707(b) of the Internal Revenue Code.

Subdivision (9) defines “research university” as an institution of higher education that is either (i) classified as a Doctoral/Research University I or II, a Masters College and University I or II, or a Baccalaureate College, Liberal Arts or General in the most recent edition of ‘A Classification of Institutions of Higher Education’ issued by the Carnegie Foundation for the Advancement of Teaching or (ii) a constituent institution of the University of North Carolina.



Subdivision (10) defines “small business” as a business whose annual receipts, combined with the annual receipts of all related persons, for the applicable period of measurement did not exceed 1 million dollars.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.2, S.L. 04-124.)

**G.S. 105-129.51 – Administration; Sunset:** Subsection (a) of this section requires a taxpayer to meet the wage standard, health insurance, environmental impact, and safety and health program requirements found in G.S. 105-129.4 to be eligible to claim the Article 3F credit. Subsection (b) provides that the Article 3F credit sunsets for taxable years beginning on or after January 1, 2009. Subsection (c) provides that the two research and development tax credits allowed in G.S. 105-129.10 of Article 3A and the research and development tax credit allowed under new Article 3F are exclusive. A taxpayer may elect to take only one of the three credits with respect to its research activities in a taxable year.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.2, S.L. 04-124; subsection (c) is repealed for taxable years beginning on or after January 1, 2006; HB 1414, s. 32D.4, S.L. 04-124.)

**G.S. 105-129.52 – Tax Election; Cap:** Subsection (a) provides that the credit in Article 3F may be claimed against either franchise tax or income tax. The taxpayer must elect the tax against which a credit will be claimed when filing the return on which the credit is first claimed. The election is binding and applies both to the credit and any carryforwards of the credit. Subsection (b) provides the Article 3F credit may not exceed 50% of the amount of tax against which it is claimed, reduced by the sum of all other tax credits allowed against that tax. This limitation applies to the cumulative amount of credit, including carryforwards. Any unused portion of this credit may be carried forward for the succeeding 15 years.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.2, S.L. 04-124.)

**G.S. 105-129.53 – Substantiation:** This section requires a taxpayer claiming a tax credit under Article 3F to maintain and make available for inspection any information or records required by the Secretary of Revenue. The burden of proving eligibility for a credit and the amount of the credit rests upon the taxpayer.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.2, S.L. 04-124.)

**G.S. 105-129.54 – Reports:** This section requires the Department of Revenue to make an annual report to the Revenue Laws Study Committee and the Fiscal Research Division of the General Assembly identifying the number of taxpayers that claimed an Article 3F tax credit itemized by the categories of small business, low-tier, other, and university research; the amount of each credit claimed in each category; and the total cost to the General Fund of the credits claimed.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.2, S.L. 04-124.)

**G.S. 105-129.55 – Credit for North Carolina Research and Development:** This section provides a credit for North Carolina research and development expenses. The credit consists of two parts – a credit for qualified North Carolina research expenses and a credit for North Carolina university research expenses. The credit for qualified North Carolina research expenses is further divided into three categories – small business, low-tier research, and other research.

Subsection (a) provides a tax credit for qualified North Carolina research expenses. The credit is equal to a percentage of the expenses based on whether the expenses qualify as small business, low-tier research, or other research. If the taxpayer was a small business as of the last day of the taxable year the applicable percentage is 3%. Research performed in a tier one, two or three area is considered low-tier research and the applicable percentage is 3%. Research expenses that do not qualify as small business or low-tier are considered other research. The applicable percentage is 1% for other expenses of 50 million dollars or less, 2% for expenses of 200 million dollars or less but more than 50 million dollars, and 3% for expenses of more than 200 million dollars. Only one credit is allowed with respect to the same expenses. If the expenses qualify in more than one category, then the credit is equal to the higher percentage, not both percentages combined. If part of the taxpayer's expenses qualify as low-tier and part of the expenses qualify as other research, the applicable percentages apply separately to each part of the expenses.

Subsection (b) provides a tax credit for North Carolina university research expenses. The credit is equal to 15% of the expenses.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.2, S.L. 04-124.)

## **CORPORATION INCOME TAX**

**G.S. 105-130.4(a)(6) – Technical Change:** This subdivision was rewritten to update the reference to the Federal Power Commission. In 1977, Congress reorganized the Federal Power Commission as the Federal Energy Regulatory Commission.

(Effective August 2, 2004; SB 1145, s. 15, S.L. 04-170.)

**G.S. 105-130.45(a)(2) – Definition of Exportation:** This subdivision was rewritten to amend the definition of exportation to include a possession of the United States and a commonwealth of the United States that is not a state in addition to a foreign country as qualifying exportation destinations.

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 5.3, S.L. 03-435 [second extra session].)

**G.S. 105-130.46 – Technical Changes:** This section was rewritten to correct erroneous cross-references in subsections (e) and (g), to make stylistic changes, and to make one substantive change. The substantive change is to subsection (b) and permits a job to be included in the employment level for a year only if the job is located in the State for more than six months during the year.

(Effective for taxable years beginning on or after January 1, 2006, and expires for exports occurring on or after January 1, 2018; SB 1145, s. 16(a), S.L. 04-170.)

## INDIVIDUAL INCOME TAX

**G.S. 105-134.6(c)(4) – Elimination of Standard Deduction Marriage Penalty Complete:** The 2001 General Assembly amended this subdivision in two phases to eliminate the marriage penalty with respect to the standard deduction. The 2002 General Assembly postponed the 2001 changes until tax years 2003 and 2004. The first phase increased the standard deduction for tax year 2003 for taxpayers filing joint returns and for married taxpayers filing separate returns to \$5,500 and \$2,750, respectively. The second phase increased the standard deduction for tax year 2004 for taxpayers filing joint returns and for married taxpayers filing separate returns to \$6,000 and \$3,000, respectively. Consequently, elimination of the standard deduction marriage penalty is complete.

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

**G.S. 105-151.12(f) – Credit for Certain Real Property Donations:** The 2001 General Assembly enacted this subsection to create a temporary exception to the change made to G.S. 105-269.15(a) in 2001 concerning the calculation of tax credits by partnerships.

Under the change made to G.S. 105-269.15(a), a maximum dollar limit on a tax credit applies to a partnership as a whole rather than to each of the individual partners. An exception to this change was made for partnerships claiming the

tax credit for real property donations so that the dollar limit on the amount of a tax credit will apply to the individual partners instead of the partnership. The exception was set to expire for taxable years ending on or after January 1, 2005. However, the 2004 General Assembly amended this subsection to extend the exception until tax years beginning on or after January 1, 2006.

(Effective July 29, 2004; HB 1602, ss. 1 and 3; S.L. 04-134.)

**G.S. 105-151.24 – Two-Step Increase in Credit for Children Complete:** The 2001 General Assembly amended this section to make a two-step increase in the tax credit for a dependent child. The 2002 General Assembly amended the effective dates of the 2001 legislation to delay the scheduled increases in the credit amounts to tax years beginning on or after January 1, 2003 and January 1, 2004. The first step increased the credit from \$60 to \$75 for tax year 2003. The second step increases the credit from \$75 to \$100 for tax year 2004.

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

**G.S. 105-151.28 – Credit for Premiums Paid on Long-Term Care Insurance Contracts:** This statute expired for taxable years beginning on or after January 1, 2004.

(Effective for taxable years beginning on or after January 1, 1999, and expires for tax years beginning on or after January 1, 2004; SB 1366, S.L. 98-212, s. 29A.6.)

**G.S. 105-160.3(b)(6) – Obsolete Reference:** This subdivision, which denied the child health insurance credit to estates and trusts, has been repealed since it was rendered obsolete by the repeal of the child health insurance credit in 2001.

(Effective August 2, 2004; SB 1145, s.17, S.L. 04-170.)

## TAX CREDITS FOR QUALIFIED BUSINESS INVESTMENTS

**G.S. 105-163.012(b) – Tax Credit Cap Increased:** This subdivision was amended to increase the total amount of all tax credits allowed to taxpayers for investments in a calendar year to \$7,000,000. Previously, the total amount of credits allowed in a calendar year was \$6,000,000.

(Effective for investments made on or after January 1, 2004; HB 1414, ss. 32C.1 and 32C.3, S.L. 04-124.)

**G.S. 105-163.015 – Sunset Extended:** The credit for qualified business investments was scheduled to sunset for investments made on or after

January 1, 2007. The credit now sunsets for investments made on or after January 1, 2008.

(Effective for taxable years beginning on or after January 1, 2004; HB 1414, s. 32C.2, S.L. 04-124)

## SALES AND USE TAX

**G.S. 105-164.3 – Definition Changes:** Some definitions were revised and some are new. The changes are as follows and become effective as noted after each definition:

*Interstate air business – (14c).* This definition was added as a result of a new exemption. The term is defined as “An interstate air courier, an interstate freight air carrier, or an interstate passenger air carrier.”

(Effective October 1, 2004; HB 1414, s. 32B.3, S.L. 04-124.)

*Interstate freight air carrier – (15b).* This definition was added as a result of a new exemption. The term is defined as “A person whose primary business is scheduled freight air transportation, as defined in the North American Industry Classification System adopted by the United States Office of Management and Budget, in interstate commerce.”

(Effective October 1, 2004; HB 1414, s. 32B.3, S.L. 04-124.)

*Prepared food – (28).* This definition was rewritten to make a technical change to the introductory sentence. The change does not affect the current application of tax to sales and purchases of prepared food.

(Effective August 2, 2004; SB 1145, s. 18, S.L. 04-170.)

*Sales price – (37).* This definition was rewritten to specifically include credit for trade-in in the list of items that are included in the definition of “sales price.” This does not represent a change in the Department’s position; a credit for a trade-in has been and continues to be considered part of the sales price of an item.

(Effective August 2, 2004; SB 1145, s. 19, S.L. 04-170.)

**G.S. 105-164.4(a) – Sales Tax Rates on Electricity:** Several changes were made to the preferential State rates on sales of electricity to manufacturers. G.S. 105-164.4(a)(1g), which provided for varying rates based on the megawatt-hour volume of qualified electricity received by a manufacturer, was repealed. G.S. 105-164.4(a)(1f)b., which provided for the State rate of 2.83% on electricity sold to a manufacturer for use in the operation of the manufacturing facility, was

reenacted. G.S. 105-164.4(a) was amended by adding new subdivision (1h). The new subdivision provides that the State rate of 0.17% applies to electricity sold to an aluminum smelting facility for use in the operation of that facility and measured by a separate meter or measuring device.

The effects of the changes reflected in the preceding paragraph are as follows: (1) The State rates of 2.25% and 2% that were to become effective July 1, 2005 will not take effect. (2) The State rate of 0.17% will remain in effect but will not be based on the quantity of electricity received and will not be available to all manufacturers. Only electricity sold to an aluminum smelting facility for use in connection with the operation of that facility and measured by a separate meter or measuring device will be subject to tax at the State rate of 0.17%. (3) All other sales of electricity to manufacturers will continue to be subject to the 2.83% State rate when used in the operation of the manufacturing facilities other than electricity used for residential heating purposes. The quantity of electricity purchased or used is not a determinative factor, but the electricity must be measured by a separate meter or device.

(Effective October 1, 2004; rate for aluminum smelters expires October 1, 2007; HB 1430, ss. 6.1, 6.2, and 6.3, S.L. 04-110.)

**G.S. 105-164.4B – Change in Sourcing Rules:** This section was rewritten to correct one of the provisions for sourcing of local tax where the delivery address is unknown. If the delivery address is unknown, the sale is sourced to the first of the following locations known to the seller: the purchaser's business or home address; the purchaser's billing address or, for prepaid mobile telecommunications service, the location associated with the mobile telephone number; or the address from which the property was shipped.

(Effective August 2, 2004; SB 1145, s. 20, S.L. 04-170.)

**G.S. 105-164.11 – Notice of Refund Request to Sellers:** This section was rewritten to add a requirement that a purchaser must provide a seller with notice of over-collected sales or use tax. The seller then has sixty days to respond to the purchaser's request for refund before the purchaser may bring a cause of action against the seller.

(Effective June 25, 2004; HB 1448, s. 1, S.L. 04-22.)

**G.S. 105-164.13 – Changes to Exemptions:** Several new exemptions were added and some of the existing exemptions were revised. The changes and their effective dates are as follows:

*Plastic mulch and plant bed covers – (1).* The existing exemption for commercial fertilizer, lime, land plaster, and seeds sold to a farmer for agricultural purposes was rewritten to add plastic mulch and plant bed covers to the list of items that

are exempt. The plastic mulch and plant bed covers will be exempt only when sold to a farmer for agricultural purposes.

(Effective October 1, 2004; HB 1414, s. 32B.2, S.L. 04-124.)

Free distribution periodicals – (39). This former exemption for free circulation publications was reenacted and rewritten. As rewritten, the exemption applies to sales of paper, ink, and other tangible personal property to commercial printers and commercial publishers for use as ingredients or component parts of free distribution periodicals and sales by printers of free distribution periodicals to the publishers of these periodicals. A free distribution periodical is “a publication that is published on a periodic basis monthly or more frequently, is provided without charge to the recipient, and is distributed in any manner other than by mail.”

(Effective July 1, 2005; HB 1414, s. 32B.4, S.L. 04-124.)

Sales to an interstate air business – (45a). This new exemption provides that sales to an interstate air business of tangible personal property that becomes a component part of or is dispensed as a lubricant into commercial aircraft during their maintenance, repair, or overhaul are not subject to the sales or use tax. The term “commercial aircraft” includes only aircraft that have a certified maximum take-off weight of more than 12,500 pounds and are regularly used to carry for compensation passengers, commercial freight, or individually addressed letters and packages.

(Effective October 1, 2004; HB 1414, s. 32B.2, S.L. 04-124.)

Delivery charges for direct mail – (49a). This new exemption provides that delivery charges for delivery of direct mail are not subject to the sales or use tax if the charges are separately stated on an invoice or similar billing document given to the purchaser. Delivery charges for delivery of other taxable tangible personal property continue to be subject to the applicable tax.

(Effective October 1, 2004; HB 1414, s. 32B.2, S.L. 04-124.)

Vending Items - (50). This exemption was rewritten by the 2003 General Assembly. Until January 1, 2004, fifty percent (50%) of the sales price of tangible personal property sold through vending machines except for closed container soft drinks and tobacco products was taxable; one hundred percent (100%) of the sales price of tobacco products and closed container soft drinks was taxable. Effective January 1, 2004, the partial exemption includes closed container soft drinks; therefore, only fifty percent (50%) of the sales price of closed container soft drinks sold through vending machines is taxable.

(Effective January 1, 2004; HB 397, s. 45.5A, S.L. 03-284.)

*State agencies - (52)*. The 2003 General Assembly added this exemption to provide that items subject to sales tax under G.S. 105-164.4, excluding electricity and telecommunications service, sold to State agencies are not subject to tax at the time of purchase. The exemption was effective for sales made on or after July 1, 2004. State agencies are required to secure an exemption number from the Department and provide the number to vendors in order to exempt a sale from tax. The exemption does not apply to purchases made by contractors in connection with performance contracts entered into with State agencies.

(Effective July 1, 2004; SB 100, s. 1, S.L.03-431.)

*Custom aerial survey data – (53)*. This new exemption provides that sales to a professional land surveyor of tangible personal property on which custom aerial survey data is stored in digital form or is depicted in graphic form are not subject to the sales or use tax. Custom data is data created to the specifications of the professional land surveyor purchasing the property. A professional land surveyor is a person licensed as a surveyor under Chapter 89C of the North Carolina General Statutes.

(Effective October 1, 2004; HB 1414, s. 32B.2, S.L. 04-124.)

**G.S. 105-164.13B – Basis for Exempting Food:** This section was rewritten by the 2003 General Assembly and changed the basis for exempting food from State sales or use tax. Although most of the changes were effective during 2003, subdivision (a)(6) was repealed effective January 1, 2004. As a result, effective January 1, 2004, all candy is exempt from the State tax and subject to only the 2% local tax.

(Effective January 1, 2004; HB 397, s. 45.6B, S.L. 03-284.)

**G.S. 105-164.14(j) – Refunds to Certain Industrial Facilities:** This subsection was rewritten to provide that, in order to qualify for an annual refund, the owner of the eligible facility must invest the required amount of private funds to construct a facility in this State. For purposes of the refund, costs of construction may include costs of acquiring and improving land for the facility and costs of equipment for the facility. The required amount of the investment is \$50,000,000 if the facility is located in an enterprise tier one, two, or three area. For all other facilities, the required amount is \$100,000,000.

It also adds four types of industries, all of which are defined in the statute, to the list of eligible facilities to which the refund provision applies. Aircraft manufacturing, computer manufacturing, motor vehicle manufacturing, and semiconductor manufacturing will be eligible for annual refunds if all eligibility conditions are met.



(Amendments regarding investment amounts and explanation of construction costs effective January 1, 2004 for sales made on or after that date; provision for four new eligible industries effective July 1, 2004 for sales made on or after that date and repealed effective July 1, 2009 for sales made on or after that date; HB 1414, s. 32B.1, S.L. 04-124.)

**G.S. 105-164.14(j) – Refunds to Certain Industrial Facilities:** This subsection was further amended to clarify that the refund provision applies only to building materials, building supplies, fixtures, and equipment installed in the construction of the facility and not for subsequent repair, renovation, or equipment replacement.

(Effective July 1, 2004 for sales made on or after that date; HB 1430, s. 5.1, S.L. 04-110.)

**G.S. 105-521 – Local Government Hold Harmless:** The hold harmless provision for local governments was extended. The original provisions required distributions on or before August 15, 2003 and August 15, 2004. As rewritten, the distributions will be made on or before August 15, 2003 and every August 15 through 2012. The requirement that the Secretary of Revenue report to the Revenue Laws Study Committee the amount distributed was extended until 2013.

(Effective July 1, 2004; HB 1414, s. 6.3, S.L. 04-124.)

**Chapter 122 of the 2004 Session Laws – Gaston County Temporary Sales Tax:** This act authorizes Gaston County to levy a temporary additional one-half percent local sales and use tax to be used only for economic development projects and tourism projects. The levy must be approved by the voters in an election to be held November 2, 2004.

Except as provided in this act, the adoption, levy, collection, administration, and repeal of the tax must be in accordance with Article 39 of Chapter 105. The tax does not apply to the sales price of food that is exempt from State tax under G.S. 105-164.13B. The tax will expire eight years after the effective date of its levy. The net proceeds of the additional Gaston County tax will be distributed to Gaston County monthly by the Department of Revenue. Gaston County will be required to distribute stipulated percentages of the net proceeds among the municipalities as set out in the act.

(Effective July 18, 2004; HB 1520, ss. 1 through 7, S.L. 04-122.)

**Chapter 123 of the 2004 Session Laws – Temporary Local Sales Tax for Beach Nourishment:** Subchapter VIII of Chapter 105 of the General Statutes was amended to add a new Article 45, Local Government Sales and Use Tax for Beach Nourishment, G.S. 105-525 through 105-531. The act authorizes the

board of commissioners of a coastal county to levy a temporary additional one percent local sales and use tax to be used only for beach nourishment.

Except as provided in the new Article, the adoption, levy, collection, administration, and repeal of the tax must be in accordance with Article 39 of Chapter 105. The tax does not apply to the sales price of food that is exempt from State tax under G.S. 105-164.13B. The tax will expire eight years after the effective date of its levy. The Department of Revenue must, on a monthly basis, distribute to each county levying the tax the net proceeds of the tax collected in that county under this Article. There is no provision for a county to share the proceeds with the municipalities in the county.

(Effective July 18, 2004; HB 142, ss. 1 through 3, S.L. 04-123.)

## **INSURANCE GROSS PREMIUMS TAX**

**G.S. 58-6-25 – Insurance Regulatory Charge; Conforming Change:** The percentage rate to be used in calculating the insurance regulatory charge under this statute is 5% for the 2004 calendar year. This charge is a percentage of gross premiums tax liability. Subsections (a) and (e) were amended to conform to changes in G.S. 105-228.5 that subject Article 65 corporations to the same rate of tax as other insurance contracts.

(2004 regulatory rate effective July 17, 2004; HB 1430, s. 3.1, S.L. 04-110; conforming change effective for taxable years beginning on or after January 1, 2004 and repealed for taxable years beginning on or after the January 1 immediately following the date the Commissioner of Insurance certifies to the Department of Revenue that there are no remaining Article 65 corporations offering medical service plans or hospital service plans; HB 397, s. 43.2, S.L. 03-284.)

**G.S. 105-228.5 – Tax Scope; Rate:** Subdivision (d)(5) of this section was rewritten to revise the scope and rate of tax with respect to Article 65 corporations. Effective for taxable years beginning on or after January 1, 2004, gross collections from membership dues received by Article 65 corporations are subject to the same tax rate as other insurance contracts. Therefore, the tax rate for Article 65 corporations increases from 1.1% to 1.9% for 2004.

Subsection (d)(6) was rewritten to decrease the tax rate applicable to HMOs from 1.1% to 1% for tax years beginning on or after January 1, 2004.

(Increase in the tax rate for Article 65 corporations effective for taxable years beginning on or after January 1, 2004 and repealed for taxable years beginning on or after the January 1 immediately following the date the Commissioner of Insurance certifies to the Department of Revenue that there are no remaining

Article 65 corporations offering medical service plans or hospital service plans; HB 397, s. 43.2, S.L. 03-284; decrease in the tax rate applicable to HMOs effective for tax years beginning on or after January 1, 2004; HB 748, s. 2, S.L. 01-489.)

## GENERAL ADMINISTRATION

### **G.S. 105-228.90(b)(1b) – Reference to the Internal Revenue Code Updated:**

This subdivision was amended to update the reference to the Internal Revenue Code from June 1, 2003 to May 1, 2004. As a result, the changes in the Military Family Relief Act of 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, and the Pension Funding Equity Act of 2004 have been adopted for North Carolina income tax purposes. Any amendments to the Internal Revenue Code enacted after June 1, 2003, that increase North Carolina taxable income for the 2003 taxable year become effective for taxable years beginning on or after January 1, 2004.

**Military Family Tax Relief Act of 2003:** One of the major provisions of the Military Family Tax Relief Act applies to certain members of the uniformed services or the Foreign Service of the United States and suspends the running of the five-year ownership and use test for purposes of determining whether the gain from the sale of a principal residence qualifies for exclusion under section 121 of the Code. The Act provides for a one-year period for eligible federal employees to claim refunds as a result of this provision that would otherwise be barred by the federal statute of limitations. Because North Carolina has its own stand-alone statute of limitations that would otherwise prohibit such refunds, the 2004 General Assembly enacted a similar exception to the State statute of limitations. Therefore, resulting State refund claims by eligible federal employees are considered timely if the claims are filed by November 11, 2004. The provision is effective for sales or exchanges occurring after May 6, 1997.

Another key provision of the Act is an above-the-line deduction for the travel expenses of members of the National Guard and Reserves. Under previous law, members could claim as itemized deductions their non-reimbursable expenses for transportation, meals, and lodging when they stay overnight for National Guard and Reserve meetings. However, the expenses were deductible only to the extent they exceeded 2% of adjusted gross income. The new provision allows an above-the-line deduction for the transportation, meals, and lodging expenses of members who travel more than 100 miles and stay overnight at National Guard and Reserve meetings.

### **Medicare Prescription Drug, Improvement, and Modernization Act of 2003:**

As part of this Act, Congress enacted Health Savings Accounts (HSAs) that allow a person to accumulate funds on a tax-preferred basis to pay for certain medical expenses. Contributions to the fund may be made by an employer, an eligible

individual, or both. The earnings in the fund grow tax free. Employer contributions to an HSA are excludable from gross income and contributions by an eligible individual are deductible in computing adjusted gross income.

Distributions from HSAs for qualified medical expenses are excluded from gross income, except for amounts distributed to pay most health insurance premiums. Distributions not spent on qualified medical expenses are included in gross income and subject to an additional 10% tax on the federal return.

**Pension Funding Equity Act of 2004:** This act changes the interest rate employers use to calculate their required pension contributions for their employees. The Act also provides temporary relief from additional contributions required of companies that have pension plans that are less than 90% funded, and allows multiemployer pension plans to defer for up to three years the amortization of part of the stock market losses that they incurred during the 2000 to 2002 period.

(Effective July 17, 2004; HB 1430, ss.1.1, 1.2, 1.3, and 1.4, S.L. 04-110.)

**G.S. 105-236.1(a) – Law Enforcement Officers:** This statute was amended to authorize the Secretary of Revenue to appoint up to eleven (11) employees of the Motor Fuels Tax Division as revenue law enforcement officers with respect to enforcing the motor fuel tax statutes only. Currently, the Motor Fuels Tax Division has five investigators. Those investigators must work in cooperation with SHP, Motor Vehicle Enforcement Administration officers. As revenue law enforcement officers, these investigators could work independently on a daily basis.

(Effective July 1, 2004, HB 1414, s. 23.4, S.L. 04-124.)

**G.S. 105-259(b) – Additional Authority to Disclose:** This subsection was rewritten by adding a new subdivision (30) authorizing the Department to publish the information required under new G.S. 105-129.54 and to prove that a business does not meet the definition of “small business” under Article 3F because the annual receipts of the business, combined with the annual receipts of all related persons, exceeds the applicable amount.

(Effective for business activities occurring on or after May 1, 2005; HB 1414, s. 32D.3, S.L. 04-124.)

**G.S. 105-259(b)(7) – Conforming:** This statute was amended to allow the Department to exchange tax information with the Division of Motor Vehicles of the Department of Transportation. This change was made necessary due to inadvertently removing this reference in prior year legislation.

(Effective August 2, 2004, SB 1145, s. 23, S.L. 04-170.)

## PROPERTY TAX

**G.S. 105-277.2(4)b – Present Use Value:** This statute is amended to allow land owned by a family business to obtain present use value when the land is not being actively farmed by the family business entity but is leased out to someone else to farm. The amendment adds the following language: “For the purpose of this sub-subdivision, the terms 'having as its principal business' and 'actively engaged in the business of the entity' include the leasing of the land for one of the activities described in subdivisions (1), (2), and (3) only if all members of the business entity are relatives.”

(Effective for taxable years beginning on or after July 1, 2004; HB 1465, ss. 1 and 2, S.L. 04-8.)

**G.S. 105-278.4 – Real and Personal Property Used for Educational Purposes:** This amendment exempts from property tax educational property held by a nonprofit entity for a public or private university or community college located in North Carolina. The ownership requirement is amended to include buildings and land owned by a nonprofit entity for the sole benefit of a constituent or affiliated institution of The University of North Carolina, an institution as defined in G.S. 116-22, a North Carolina community college, or a combination of these. This bill also amends the definition of educational purpose to include the operation of a student housing facility and a student dining facility.

(Effective for taxable years beginning on or after July 1, 2004, SB 277, ss. 1 and 2, S.L. 04-173.)

**G.S. 105-322(g) – Special Board of Equalization and Review:** This amendment allows Cabarrus County to appoint a special board of equalization and review. This amendment applies only to Cabarrus County.

(Effective July 15, 2004, SB 1315, ss. 1 through 4, S.L. 04 -100.)

**G.S.153A-15.1 – Reimbursement for Wetlands Mitigation:** This amendment adds a new section which requires state and local government agencies that acquire land for wetlands mitigation to reimburse the county in which the land is located for its lost property taxes due to the acquisition.

(Effective August 17, 2004; SB 933, ss. 1 through 7, S.L. 04-188.)

**G.S. 153A-143 – Monetary Compensation for Removal of Outdoor Advertising Signs:** This amendment adds a new section which requires local governments to pay monetary compensation for removal of lawfully erected off-premises outdoor advertising signs and to authorize local governments to enter into relocation and reconstruction agreements with owners of nonconforming off-premises outdoor advertising signs.

(Effective August 2, 2004; HB 1213, ss. 1 through 4, S.L. 04-152.)

**G.S. 161-31 – Tax Certification:** This amendment adds Edgecombe, Halifax, Lenoir, Nash, Pender, and Wilson counties to those counties authorized to use a tax certification process to assist in the collection of delinquent property taxes. This allows the board of commissioners of a county, by resolution, to require the register of deeds not to accept any deed transferring real property for registration unless the county tax collector has certified that no delinquent property taxes or other taxes the collector is charged with are a lien on the property described in the deed.

(Effective July 8, 2004; SB 1093, ss. 1 and 2, S.L. 04-65.)

## MOTOR FUELS TAX

**G.S. 105-449.47(a1) – Clarifying:** This statute was amended to clarify that identification markers must be reissued each year.

(Effective August 2, 2004, SB 1145, s. 24, S.L. 04-170.)

**G.S. 105-449.52(a) – Clarifying:** This statute was amended to clarify that motor carrier is subject to a civil penalty for failure to carry a registration card or failure to display an identification marker. This statute was further amended to allow payment of certain civil penalties to be made to the Department of Crime Control and Public Safety. This change was made necessary with the reorganization of the Department of Transportation, Division of Motor Vehicles section.

(Effective August 2, 2004, SB 1145, s. 25, S.L. 04-170.)

**G.S. 105-449.54 – Simplification:** This statute was amended to simplify the verbiage of the process agent statute.

(Effective August 2, 2004; SB 1145, s. 26, S.L. 04-170.)

**G.S. 105-449.60(7) – Clarifying:** This statute was amended to clarify the diesel fuel definition to include biodiesel, soy oil, heating oil, high-sulfur dyed diesel fuel, and kerosene.

(Effective August 2, 2004, SB 1145, s. 27, S.L. 04-170.)

**G.S. 105-449.72(a) – Clarifying:** This statute was amended to clarify that acceptance of an irrevocable letter of credit is conditional in the same manner as a surety bond.

(Effective August 2, 2004, SB 1145, s. 28, S.L. 04-170.)

**G.S. 105-449.74 – Clarifying:** This statute was amended to clarify that the Department will issue one license to each licensee. The licensee will be responsible for making the necessary copies for each business location. Currently the Department is supposed to issue a duplicate license for each business location.

(Effective August 2, 2004, SB 1145, s.29, S.L. 04-170.)

**G.S. 105-449.81(3a) – Clarifying:** This statute was amended to remove the term “fuel grade alcohol” and include “fuel alcohol” and biodiesel. Fuel alcohol is currently defined by statute.

(Effective August 2, 2004, SB 1145, s. 30, S.L. 04-170.)

**G.S. 105-449.123 – Clarifying:** This statute was amended to include biodiesel and kerosene in the marking requirements for dyed fuel. Dyed diesel fuel was replaced with dyed motor fuel, which will represent all dyed products.

(Effective August 2, 2004, SB 1145, s. 31, S.L. 04-170.)

**G.S. 105-449.125 – Distribution of Tax Revenue Among Various Funds:** This statute was amended to increase the allocation percentage of excise tax revenue, to the Leaking Underground Storage Tank (L.U.S.T.) Cleanup Funds, from 0.5¢ to 1.1¢. The statute further provided for a change in the percentage of allocation to the individual L.U.S.T. fund. The statute provided for a lump-sum, up-front payment of \$19,000,000 in the month of October. Each month, thereafter, the monthly allocation to the L.U.S.T. fund will be reduced by the calculated apportioned overpayment that occurred during the month of October. This statute is in effect for fiscal year ending 2004-05 only.

(Effective July 1, 2004, HB 1414, s.30.10, S.L. 04-124.)

**Session Law Chapter 124 – Revenue Tax Evasion Project: Section:** The Continuation, Capital and Expansion Budgets authorized funding for 10 motor fuels positions to investigate and collect delinquent motor fuels taxes. Funding was also provided for an electronic tracking system that will accept returns filed through EDI and the Internet, cross-match data from various returns, and allow query-capability on all data for audit purposes.

## DEBT SETOFF

**G.S. 105A-2(6) and (9)b – Definitions Expanded and Revised:** The definition of a “Local Agency” has been expanded to include a “regional joint agency,” created by interlocal agreement under Article 20 of Chapter 160A of the General Statutes between two or more counties, cities, or both.

Previously, the definition of a “State agency” was any of the following: (a) A unit of the executive, legislative, or judicial branch of State government and (b) A county, to the extent it administers a program supervised by the Department of Health and Human Services or it operates a Child Support Enforcement Program. In (b), the term “county” has been deleted and replaced with “local agency.”

(Effective January 1, 2004, and applies to income tax refunds determined on or after that date; HB 1420, s. 1, S.L. 04-138.)

**G.S. 105A-13(a) – Collection Assistance Fee Decreased:** This subsection was amended to impose a flat collection assistance fee of \$5 for each debt collected through setoff. The subsection was also amended to delete the provision that required the Department of Revenue to set the amount of the collection assistance fee based on the actual cost of collection (\$15 maximum) for the immediately preceding year.

(Effective for fees assessed on or after January 1, 2005; HB 1497, ss. 1 and 2, S.L. 04-21.)

## PROFESSIONAL EMPLOYER ORGANIZATIONS

### Chapter 58, Article 89

This Article was rewritten to require Professional Employer Organizations (PEO) to be licensed in order to do business in this State. PEOs offer professional employer services to contracts with clients by assigning workers to the clients for assignments that are intended to be of a long-term or continuing nature. The contract does not include employment of a temporary nature. The employment responsibilities are shared between the PEO and the client. Because of the shared employment responsibilities, the Article was also rewritten to address how the contract affects PEOs and clients for tax purposes.

**G.S. 58-89-31 – Tax Credits and Other Incentives:** This section provides that the client is considered the employer of the assigned employees for purposes of tax credits and other incentives offered by the State based on employment. The PEO must provide to the client any information necessary for the client to be able to claim and substantiate the tax credit or incentive.

**G.S. 58-89-120 – Payroll Taxes:** This section provides that the PEO is the employer of an assigned employee for purposes of Chapter 105 of the General Statutes.



(Effective January 1, 2005, and applies to any contracts entered into, any business conducted, and any actions taken on or after that date; SB 20, s. 1, S.L. 04-162)

## **JOB DEVELOPMENT INVESTMENT GRANT PROGRAM**

### **G.S. 143B, Article 10, Part 2F – Job Development Investment Grant**

**Program:** The 2002 General Assembly created a new economic development tool for new and expanding businesses in North Carolina called the Job Development Investment Grant Program (JDIG). The purpose of the program is to attract businesses to the State by allowing a five-member committee to award grants to businesses. The Secretary of Revenue is a member of the Committee. The amount of the grant is based on the income tax withholdings from new jobs created by a business. No grant amount may be disbursed until the Secretary of Revenue has certified to the Committee the amount of income tax withheld by the business from the wages of employees in eligible positions and that the business has no outstanding overdue tax debts.

The 2004 General Assembly amended JDIG to extend the authority of the Committee to enter into new agreements until January 1, 2006 (was January 1, 2005); to increase the maximum number of agreements the Committee may enter into each calendar year from 15 to 25; to increase the maximum total annual liability for grant agreements entered into in any single calendar year from \$10 million to \$15 million; to provide that by March 1 of each year (was February 1) every business that is awarded a JDIG grant must submit a report showing withholdings as a condition of its continuation in the grant program; to provide that payroll and tax information submitted to the Committee is subject to the secrecy provisions in G.S. 105-259; to provide that an agreement is a binding obligation of the State and is not subject to State funds being appropriated by the General Assembly; and to include a provision requiring that the terms of the agreement include a provision encouraging the business to contract with small businesses headquartered in the State for goods and services.

(JDIG originally effective January 1, 2003; HB 1734, S.L. 2002-172; amendment to change reporting date and to make agreements binding on state effective October 31, 2002; amendment to increase maximum grant to \$15 million effective for agreements entered into on or after January 1, 2004; remaining amendments effective July 20, 2004, HB 1414, s 32G.1.(a) through (g), S.L. 04-124.)