

North Carolina

Supplement to 2003
Tax Law Changes

**Extra Session on Economic
Development Incentives**

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 tax law changes enacted by the 2003 Extra Session on Economic Development Incentives. This document is a supplement to the North Carolina 2003 Tax Law Changes document previously published by the Department of Revenue.

The changes are listed by type of tax. The order of the tax types is their order in the General Statutes. Within a tax type, the changes are listed in numerical order.

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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TAX INCENTIVES FOR NEW AND EXPANDING BUSINESSES

Article 3A

G.S. 105-129.2(8a) – Definition of Eligible Major Industry: This section was amended to add a new subsection (8a) to define an eligible major industry. 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.

(Effective for taxable years beginning on or after January 1, 2004; HB 2, s. 3.1, S.L. 03-435 [second extra session].)

G.S. 105-129.2A(a2) – 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. 105-129.4(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(d) – Forfeiture of Eligible Major Industry Credits: This subsection was amended to provide that a taxpayer forfeits all credits allowed that it would not have been eligible for if it were not an eligible major industry if it 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. 105-129.8(d) - Time Period to Create New Jobs Under Letter of Commitment Extended for Eligible Major Industries: This subsection was amended to allow eligible major industries seven years to create at least twenty new jobs to qualify for the credit based on 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. 3.6, S.L. 03-435 [second extra session].)

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 for the credit based on 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].)

CORPORATE INCOME TAX

G.S. 105-130.45 – Credit for Manufacturing Cigarettes for Exportation Extended; Substantive, Clarifying, and Technical Changes: Section 10 of Session Laws 1999-333 was amended to extend the sunset of the credit for manufacturing cigarettes for exportation to cigarettes exported on or after January 1, 2018. The credit was scheduled to sunset for cigarettes exported on or after January 1, 2005.

Substantive changes were made to subsection (a) of this statute. The definition of base year exportation volume in subdivision (1) was amended from 1998 to 2003 so that future tax credits are based on the increase in a year's exportation volume as compared to the exportation volume in 2003. The definition of exportation in subdivision (2) was amended 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. Subdivision (3) was added to provide a definition for successor in business. A successor in business is a corporation that through amalgamation, merger, acquisition, consolidation, or other legal succession becomes invested with the rights and assumes the burdens of the predecessor corporation and continues the cigarette exportation business.

Substantive and clarifying changes were made to subsection (b). The first substantive change imposes an additional requirement on a cigarette exporter to be eligible to claim the credit. In addition to exporting a volume of cigarettes in excess of the volume of cigarettes exported in the base year, the corporation must also use the North Carolina state ports during the taxable year to export cigarettes. The law does not identify a specific quantity of cigarettes that must be exported through the ports nor is the credit limited to the volume of cigarettes exported through the ports. Another substantive change addresses the case of a successor in business. To determine the applicable credit percentage, a successor in business compares its exportation volume in the current year with the combined exportation volume of the corporation and all of its predecessors in the base year. The clarifying change clarifies that the maximum allowable credit for cigarettes exported during a tax year is six million dollars, before applying the tax limitations provided for in subsection (c).

A technical change was made to subsection (d). Subdivision (3) was amended to reflect the name change of the former Bureau of Alcohol, Tobacco, and Firearms. The agency's new name is the Alcohol and Tobacco Tax and Trade Bureau.

The final substantive change to G.S. 105-130.45 was the enactment of subsection (e). This new section prohibits a taxpayer from claiming this credit and the new credit allowed under G.S. 105-130.46 for the same activity.

(Extension of sunset of credit effective December 16, 2003; HB 2, s. 5.1; changes to subdivision (a)(1) and subsections (b) and (d) and enactment of subdivision (a)(3) and subsection (e) effective for taxable years beginning on or after January 1, 2005; HB 2, s. 5.2; change to subdivision (a)(2) 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 – New Credit for Manufacturing Cigarettes for Exportation While Increasing Employment and Utilizing State Ports: Part 1 of Article 4 was amended to enact a new tax credit for manufacturing cigarettes for exportation. This credit is similar to the credit allowed under G.S. 105-130.45 in most respects. However, this credit differs from the credit in G.S. 105-130.45 in three major respects. First, to be eligible for this credit, a taxpayer must maintain an employment level in this State at the end of a taxable year that exceeds the

taxpayer's employment level in this State at the end of the 2004 calendar year by at least 800 full-time jobs. Second, the maximum eligible credit for cigarettes exported during a taxable year is ten million dollars. Third, this credit may be claimed against either franchise tax or income tax.

Subsection (a) explains the purpose of this credit.

Subsection (b) provides definitions for employment level, exportation, full-time job, and successor in business. Employment level is defined as the total number of full-time jobs and part-time jobs converted into full-time equivalents. Exportation has the same meaning as in G.S. 105-130.45 prior to the change to subdivision (a)(2) described above. Therefore, a foreign country is a qualifying exportation destination but a possession of the United States and a commonwealth of the United States that is not a state are not. A full-time job is a position that requires at least 1,600 hours of work per year and is intended to be held by one employee during the entire year. A successor in business has the same definition as in G.S. 105-130.45(a)(3) described above.

Subsection (c) addresses the employment level requirements to claim the credit. To first be eligible for a credit under this section, a taxpayer must have at least 800 more full-time jobs in this State at the end of the taxable year than the taxpayer had in this State on December 31, 2004. The taxpayer is eligible for full credits under this section in future years if the taxpayer maintains an employment level in this State at the end of the taxable year that exceeds the employment level in this State on December 31, 2004 by 800 or more employees. A successor in business's employment level is compared to the combined employment level of the successor and all of its predecessors. A job is located in this State if more than 50% of the employee's duties are performed in this State.

Subsection (d) provides three requirements to qualify for a credit under this section. Those three requirements are:

- (i) the corporation satisfies the employment level requirements in subsection (b);
- (ii) the corporation is engaged in the business of manufacturing cigarettes for export; and
- (iii) the taxpayer exports cigarettes and other tobacco products through the North Carolina state ports during the taxable year.

A corporation that meets all three requirements is entitled to a credit equal to 40 cents per one thousand cigarettes exported. The maximum credit for cigarettes exported during the taxable year is ten million dollars.

Subsection (e) provides for a reduction in the credit in subsequent years if a taxpayer that has previously satisfied the employment level requirements in subsection (b) fails to satisfy the employment level requirements in the subsequent year. The reduced credit is calculated by multiplying the credit that would have been allowed if the employment level in this State had been

maintained by a fraction. The numerator of the fraction is the number of full-time jobs by which the taxpayer's employment level in this State exceeds the employment level in this State in 2004 and the denominator of the fraction is 800.

Subsection (f) provides for allocation of the credit against corporate income tax and franchise tax. At the time the taxpayer files the return on which the credit is claimed, the taxpayer elects the percentage of the credit to be applied against each of the two taxes. That election is binding for that year and for all carryforwards of that credit. The taxpayer can elect a different percentage for each year in which it qualifies for the credit.

Subsection (g) provides that the amount of credit that may be taken in a taxable year is limited to the lesser of ten million dollars or fifty percent of the amount of tax against which the credit is taken reduced by the sum of all other credits against the tax except tax payments made by or on behalf of the taxpayer. The limitation applies to the cumulative amount of credit allowed, including carryforwards of this credit or the credit claimed under G.S. 105-130.45 for previous years.

Subsection (h) provides for a ten-year carryforward of any unused portion of this credit. The carryforward must be claimed against the tax against which the credit was originally claimed. A successor in business is entitled to claim carryforwards of credits originally claimed by predecessor corporations.

Subsection (i) requires a taxpayer that claims this credit to include with its tax return the following information:

- (i) A statement of the exportation volume on which the credit is based.
- (ii) A list of the monthly export volumes reported to the Alcohol and Tobacco Tax and Trade Bureau of the United States Treasury for the year in which the credit is claimed.
- (iii) Any other information required by the Department of Revenue.

Subsection (j) prohibits the taxpayer from claiming both this credit and the credit under G.S. 105-130.45 for the same activity.

Subsection (k) requires a corporation that takes this credit to file annual reports with the Senate and House Appropriations and Finance Committees and the Fiscal Research Division of the General Assembly by May 1 of each year. The report must state the amount of credit earned by the corporation during the previous year, the amount of credit, including carryforwards, claimed by the corporation during the previous year, and the percentage of domestic leaf content in cigarettes produced by the corporation during the previous year. The first reports are due by May 1, 2006.

(Effective for taxable years beginning on or after January 1, 2006, and expires for exports occurring on or after January 1, 2018; HB 2, s. 6.1, S.L. 03-435 [second extra session].)

SALES AND USE TAX

G.S. 105-164.14(j) – Refunds for Major Industrial Facilities: The General Assembly enacted this subsection to allow an annual refund to an eligible facility of sales and use taxes paid by it on building materials, building supplies, fixtures, and equipment that become a part of the real property of the eligible facility. Liability incurred indirectly on these items is considered tax paid by the owner of the eligible facility. The refund provisions apply to State and local sales or use taxes paid.

An eligible facility is a taxpayer that is primarily engaged in one of the qualifying industries listed herein and has been certified by the Secretary of Commerce that the owner of the facility will invest at least one hundred million dollars (\$100,000,000) of private funds to acquire, construct, and equip the facility in North Carolina.

For purposes of this refund provision, qualifying industries are:

- a. Bioprocessing. Bioprocessing means biomanufacturing or processing that includes the culture of cells to make commercial products, the purification of biomolecules from cells, or the use of these molecules in manufacturing.
- b. Pharmaceutical and medicine manufacturing and distribution of pharmaceuticals and medicines. Pharmaceutical and medicine manufacturing means any of the following:
 1. Manufacturing biological products (preparations that are synthesized from living organisms or their products and used medically as diagnostic, preventive, or therapeutic agents) and medical products.
 2. Processing botanical drugs and herbs by grading, grinding, and milling.
 3. Isolating active medicinal principals from botanical drugs and herbs.
 4. Manufacturing pharmaceutical products intended for internal and external consumption in forms such as ampoules, tablets, capsules, vials, ointments, powders, solutions, and suspensions.

An annual claim for refund is due within six months after the end of the State's fiscal year for taxes paid during the State's fiscal year. Refunds applied for after the due date are barred. Form E-588, Business Claim for Refund State and County Sales and Use Tax, is the form to be used in claiming this refund.

If the owner of an eligible facility does not make the required minimum investment within five years after the first refund with respect to the facility, the facility loses its eligibility and the owner forfeits all refunds received under G.S. 105-164.14(j). Upon forfeiture, an owner is liable for the amount of tax that was refunded plus applicable interest from the date each refund was issued.

(Effective January 1, 2004, and applies to sales made on or after that date; HB 2, s. 4.1, S.L. 03-435 [second extra session].)