



HOUSE BILL 117: NC Competes Act

**This Bill Analysis
reflects the contents
of the bill as it was
presented in
committee.**

2015-2016 General Assembly

Committee:		Date:	September 18, 2015
Introduced by:	Reps. S. Martin, Jeter, Collins, Steinburg	Prepared by:	Cindy Avrette
Analysis of:	Conference Report		Committee Counsel

SUMMARY: *The Proposed Conference Committee Substitute for House Bill 117 does the following:*

- **Part I: JDIG Modifications.** – *No changes from the Sixth Edition. The bill would extend the program, increase the amount that may be committed as grants under the program, provide additional commitment for a high yield projects, and make other changes to the program.*
- **Part II: One NC.** – *No changes from the Sixth Edition. The bill would modify the local match requirements.*
- **Part III¹: Datacenter Infrastructure Act.** – *The CCS would change the effective date from October 1, 2015, to January 1, 2016. The bill would provide a sales tax exemption for qualifying datacenters, as included in House Bill 117, Sixth Edition, and as included in House Bill 97, Fifth Edition.*
- **Part IV: Sales Tax Relative to Aviation.** – *The CCS adds a provision in Section 4.1(e) to address the sunset of the current sales tax refund provision for interstate passenger air carriers. The remaining provisions are the same as in HB 117, Sixth Edition. Effective January 1, 2016, the bill would exempt from sales tax fuel sold to an interstate air business for use in a commercial aircraft; tax remaining sales of aviation gasoline and jet fuel at 7%; and earmark the revenue from the tax to the Division of Aviation, Department of Transportation. The CCS does not change the sales tax rate on boats. Effective October 1, 2015, the bill would increase the sales tax rate on aircraft and tax qualified jet engines at 4.75% with a maximum tax of \$2,500 and exempt service contracts and repairs, maintenance, and installation services on qualified aircraft and qualified jet engines from sales tax.*
- **Part V: Exempt Motor Vehicle Service Contracts from Sales Tax.** – *New to the CCS. This Part would exempt service contracts on motor vehicles from sales tax. As part of the budget bill, S.L. 2015-241 (H97), sales tax is imposed on repair, maintenance, and installation services. The taxation of this service mitigates the need to impose the tax on service contracts and eases the administrative issues associated with the sales tax on service contracts for motor vehicles.*
- **Part VI²: Extend Sales Tax Preference for Motorsports Parts and Fuel.** – *New to CCS; originally in Senate Bill 605 and House Bill 97, 5th edition. This Part would codify current*

¹ Part III of the last version of the bill, Sixth Edition Engrossed, has been removed because its contents (Phase-In Single Sales Factor Apportionment) has been enacted in HB 97, the budget bill.

² Part VI of the last version of the bill, Sixth Edition Engrossed, has been removed because the issue it concerned (Sales Tax for Local Governments) was addressed in HB 97, the budget bill.

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practice and extend the current sales tax preferences for motorsports from January 1, 2016, to January 1, 2020.

- ***Part VII: Tax Compliance and Tax Fraud Prevention.*** – *New to CCS; originally in Senate Bill 605. This Part would make enhance reporting requirements to the Department of Revenue. The Department will be able to use the additional information to enhance tax compliance efforts through the use of GDAC and to more effectively monitor and detect tax fraud.*

PART I. JDIG MODIFICATIONS

JDIG is a discretionary program of the State that provides funds to incentivize new or expanding business to create jobs in the State. The amount that can be committed in JDIG grants has statutorily been capped at \$15M per calendar year. Under current law, the period is not based on the calendar year but was based on the 2013-15 biennium (with a \$22.5M cap) and a half-year period of 7/1/15 through 12/31/15 (with a \$7.5M cap).

Regarding commitment availability, the bill would (i) collapse the prior biennium with the current half-year period, (ii) add \$5M of additional capacity for the current period (iii) increase the calendar year statutory cap from \$15M to \$20M on an on-going basis, and (iv) extend the program three years, allowing JDIG commitments through 1/1/19.

The amount a business receives via JDIG would be changed two ways: (i) the JDIG award calculation is changed from a flat 10-75% the personal income tax withholdings generated by the eligible created positions to a tiered maximum percentage of withholdings (80% of withholdings if the project is in Tier 1 and 75% for all other areas and (ii) the portion of the award diverted to the Utility Account³ in tier 2 areas is changed from 15% to 10%.

Minimum criteria for participation in the program would be increased. Job creation requirements would increase from 20 jobs to 50 jobs for tier 3.

The bill would create a component for recruitment of megasites or high-yield projects where a business invests at least \$550M and creates at least 1,750 jobs. Programmatically, when a high-yield project is landed, the annual JDIG commitment cap for that year increases from \$20M to \$35M. If the business meets the job creation and investment requirement and meets all performance metrics for three consecutive years, the business' JDIG award is augmented 3 ways: (a) the basis for calculating the award increases to 100% of the withholdings associated with the created, eligible positions; (b) up to 8 years is added to the 12-year term limitation; and (c) any UA diversion is eliminated. In the event the high-yield project fails to meet performance metrics after receiving the augmented award in any year, the augmented benefits expire and the company cannot, thereafter, regain the augmented benefits.

The bill would address concerns that Commerce consumed JDIG availability too quickly each calendar year by splitting the single year \$20M basis for commitment caps into 2 equal semiannual installments of \$10M. Within the calendar year, amounts not utilized in a period roll over to the next period.

Final miscellaneous changes to JDIG include (i) adding a pre-requisite finding that the local has appropriately participated in recruit efforts and in incentives offered; (ii) strengthening the recapture provision for failure to maintain operations for 150% of the grant term; (iii) modifying the relevant time

³ Utility account is used to assist local governments in tier 1 and 2 counties to create jobs. Can be used for construction of/improvement to new/existing water, sewer, gas, telecom, high-speed broadband, electrical utility distribution lines/equipment, transportation infrastructure for existing/new/proposed buildings. No local match for top 25 most economically distressed counties. 25% match for remainder of eligible counties.

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period against which increases in employment are measured;⁴ and (iv) adding to the annual reporting requirement a tier-itemized listing of unaccepted offers and their aggregate value and adding a single-time report requiring the Department to study factors contributing to grant termination in view of other states' efforts with the goal of identifying ways to decrease the incidence of terminations.

PART II. ONE NC MODIFICATIONS

The One NC fund is a discretionary fund by the State to provide money to locals to secure commitments for recruitment, expansion, or retention of new or existing businesses. Part 2 of the bill would modify the local match requirement of the One NC Fund to a tiered requirement: 3 State dollars for 1 local dollar for tier 1, 2 State dollars for 1 local dollar for tier 2, and an even local match for tier 3.

PART III. DATACENTER INFRASTRUCTURE ACT

Under current law, an eligible Internet datacenter may receive a sales tax exemption for electricity and certain business property that is located and used at the datacenter. An eligible Internet datacenter is one that is used primarily by a business engaged in software publishing or an Internet activity, that is comprised of structures located on contiguous parcels of land that are commonly owned by the operator of the facility, is located in a development tier one or two area, and has a written determination provided by the Secretary of Commerce that at least \$250 million in private funds has been or will be invested in the property. To be eligible for the exemption, the business property must be capitalized for tax purposes under the Code and must be used for the provision of services related to the business of the primary user of the datacenter; used for the generation, transmission, transformation, distribution, or management of electricity; or used to provide related computer engineering or computer science research.

There were two other tax benefits available to certain datacenters, but those benefits have expired.⁵

Section 3 would create a similar, but not identical, sales tax exemption for datacenter equipment and electricity. There are slight differences in the requirements that would need to be met to qualify for the exemption, and there appears to be more flexibility in the types of business property that would qualify for the sales tax exemption. To qualify for the sales tax exemption, the taxpayer would need to meet wage standard and health insurance requirements, and would need to have a written certification from the Secretary of Commerce that at least \$75 million in private funds has been or will be invested by one or more owners, users, or tenants of the datacenter within five years of the date the initial investment is made. Initial investments made on or after January 1, 2012, may be included to meet the investment threshold. This section becomes effective for purchases made on or after January 1, 2016.

PART IV. SALES TAX RELATIVE TO AVIATION

Part IV addresses several sales tax issues related to aviation.

Expiring sales tax refund for interstate passenger air carrier with a hub in NC

An interstate passenger air carrier with a hub in the State is allowed a sales tax refund of State and local sales tax paid on fuel in excess of \$2.5 million. The General Assembly enacted the refund provision in 2004, effective January 1, 2005, with a sunset that has been extended several times. The refund tax benefit is repealed for purchases made on or after January 1, 2016. Section 4.1(e) would make an adjustment to the amount of sales tax paid on fuel by an interstate passenger air carrier to qualify for the

⁴ Under current law, the business must maintain employment levels at the level of the year immediately preceding the base period. The bill would change the relevant comparison point for employment levels from immediately preceding the base period to the greater of the employment levels at the date of application or date of award.

⁵ G.S. 105-164.14A(a)(3) provided a sales tax refund for information technology companies in a tier one area for machinery and equipment. This preference expired January 1, 2014. G.S. 105-187.51C imposed a 1% excise tax, in lieu of a State and local sales tax, on certain equipment and machinery. This preference expired July 1, 2015.

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refund so that the amount corresponds with the refund period. The amount of the tax that must be remitted before the refund provision applies is for a 12-month period. The refund provision expires January 1, 2016, thus creating a 6-month refund period.

Section 4.1(c) would address the expiration of the sales tax refund by exempting aviation gasoline and jet fuel sold to an interstate air business for use in a commercial aircraft. The exemption is effective for sales made on or after January 1, 2016. It expires for sales made on or after January 1, 2020.

The exemption is broader than the current refund provision; it is available to all interstate air businesses at all airports in the State. The exemption provided in this bill for fuel mirrors the existing sales tax exemption for tangible personal property sold to an interstate air business that becomes a component part of a commercial aircraft during its maintenance, repair, or overhaul. For purposes of these two exemptions, a commercial aircraft is defined as one that has a certified maximum take-off weight of more than 12,500 pounds and is regularly used to carry for compensation passengers, commercial freight, or individual addressed letters and packages. An interstate air business is one or more of the following:

- An interstate air courier. – A person whose primary business is the furnishing of air delivery of individually addressed letters and packages for compensation, in interstate commerce, except by the United States Postal Service.
- An interstate freight air carrier. – 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.
- An interstate passenger air carrier. – A person whose primary business is scheduled passenger air transportation, as defined in the North American Industry Classification System adopted by the United States Office of Management and Budget, in interstate commerce. Charter flights, by definition, do not appear to be an interstate passenger air carrier.

FAA policy that revenue from tax on aviation fuel must be used for aviation purposes

On November 7, 2014, the Federal Aviation Administration (FAA) adopted an amendment to its policy on Federal requirements for the use of proceeds from taxes on aviation fuel.⁶ The action confirmed the FAA's long-standing policy that airport operators that have accepted Federal assistance generally may use airport revenue only for airport related purposes.⁷ Failure to do so could result in a loss of federal funds. States must have an action plan as to how it plans to comply with the FAA policy by December 8, 2015; and the State must be in compliance with the policy by December 8, 2017.

North Carolina has included fuel in its State and local sales and use tax base for decades without restricting its use to aviation purposes. Of the State sales tax rate of 4.75%, 3% is grandfathered but the remaining 1.75% must be in compliance with the FAA policy. Of the local sales tax rate, 2% is grandfathered but any local option sales taxes imposed since 1987 are not. Rather than trying to administratively account for the tax revenue derived from the grandfathered rates and the revenue derived from the remainder of the sales tax levies, this section simplifies the process by imposing the combined general rate of sales tax on aviation gasoline and jet fuel⁸ and using all of the proceeds from the tax for aviation purposes. Most of the sales tax on aviation gasoline and jet fuel is attributable to

⁶ Federal Register at 64 FR 7696 on February 16, 1999 ("Revenue Use Policy")

⁷ Taxes enacted prior to 1987 are grandfathered and are not subject to the use restriction.

⁸ Section 5.1(b) would impose the combined general rate of tax on the gross receipts derived from aviation gasoline and jet fuel. The combined general rate of 7% is the general rate (4.75%) plus the highest authorized local option sales tax rate available to all counties (2.25%).

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purchases made by interstate air businesses, and those purchases would be exempt from sales tax under Section 4(c).

This change means there will not be a local tax rate on aviation gasoline and jet fuel.⁹ All of the revenue derived from the sales tax on aviation gasoline and jet fuel must be transferred to the Highway Fund within 75 days after the end of the fiscal year and is appropriated to the Division of Aviation of the Department of Transportation for prioritized capital improvements to public airports and time-sensitive aviation capital improvement projects for economic development purposes. This change becomes effective January 1, 2016.

Sales tax exemptions for qualified aircraft and qualified jet engines

S.L. 2013-316 expanded the sales tax base to include the sales price of a service contract. A service contract is defined as a warranty agreement, a maintenance agreement, a repair contract, or a similar agreement or contract by which the seller agrees to maintain or repair tangible personal property. Service contracts on the following items are exempt:

- An item exempt from tax under the sales tax Article, other than a motor vehicle exempt from tax.
- A transmission, distribution, or other network asset contained on utility-owned land, right-of-way, or easement.
- An item purchased by a professional motorsports racing team for which the team may receive a sales tax refund under G.S. 105-164.14A(5).
- An item subject to tax under Article 5F of Chapter 105 of the General Statutes

Section 4.2(c) would exempt from sales tax service contracts on a qualified aircraft or qualified jet engine, and also from sales tax on repairs parts and repair, maintenance, and installation services. A qualified aircraft is defined as an aircraft with a maximum take-off weight of more than 9,000 pounds but not in excess of 15,000 pounds; a qualified jet engine is an engine certified under Part 33 of Title 14 of the Code of Federal Regulations. In addition, Section 4.2(d) would exempt parts and accessories for use in the repair or maintenance of a qualified aircraft or a qualified jet engine.

This section becomes effective October 1, 2015. Both the House and the Senate budgets (HB 97, V4 and V7) provided an exemption for service contracts

Sales tax rate and cap on boats, aircraft, and qualified jet engines

The State sales tax rate on boats and aircraft is 3%, with a cap of \$1,500. There is no local sales tax on boats or aircraft. Section 4.2(b) would increase the rate on aircraft to the general rate, which is currently 4.75%. It would also increase the cap on the sales tax on aircraft to \$2,500. Section 4.2(f) is a conforming change to remove aircraft from the local sales tax base, even though they would be subject to the State general rate. It also removes qualified jet engines from the local sales tax base.

Under the Streamlined Sales Tax Agreement, a taxing jurisdiction must have uniform tax rates and may not have caps or thresholds. Aircraft and boats are two exceptions to that provision. A qualified jet engine does not fall within one of the exceptions. To afford similar tax treatment for qualified aircraft and qualified jet engines, Section 4.2(e) would allow the purchaser of a qualified jet engine to pay the use tax through a direct pay permit in lieu of the sales tax, and provide that the maximum use tax would be \$2,500.

⁹ Under the Streamlined Sales Tax Agreement, the tax base must be uniform in the taxing jurisdiction. To maintain a local uniform tax base, and meet the FAA use restrictions, would be administratively difficult. There is also some uncertainty how the FAA use restrictions would apply to local sales tax levies. The elevation of the tax to a State tax, and the use of all the proceeds from the tax for aviation-related purposes, eliminates many of these issues.

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This section would become effective October 1, 2015.

PART V. EXEMPT MOTOR VEHICLE SERVICE CONTRACTS FROM SALES TAX

Effective January 1, 2014, service contracts for motor vehicles became subject to sales tax. The implementation of this change has been difficult for dealerships to administer. Sometimes it is unclear whether the repair or maintenance is performed under a service contract. If a repair is made under a service contract, the parts are not taxable; but if the repair is not under a service contract, the part is taxable. Sometimes dealers are uncertain how to distinguish between taxable parts and exempt parts. It is also difficult to know when a service contract may be taxable if it is sold for a vehicle that will be titled out-of-state. Under the sales tax sourcing rules, it is taxable in the state where it may first be used.

Under S.L. 2015-241, the sales tax base is expanded to include repair and maintenance services. This section simplifies the administration of sales tax as it relates to service contracts on motor vehicles by exempting the service contracts from tax and taxing the repairs and maintenance services, regardless of whether the service is provided under a service contract. The only repair and maintenance services that would be exempt from tax would be those services that fulfill a dealer's warranty or a manufacturer's warranty. The cost of those warranties is included in the price of the vehicle and subject to highway use tax. The repairs and maintenance performed under those warranties are easily identifiable transactions.

This section becomes effective when the sales tax base expansion to maintenance and repair services becomes effective, March 1, 2016.

PART VI. SALES TAX PREFERENCES FOR MOTORSPORTS PARTS AND FUEL

This Part would clarify the law concerning motorsports and modify the sales tax preferences for motorsports. These changes have been considered by the Senate in Senate Bill 605 and by the House in its version of the budget, House Bill 97, 5th Edition.

Subsections (a) and (b) codify the current administrative practice by exempting from sales and use tax a transmission, engine, or rear-end gears leased or rented by a professional motorsports racing team or a related member of a team for use in competition in a sanctioned race series. Under a final Revenue agency decision in 1997, an engine service program agreement was determined to not constitute the lease or purchase of tangible personal property and therefore not subject to sales and use tax. The General Assembly changed the definition of the term "lease or rental" in 2003 to conform to the definition of the term in the Streamlined Sales Tax Agreement. Since that time, the Ruling has conflicted with the plain meaning of the statute. This subsection codifies the current practice by exempting the transaction, but sunsets the exemption in four years. Under current law, if the underlying property subject to a service contract is exempt from sales tax, then the service contract on that item is exempt from sales tax. Therefore, this change in the law also means that a service contract on that item is exempt.

Subsection (c) clarifies that the exemption from sales tax on a service contract for an item purchased by a professional motorsports racing team conforms to the corresponding sales tax refund provision for that item. This subsection applies to service contracts purchased on or after January 1, 2014; that is the date the sales tax on service contracts and the exemption for this item became effective. This exemption expires January 1, 2020.

Subsection (d) would extend two sales tax refunds for sales tax paid by a professional motorsports racing team or a related member of such a team. The refunds currently expire January 1, 2016.¹⁰ This section would extend the two refund provisions to January 1, 2020:

¹⁰ The refund provisions were originally enacted in 2005.

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- Refund equal to the amount of sales and use tax paid on aviation fuel used to travel to or from a motorsports event in this State, from this State to a motorsports event in another State, or to this State from a motorsports event in another State.¹¹
- Refund equal to 50% of the sales tax paid on tangible personal property that comprises part of a professional motorsports vehicle, other than tires or accessories.¹²

PART VII. TAX COMPLIANCE AND TAX FRAUD PREVENTION

This Part contains changes requested by the Department of Revenue. The Department believes the changes in this Part will give it the tools it needs to reduce the occurrence of stolen identities and refund fraud and to better ensure tax compliance. The changes are also in Senate Bill 605, Various Changes to the Revenue Laws; this bill is currently in House Rules.

The changes are as follows:

Section	Bill Analysis
7.1(a)	Provides that the report an employer must file with the Department of Revenue re: to the amount of wages paid to an employee must be filed by January 31st and must be filed electronically. The Secretary could waive the electronic filing requirement for good cause. The information must also be submitted to the IRS, but the time for submission dates would be different; under current law, the submission dates are the same. The Department has requested an earlier submission date to enable it to timelier match taxpayer information for the taxable year for which returns are being submitted.
7.1(b)	Makes the failure to file the informational return required by subsection (a) of this section subject to a \$50 penalty. This subsection becomes effective January 1, 2017, to enable the Department to educate employers on the State's earlier submission date before subjecting the employer to a penalty for failure to file the informational return by the due date.
7.1(c)	Requires a pension payer who withholds taxes to file an informational return with the Secretary on the amounts withheld.
7.1(d)	Requires the Lottery Commission to file an informational return with the Secretary on a person's winnings and the amounts withheld.
7.1(e)	Requires persons who must withhold income taxes from compensation paid to contractors to file an informational return with the Secretary.
7.2	Allows the Secretary to reduce or waive interest payments on past due taxes imposed during a period for which a taxpayer has declared bankruptcy.
7.3	Requires licensing boards to provide information to the Secretary re: licensees' names, addresses, taxpayer identification numbers, and license numbers. This section becomes effective July 1, 2016.

¹¹ Senate Bill 605 did not extend this provision; House Bill 97, 5th edition, extended it four years.

¹² Senate Bill 605 would have phased the refund amount down to zero over four years; House Bill 97, 5th edition, extended it four years.