



SENATE BILL 105: 2021 Appropriations Act – Finance Provisions.

2021-2022 General Assembly

Committee:		Date:	November 15, 2021
Introduced by:		Prepared by:	Finance Team
Analysis of:	Conference Committee Substitute (S105-CCSMLxr-3)		

OVERVIEW: *The Conference Committee Substitute for Senate Bill 105 (2021 Appropriations Act) would make the following tax changes:*

❖ **PERSONAL INCOME TAX CHANGES**

- *Reduce the personal income tax rate to 3.99% over 6 years.*
- *Increase the standard deduction by approximately 18.6%.*
- *Increase the child deduction by \$500 and expand eligibility.*
- *Eliminate the tax on military pension income.*
- *Conform to the permanent federal medical expense deduction threshold.*

❖ **CORPORATE INCOME TAX & FRANCHISE TAX CHANGES**

- *Eliminate the corporate income tax by 2030. Beginning in 2025, the rate would be 2.25%; 2% in 2026; 1% in 2028, and 0% in 2030.*
- *Eliminate the two property bases for purposes of calculating the franchise tax.*

❖ **OTHER BUSINESS-RELATED TAX CHANGES**

- *Conform to the deductibility of expenses using funds from forgiven PPP loans and from similar pandemic-related loan or grant programs through 2022.*
- *Reduce the impact of the federal SALT cap by allowing certain pass-throughs to elect to pay at the entity level.*
- *Create a separate net operating loss calculation for individual income tax purposes.*

❖ **EXTENSION OF MILL & HISTORIC REHABILITATION TAX CREDIT PROGRAMS**

- *Re-enact the mill rehabilitation tax credit for new projects through 2030, including railroad projects, and extend time to complete previously eligible mill rehabilitation and railroad rehabilitation projects.*
- *Expand the historic rehabilitation tax credit to include an increased credit amount for historic schools and extend the program through 2030.*

❖ **EXCISE TAX CHANGES**

- *Subject online sales of cigars to the current 12.8% rate of excise tax and cap the excise tax on sales of all cigars, whether online or in-person, at 30 cents per cigar.*

Jeffrey Hudson
Director



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❖ PROPERTY TAX CHANGES

- *Exempt from property tax commercial cemeteries and vaccines held by private medical practices.*

❖ OTHER TAX CHANGES

- *Update the Internal Revenue Code reference to April 1, 2021, with corresponding decoupling provisions consistent with previous NC practice.*
- *Credit the proceeds of the alternate highway use tax on short-term vehicle rentals to the Highway Fund.*
- *Limit the gross premiums tax on surety of bail bonds to amounts received by an insurer from a surety bondsman.*
- *Graduate late payment penalties.*
- *Make technical, clarifying, and administrative changes recommended by the Department of Revenue.*

CURRENT LAW, BILL ANALYSIS, AND EFFECTIVE DATES:

PERSONAL INCOME TAX CHANGES ¹		
Section	Description	Effective Date
42.1.(a)	<p><u>PIT Rate Reduction</u></p> <p>Reduce the individual income tax rate from 5.25% to 3.99% over a period of 6 years (2022: 4.99%; 2023: 4.75%; 2024: 4.6%; 2025: 4.5%; 2026: 4.25%; 2027 and thereafter: 3.99%).</p> <p>North Carolina moved to a flat tax rate system in 2014. Prior to that date, the State used a tiered tax rate system ranging from 6% to 7.75%. The rate in 2014 was 5.8%. The rate has gradually decreased over time to 5.25%, where it stands today.</p>	For taxable years beginning on or after January 1, 2022
42.1.(b)	<p><u>Increase Standard Deduction</u></p> <p>Increase the standard deduction amounts as listed below, effective for taxable years beginning on or after January 1, 2022.² The change would increase the standard deduction amounts by approximately 18.6%:</p> <ul style="list-style-type: none">• Married filing jointly: \$21,500 to \$25,500• Married filing separately: \$10,750 to \$12,750• Head of Household: \$16,125 to \$19,125• Single: \$10,750 to \$12,750	For taxable years beginning on or after January 1, 2022

¹ Conformity to the permanent federal medical expense deduction threshold is discussed in the IRC Update section, beginning on page 5 of this Bill Analysis.

² The federal standard deduction amounts for 2022 are slightly higher than these amounts and are indexed annually: \$25,900 (MFJ); \$19,400 (HoH); \$12,950 (S/MFS). The provision in this bill does not provide for annual indexing.

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<p>42.1(c)</p>	<p><u>Increase Child Deduction</u></p> <p>Increase the child deduction amount by \$500 and expand eligibility for the credit, effective for taxable years beginning on or after January 1, 2022.</p> <p>North Carolina provides a child deduction of up to \$2,500 per child for a taxpayer who is allowed a federal child tax credit under section 24 of the Code.³ The deduction amount is based upon the AGI and filing status of the taxpayer. The deduction amount is currently \$0 for taxpayers, married filing jointly, whose AGI is over \$120,000. This section increases the <u>maximum</u> deduction amount to \$3,000 per child, and it expands the number of taxpayers who could benefit from the deduction by increasing the AGI limit for married filing jointly to \$140,000. For married filing jointly, the deduction amounts and AGI brackets are as follows:</p> <table border="0" style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th style="text-align: center;"><u>AGI</u></th> <th style="text-align: center;"><u>Deduction Amount</u></th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">Up to \$40,000</td> <td style="text-align: center;">\$3,000</td> </tr> <tr> <td style="text-align: center;">Over \$40,000 – Up to \$60,000</td> <td style="text-align: center;">\$2,500</td> </tr> <tr> <td style="text-align: center;">Over \$60,000 – Up to \$80,000</td> <td style="text-align: center;">\$2,000</td> </tr> <tr> <td style="text-align: center;">Over \$80,000 – Up to \$100,000</td> <td style="text-align: center;">\$1,500</td> </tr> <tr> <td style="text-align: center;">Over \$100,000 – Up to \$120,000</td> <td style="text-align: center;">\$1,000</td> </tr> <tr> <td style="text-align: center;">Over \$120,000 – Up to \$140,000</td> <td style="text-align: center;">\$500</td> </tr> <tr> <td style="text-align: center;">Over \$140,000</td> <td style="text-align: center;">0</td> </tr> </tbody> </table>	<u>AGI</u>	<u>Deduction Amount</u>	Up to \$40,000	\$3,000	Over \$40,000 – Up to \$60,000	\$2,500	Over \$60,000 – Up to \$80,000	\$2,000	Over \$80,000 – Up to \$100,000	\$1,500	Over \$100,000 – Up to \$120,000	\$1,000	Over \$120,000 – Up to \$140,000	\$500	Over \$140,000	0	<p>For taxable years beginning on or after January 1, 2022</p>
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Up to \$40,000	\$3,000																	
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<p>42.1A</p>	<p><u>Eliminate Tax on Military Pension Income</u></p> <p>Exempt the following military retiree income from taxation:</p> <ul style="list-style-type: none"> • Military retirement pay received by a retired member of the Armed Forces of the United States who served at least 20 years or was medically retired. • Payments from the Survivor Benefit Plan to a beneficiary of a retired member of the Armed Forces of the United States who served at least 20 years or was medically retired. <p>Members of the military pay federal income tax on their retirement pay. North Carolina residents pay a flat 5.25% income tax rate on their adjusted gross income unless it is otherwise exempt. While there continues to be an income tax exemption of retirement pay for a retired member of the military who vested prior to August 12, 1989, because of</p>	<p>For taxable years beginning on or after January 1, 2021.</p>																

³ To qualify for the federal credit, a child must be under the age of 17 and meet certain other tests, such as dependency and residency requirements.

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	<p>the <i>Bailey</i> court decision, the tax simplification and reform legislation enacted in 2013 eliminated the \$4,000 income tax exemption for all other governmental retirees, including military retirees, effective for taxable years beginning on or after January 1, 2014.</p> <p>For a more detailed summary of this provision, please see the most recent Bill Analysis for House Bill 83.</p>	
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CORPORATE AND FRANCHISE TAX CHANGES		
Section	Description	Effective Date
<p>42.2(a) and (b)</p>	<p><u>CIT Rate Reduction</u></p> <p>Eliminates the corporate income tax over six years, beginning with the 2025 tax year. The current rate is 2.5%. For taxable years beginning on or after 2025, the rate would be 2.25%; 2% in 2026; 1% in 2028; and 0%, beginning with the 2030 tax year.</p> <p>North Carolina began reducing the corporate income tax rate in 2014 when it decreased the rate from 6.9% to 6%. The rate was last reduced from 3% to 2.5% in 2019.</p>	<p>For taxable years beginning on or after January 1, 2025.</p>
<p>42.3</p>	<p><u>Simplify Franchise Tax Base</u></p> <p>Simplify the franchise tax base calculation and, for some taxpayers reduce the franchise tax amount, by eliminating the two tax bases calculated using property values. The elimination of the two property bases will reduce the franchise tax liability of corporations that have significant real and personal property investments in the State.</p> <p>The franchise tax is imposed on C corporations and S corporations for the privilege of engaging in business in this State. The tax does not apply to a business organized as a limited liability company, unless the LLC elects to be taxed as a corporation for franchise tax purposes, or to a general partnership or sole proprietorship. The rate of tax is \$1.50 per \$1,000, subject to a minimum tax of \$200.⁴ The tax rate applies to the highest of three bases. The three bases are:</p> <ul style="list-style-type: none"> • Net worth as computed in accordance with generally accepted accounting principles.⁵ <i>Under this section, this base would become the franchise tax base for all taxpayers. Most taxpayers use this base and would not see any change in their tax liability.</i> • Book value of North Carolina real and tangible personal property, less outstanding debt created to acquire or 	<p>For taxable years beginning on or after January 1, 2023, and applicable to the calculation of franchise tax reported on the 2022 and later corporate income tax returns.</p>

⁴ The maximum franchise tax on a holding company is \$150,000. A S-corporation pays a flat rate of \$200 on the first \$1,000,000 of net worth and \$1.50 for every \$1,000 of net worth over \$1,000,000. The General Assembly reduced the franchise tax on S-corporations for taxable years beginning on or after January 1, 2019.

⁵ The General Assembly significantly simplified the franchise tax base calculation when it moved from the capital base calculation to the net worth base calculation, effective for franchise tax returns due in 2017.

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	<p>improve the real property. <i>This section would eliminate this base and taxpayers currently using this base would probably see a reduction in their tax liability.</i></p> <ul style="list-style-type: none"> • 55% of the appraised value of North Carolina real and tangible personal property. <i>This section would eliminate this base and taxpayers currently using this base would probably see a reduction in their tax liability.</i> 	
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CONFORM TO FEDERAL TAX TREATMENT FOR PANDEMIC-RELATED ASSISTANCE/IRC UPDATE		
Section	Description	Effective Date
<p>42.4(a); 42.4 (d)</p>	<p><u>Update IRC Reference and Conformity</u></p> <p>Update the reference to the Internal Revenue Code used in defining and determining certain State tax provisions from May 1, 2020 to April 1, 2021.</p> <p>North Carolina's tax law tracks many provisions of the federal Internal Revenue Code by reference to the Code.⁶ The General Assembly determines each year whether to update its reference to the Code.⁷ Updating the reference makes recent amendments to the Code applicable to the State to the extent that State law previously tracked federal law. The General Assembly's decision whether to conform to federal changes is based on the fiscal, practical, and policy implications of the federal changes.</p> <p>The update of the Code reference would result in the following changes:</p> <ul style="list-style-type: none"> • Conforming the State's <u>medical expense deduction</u> to the permanent lowering of the threshold for taking the federal medical expense deduction from 10% of AGI to 7.5%. This deduction allows a taxpayer to deduct unreimbursed medical expenses that exceed 7.5% of the taxpayer's AGI. The "floor" for the medical expense deductions has fluctuated during recent years between 7.5% and 10%. The floor was scheduled to return to 10% for the 2021 taxable year. The Consolidated Appropriations Act, 2021, enacted on December 27, 2020, made the 7.5% floor permanent. 	<p>When it becomes law.</p>

⁶ North Carolina first began referencing the Internal Revenue Code in 1967, the year it changed its taxation of corporate income to a percentage of federal taxable income.

⁷ The North Carolina Constitution imposes an obstacle to a statute that automatically adopts any changes in federal tax law. Article V, Section 2(1) of the Constitution provides in pertinent part that the "power of taxation ... shall never be surrendered, suspended, or contracted away." Relying on this provision, the North Carolina court decisions on delegation of legislative power to administrative agencies, and an analysis of the few federal cases on this issue, the Attorney General's Office concluded in a memorandum issued in 1977 to the Director of the Tax Research Division of the Department of Revenue that a "statute which adopts by reference future amendments to the Internal Revenue Code would be invalidated as an unconstitutional delegation of legislative power."

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	<ul style="list-style-type: none"> Conforming to the federal tax treatment afforded expenses using <u>PPP loans and other federal pandemic-related assistance</u>. Specifically, it would allow individual and corporate taxpayers an income tax deduction for expenses paid using a loan forgiven under the Paycheck Protection Program or the Economic Injury Disaster Loan (EIDL) program, or Shuttered Venue and Restaurant Revitalization grants. However, the bill limits this treatment through 2022. (<i>See Section 42.4(d)</i>). 	
<p>42.4(b) & (c)</p>	<p><u>Decoupled Provisions</u></p> <p>Decouple from the following provisions that were enacted or extended by Congress under either the Consolidated Appropriations Act, 2021 (CAA), or the American Rescue Plan Act of 2021 (ARPA):</p> <ul style="list-style-type: none"> <i>Charitable Giving.</i> – The following two items would maintain NC's current policy of decoupling from provisions originally enacted by Congress under the CARES Act related to charitable giving. One affects itemizers and the other affects nonitemizers: <ul style="list-style-type: none"> For itemizers, there is a temporary suspension of the 60% AGI limitation with respect to the deduction for certain cash charitable contributions at the federal level. Under prior law, if the aggregate amount of an individual's contributions for the year exceeded 60% of AGI, then the excess was carried forward and treated as a deductible charitable contribution in each of the five succeeding tax years. <p>Under the CARES Act, to encourage charitable giving during the COVID-19 pandemic, taxpayers were permitted to deduct 100% of cash contributions made to a qualified public charity during 2020. NC decoupled from this provision, meaning that taxpayers were limited to deducting 60% for tax year 2020 and carrying forward the excess. The CAA extended this temporary suspension for 2021; under this section, NC would continue to decouple from this provision.</p> For nonitemizers, the CARES Act created an above-the-line deduction for charitable contributions of up to \$300. The CARES Act did not specifically address how the deduction applied to a married couple. NC decoupled from this provision last year. <p>Under the CAA, Congress made this provision permanent and clarified that the deduction applied to each person, allowing MFJ filers to deduct up to \$600. Additionally, this deduction was converted to a below-the-line deduction. As such, NC need not take any legislative action to decouple since the starting point for calculating</p>	<p>When it becomes law.</p>

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	<p>North Carolina taxable income is federal AGI. As a practical matter, nonitemizers will not be able to take this deduction at the State level.</p> <ul style="list-style-type: none"> • Mortgage Insurance. – Deduction for mortgage insurance premiums treated as interest for taxpayers who itemize. The General Assembly has decoupled from this provision every year since 2014. • Principal Residence Indebtedness. – Income exclusion for the discharge of qualified principal residence indebtedness through 2025. The General Assembly has decoupled from this provision every year since 2014. • Student Loans. – Two provisions relate to student loans: <ul style="list-style-type: none"> ○ Income exclusion for employer payments of student loans. The General Assembly decoupled for tax year 2020. ○ Income exclusion for the discharge of a student loan in 2021-2025. This was a new provision under ARPA. • "Business Lunches." – 100% deduction for business related expenses for food and beverages provided by a restaurant for 2021 and 2022. NC would continue to allow a 50% deduction for these expenses. 	
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SALT CAP WORKAROUND AND STATE NOL CALCULATION		
Section	Description	Effective Date
42.5	<p><u>SALT Cap Workaround</u></p> <p>Allow pass-through entities to elect to pay the State income taxes at the entity level, which is not subject to the federal state and local tax (SALT) cap of \$10,000.</p> <p>The 2017 Tax Cuts and Jobs Act (TCJA) imposed a \$10,000 cap on the amount of SALT individual taxpayers can deduct on their federal returns. Typically, pass-through entities such as partnerships and S corporations allocate business income to the owners' individual income tax returns, which is subject to the SALT cap. In proposed regulations, Notice 2020-75, the Internal Revenue Service and the Department of the Treasury signaled their approval of a workaround that allows the pass-through entity to pay the state income taxes at the entity level, which is not subject to the SALT cap. This workaround allows the owners to avoid the SALT cap on the taxes paid by the entity. The workaround only works for shareholders and members of S corporations, partnerships, and LLCs treated as partnerships for federal income tax purposes.</p>	For taxable years beginning on or after January 1, 2022.

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	<p>Subsection (c) would allow an S corporation to elect to be taxed at the State level. The election is made on its timely filed annual return, is irrevocable, and covers that taxable year. The election must be made each year. Tax credits and any carryforwards or installments of those tax credits must be taken by the taxpayer that filed the return for the year the initial tax credit was taken. The full amount of tax payable as shown on the return must be paid within the time allowed for filing the return. If the taxed S corporation does not pay the amount shown as due, the Secretary must issue a notice of collection for the tax debt to the taxed S Corporation. If the tax debt is not paid within 60 days of the date the notice of collection is mailed to the taxed S corporation, Secretary must send the shareholders a notice of proposed assessment.</p> <p>Subsection (h) would allow a partnership to elect to be taxed at the State level. The provisions governing this election are the same as the provisions for a taxed S corporation. The election cannot be made by a publicly traded partnership or by a partnership that has at any time during its taxable year a partner who is not an individual, an estate, a trust, or an organization described in section 1361(c)(6) of the Code.</p> <p>Subsection (i) would allow an individual income taxpayer who is a shareholder of a taxed S corporation or a partner of a taxed partnership to make the following adjustments to the taxpayer's adjusted gross income:</p> <ul style="list-style-type: none"> • A deduction of the amount of the taxpayer's pro rata share or distributive share of income from the taxed pass-through entity to the extent it was included in the taxed pass-through entity's NC tax income and the taxpayers AGI. • An addition of the amount of the taxpayer's pro rata share or distributive share of loss from the taxed pass-through entity to the extent it was included in the taxed pass-through entity's NC taxable income and the taxpayer's AGI. <p>Subsection (j) would not allow a shareholder or partner of a taxed pass-through entity, or fiduciaries and beneficiaries of estates and trusts who are shareholders or partners of a taxed pass-through entity, a credit for taxed paid by the taxed pass-through entity to another state or country. The taxed pass-through entity is allowed the credit. Subsection (m) would provide that a taxed pass-through entity must pay estimated taxes.</p>	
<p>42.6</p>	<p><u>State NOL Calculation</u></p> <p>Create a separate North Carolina net operating loss (NOL) calculation. A separate State NOL calculation would more closely align to the calculation of North Carolina taxable income by adjusting for differences between federal and State law and business activities taking place in multiple states.</p> <p>North Carolina has a corporate NOL calculation that is separate from the federal calculation, but it does not have a separate NOL calculation for</p>	<p>For taxable years beginning on or after January 1, 2022.</p>

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	<p>individual income tax. The federal loss amount is the taxpayer's State loss amount. This calculation benefits some taxpayers but hurts others.</p> <p>Subsection (a) would require a taxpayer to add-back the amount allowed as a NOL under the Code, and to deduct the State NOL amount. Subsection (b) would provide the new rules for calculating the State NOL deduction amount. It provides that any remaining losses from years prior to January 1, 2022, may be carried forward, but the old loss amounts would not be calculated using the new rules. This transition rule is consistent with how the State treated prior year losses when it modified the corporate NOL calculation in 2015.</p>	
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MILL REHABILITATION & HISTORIC REHABILITATION TAX CREDITS		
Section	Description	Effective Date
42.7B	<p><u>Mill Rehabilitation Credit</u></p> <p>Re-enact and extend the mill rehabilitation tax credit, including the credit for a rehabilitated railroad station.</p> <p>In 2006, the General Assembly created a tax credit for rehabilitating vacant historic manufacturing sites if the taxpayer spent at least \$3 million to rehabilitate the site. The credit is a percentage of the qualified rehabilitation expenditures, and the percentage varies depending on the enterprise tier location of the site and the eligibility for the federal credit. This credit expired January 1, 2015, for projects that had not obtained an eligibility certification by that date. For projects that had obtained an eligibility certification by that date, the credit will expire for projects not placed in service by January 1, 2023.</p> <p>In 2019, the General Assembly created a specific mill rehabilitation tax credit for an eligible railroad station. This credit sunsets for expenditures occurred on or after January 1, 2022, and for rehabilitation projects not completed and placed in service prior to January 1, 2022.</p> <p>This provision does three things:</p> <ul style="list-style-type: none"> • It re-enacts the mill rehabilitation credit for new projects with a 2030 sunset. • It extends the sunset rehabilitated railroad station projects from 2022 to 2030 and modifies the eligibility conditions so that additional projects may qualify. • It clarifies that the re-enactment and extension of the credit does not require a project that obtained an eligibility certification prior to January 1, 2015, to reapply for certification. 	<p>When it becomes law.</p>
42.7A	<p><u>Historic Rehabilitation Credit</u></p>	<p>For taxable years</p>

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	<p>Expand and extend the historic rehabilitation tax credit.</p> <p>Article 3L of Chapter 105 is the Historic Rehabilitation Tax Credits Investment Program, providing tax credits for rehabilitating income-producing and non-income producing historic structures. To qualify, the taxpayer must qualify for the federal income tax credit under section 47 of the Code, and the credit amount is based on a percentage of expenses and, for income-producing structures, the location of the structure. Article 3L sunsets for rehabilitation expenditures incurred on or after January 1, 2024.</p> <p>Subsection (a) would expand the credit by increasing the credit amount if the certified historic structure is used for an educational purpose. The bonus amount is equal to 5% of rehabilitation expenses with a cap of \$1 million. The certified historic structure must have had an original use as an educational building, return to service as an educational building following the rehabilitation, and remain an educational building when the tax credit is taken. For a certified historic structure used for multiple purposes, the bonus amount is prorated based on the area of the building used for an educational purpose. An educational purpose is defined as: "A purpose that has as its objective the education or instruction of human beings; it comprehends the transmission of information and the training or development of the knowledge or skills of individual persons."</p> <p>Subsection (b) extends the sunset date for the credit program from January 1, 2024, to January 1, 2030.</p>	<p>beginning on or after January 1, 2021, and when law.</p>
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LIMIT GROSS PREMIUMS TAX ON SURETY BONDS FOR BAIL BONDS		
Section	Description	Effective Date
<p>42.8</p>	<p>Limit the gross premium tax base for premiums paid to a surety bondsman to the amount paid by the surety bondsman to the insurer of the bail bonds. The amount paid to a surety bondsman consists of two parts, the amount paid to the insurer of the bail bonds and the amount retained by the surety bondsman for its services. The limitation of the tax base only applies to the transactions related to the insuring of bail bonds, and not to any other line of insurance.</p> <p>The gross premiums tax levied on insurers is imposed on the gross premiums from business done in this State. In determining the amount of gross premiums from business in this State, all gross premiums received in this State unless the statute provides otherwise. This section would limit this calculation in the case of an insurer of bail bonds. The tax rate applied to the taxable gross premiums is 1.9%.</p>	<p>For taxable years beginning on or after January 1, 2022.</p>

EXCISE TAX CHANGES

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Section	Description	Effective Date
42.9	<p>Subject remote sales of cigars to the current rate of excise tax, which is 12.8% of the cost price per cigar, subject to a cap of 30¢ per cigar for all purchases of cigars, regardless of whether purchased in-person or online. Effectively, this cap would phase out the tax on amounts paid by a dealer in excess of \$2.35 per cigar. At this price point, the primary impact of the cap would be on premium, or hand-rolled, cigars, which are typically more expensive than machine-made cigars, which are unlikely to hit the cap.</p> <p>Under current law, cigars are subject to an excise tax at the rate of 12.8% of the cost price of the product, but because the tax is paid by the first person in the State to handle the product, a remote seller is not required to collect the tax.</p> <p>This section would also modify existing excise tax statutes to address and distinguish between delivery sales and remote sales of tobacco products. "Delivery sales" are sales of tobacco products subject to the federal PACT Act, which are cigarettes, smokeless tobacco, and vapor products, where the purchase is not made in-person. "Remote sales" are also sales not made in-person but are of tobacco products that are not subject to the PACT Act, like cigars and pipe tobacco. The PACT Act requires age verification, special labeling, detailed reporting, licensing and tax compliance, and registration with ATF and prohibits delivery through U.S. Mail.</p> <p>All tobacco products, whether sold in-person or online, are already subject to sales tax.</p> <p>This section would become effective July 1, 2022, and apply to sales or purchases occurring on or after that date.</p>	July 1, 2022

CREDIT SHORT-TERM VEHICLE RENTAL PROCEEDS TO HIGHWAY FUND		
Section	Description	Effective Date
42.10	Credit 100% of the proceeds derived from the 5% and 8% alternate highway use tax applied to short-term vehicle rentals to the Highway Fund. Currently, only \$10 million from these taxes goes to the Highway Fund with the remainder going to the General Fund.	July 1, 2021.

GRADUATE LATE PAYMENT PENALTIES		
Section	Description	Effective Date

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<p>42.11</p>	<p>Replace the flat penalty amount assessed for failure to pay a tax when due to a graduated amount. The current flat penalty amount is equal to 10% of the tax. This section would reduce the penalty amount to 2% of the tax for the first month, increased 2% for each succeeding month or fraction thereof, not to exceed 10%.</p>	<p>July 1, 2022, and applies to tax assessed on or after that date.</p>
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PROPERTY TAX CHANGES

Section	Description	Effective Date
<p>42.12</p>	<p>Exempt Commercial Cemetery Property</p> <p>G.S. 105-278.2 currently exempts all real property set apart for burial purposes from property taxation unless it is owned and held for purposes of (1) sale or rental, or (2) sale of burial rights therein. Real property includes land, tombs, vaults, monuments, and mausoleums.</p> <p>Section 42.12(a) would exempt burial property owned and held for purposes of sale or rental, or sale of burial rights therein from property taxation, effective for taxes imposed for taxable years beginning on or after July 1, 2022. Section 42.12(b) would require a taxpayer to file a single application with the county assessor in which the property is situated to receive the exemption.</p> <p><u>Exempt Vaccines</u></p> <p>Vaccines held by pharmacies and other retailers are currently exempt from property tax because they are inventory, and inventory of retailers is exempt from tax. Vaccines held by nonprofit medical facilities are exempt from property tax because real and personal property of the nonprofit are exempt from tax. However, vaccines held by private medical facilities and doctors' offices are currently taxable as business personal property. The value of the property is usually assigned based on an estimate of the amount routinely held by that facility, not on the amount held on a certain day or the amount held throughout the year.</p> <p>Section 42.12(c) would exempt all vaccines from property tax, regardless of who holds the vaccines.</p>	<p>For taxable years beginning on or after July 1, 2022.</p>

REVENUE LAWS TECHNICAL, CLARIFYING, AND ADMINISTRATIVE CHANGES

SUBPART A: PERSONAL INCOME TAX CHANGES

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42.13A(a)	This section does two things: <ul style="list-style-type: none">• Makes technical correction by renumbering a subdivision.• Extends the sunset of the deduction from federal AGI of any amounts the taxpayer received from the State as an Extra Credit grant amount from January 1, 2021 to January 1, 2022. The grant program was extended into the 2021 taxable year.	When the act becomes law.
42.13A(b)	Corrects an unintended consequence when NC decoupled from a provision in the CARES Act by allowing a taxpayer to fully deduct the applicable amount of business interest expense over time. NC conformed to the federal TCJA in 2017. Part of the TCJA limited the interest expense deduction under section 163(j) of the Code for taxpayers with \$25M or more in receipts per year to 30% of the taxpayer's AGI. Under the CARES Act, Congress increased the interest expense limitation from 30% to 50% for the 2019 and 2020 taxable years. NC decoupled from this change and remains at 30%. To decouple from the federal provision, State law requires a taxpayer to addback the difference. This section does two things: <ul style="list-style-type: none">• It provides that the add-back is not required to the extent the amount was added back under another provision of State law to avoid a double add-back.• It provides a taxpayer may deduct over a five-year period the amount of interest expense allowed under federal law that exceeds the State's 30% limit. Without this change, the taxpayer would be permanently disallowed the full amount of the deduction.	When the act becomes law.
42.13A(c)	Makes technical correction by deleting a reference to a repealed statute.	When the act becomes law.
42.13A(d)	Increases the time allowed for an employer to file an informational return reporting wages (Form NC-3) when the employer terminates its business. Under current law, an employer who terminates its business or permanently ceases paying wages must file an informational return within 30 days of the last payment of wages. Informational returns would now be due the month after the end of the calendar quarter when the employer terminates its business (but no later than January 31 of the succeeding year). This section also removes the duty to file when an employer permanently ceases paying wages. This section matches federal filing requirements for IRS Forms W-2, W-3, and 1099.	When the act becomes law.
42.13A(e)	Explicitly states the Secretary of Revenue can assess a withholding agent based on an estimate of the tax due when the withholding agent fails to file a return or files a grossly incorrect, false, or fraudulent return. New G.S. 105-163.8(c) mirrors existing G.S. 105-164.32 which has the same language for sales and use tax.	When the act becomes law.

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42.13A(f)	Clarifies that a request for a tax refund is due 6 months after the contingent event concludes. Under current law, refund claims delayed due to litigation or a state tax audit are due 6 months after the litigation or audit concludes. This section clarifies that the same period applies to other contingent events that prevent the taxpayer from filing an accurate and definite request for a refund.	When the act becomes law.
42.13A(g)	Authorizes the Secretary of Revenue to allow the use of truncated taxpayer identification numbers (TTIN) on tax returns and other documents. TTIN helps prevent identity theft by using only the last 4 digits of a Social Security number (e.g., XXX-XX-9999). Under current law, the General Assembly must authorize the use of a TTIN on each type of tax form. The Secretary wants to avoid repeated law changes as IRS forms, payroll forms, and tax return forms change. For example, for the 2020 tax year, the IRS allows payroll providers to submit IRS Form W-2 with TTIN to prevent identity theft. The NC Department of Revenue lacks the authority to conform to the use of the TTIN.	When the act becomes law.
42.13A(h)	S.L. 2021-16 provided for the nonaccrual of interest on individual income tax returns due on or before April 15, 2021, from April 15 through May 17, 2021. This section clarifies that for the purposes of the nonaccrual of interest, an individual income tax return includes partnership and estate and trust tax returns.	When the act becomes law.
SUBPART B: CORPORATE INCOME TAX CHANGES		
42.13B(a)	Corrects an omission from 2015 when the General Assembly made the policy decision to tax banks in the same manner as other corporations. As part of that legislation, the General Assembly repealed the privilege license tax on banks ⁸ but it failed to make a corresponding change to the exemption for banks from the privilege license tax on installment paper dealers. This section makes that change.	Effective retroactively to the 2016 taxable year.
42.13B(b)	Prevents a double denial of interest expenses. Substantially the same explanation as Section 4A.2, while considering the limitation that may be required under G.S. 105-130.7B.	When the act becomes law.
42.13B(c) and (d)	Prevents a double denial of nondeductible interest expenses. Both State and federal tax law limit the deduction amount allowed for net business interest expenses. Therefore, it is possible that a partial limitation has been imposed on the intercompany interest under section 163(j) of the Code, and if that is the case, that deduction needs to be recognized by G.S. 105-130.7B. Otherwise, the taxpayer may have to add back more interest than it actually incurred in total.	Effective retroactively to taxable years beginning on or after January 1, 2018. ⁹
42.13B(e)	Clarifies that, for taxable years beginning on or after January 1, 2015, the limitations of Code sections 381 and 382 apply to all losses from mergers	When the act becomes law.

⁸ The corporate income tax change resulted in an increased tax burden on banks. The repeal of the privilege tax on banks helped to offset this tax burden.

⁹ The taxable year the federal law changes under section 163(j) became effective.

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	and acquisitions regardless of the date of the merger or acquisition. The clarification takes the position most favorable to the taxpayer. It also provides parity among taxpayers and eases the administration of the carry-forward for both the taxpayer and the Department.	
42.13B(f)	This section requires a taxpayer to provide financial or tax documentation necessary for the Department to make the appropriate adjustments and determinations under G.S. 105-130.5A. G.S. 105-130.5A requires the Secretary to adjust net income or require a combined report when the Secretary has reason to believe a corporation fails to accurately report its State net income using intercompany transactions. This change provides that if the Secretary requests information or documentation needed under G.S. 105-130.5A, and the information is not timely provided, the Secretary may propose any allowable adjustment, including the filing of a combined return. All tax information is protected by the tax secrecy provisions of G.S. 105-259. ¹⁰	When the act becomes law.
<i>SUBPART C: SALES AND USE TAX CHANGES</i>		
42.13C(a)	Expands the sales and use tax exemptions for certain purchases made by qualifying farmers and conditional farmers to include fowl. Currently, livestock, baby chicks, and poulters are exempt from sales and use tax when purchased by a qualifying farmer or conditional farmer and used primarily in farming operations. This section would expand the types of animals that are exempt from sales and use taxes to include, among other things, adult chickens and turkeys.	Effective retroactively to July 1, 2020 and applies to purchases made on or after that date.
42.13C(b)	Removes obsolete language. The statutes referenced G.S. 105-259(b)(5b) have been repealed and the subdivision is no longer needed.	When the act becomes law.
<i>SUBPART D: EXCISE TAX HEARING CHANGES</i>		
<p>This Part represents a comprehensive restructuring of the license revocation and hearing procedures across all excise tax schedules to streamline and make consistent these procedures. The affected schedules are tobacco products, motor carriers, motor fuels, and alternative fuels.</p> <p>Below is a summary of the current law. This Part maintains the two distinct methods for revocation – summary and non-summary – but provides more specificity with respect to the process and makes them more consistent across all excise tax schedules. <i>Please see the tables at the end of this summary that show how the procedures proposed by this Part differ from the current law.</i></p> <p><u>License Revocation for Tobacco, Motor Fuels, and Alternative Fuels Licensees.</u> – The license revocation and hearing procedures under the tobacco product, motor fuel, and alternative fuel schedules share similar features. Specifically, the Secretary of Revenue may revoke a license in two ways:</p>		Effective January 1, 2022 and applies to summary revocations and non-summary revocations initiated by the Department on or after that date.

¹⁰ Violation of the tax secrecy provisions is a Class 1 misdemeanor and dismissal of the employee from public employment.

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<p><u>Summary Revocation.</u> – The Secretary may summarily revoke a license, which means that the license is revoked <u>prior</u> to a hearing, if the Secretary discovers that a licensee is incurring tax liability after failing to pay a tax when due. The Secretary must hold a hearing within 10 days of the revocation after sending notice to the revoked licensee. Summary revocation is not often used by the Department and is reserved for extraordinary circumstances.</p> <p><u>Non-Summary Revocation.</u> – The more common method for revoking a license is after holding a hearing, regardless of whether the licensee has requested one. The Secretary must provide the licensee with at least 10 days' written notice of the hearing. If the licensee fails to attend the hearing, the license revocation is effective 15 days after the noticed hearing. The statutes are silent as to when the Secretary must issue a final decision and the content of that decision if the licensee attends the hearing. The Department asserts that holding a hearing even if a licensee has not requested one is an inefficient use of its resources because it requires them to fully prepare and conduct a hearing whether or not the licensee has expressed their intention to maintain the license or attend the hearing.</p> <p><u>License Revocation for Motor Carriers.</u> – Not only is the revocation and hearings procedure for motor carriers different than the other excise tax schedules, but it is also not set out in statute. G.S. 105-449.57 permits the Secretary to enter into cooperative agreements with other jurisdictions regarding the administration of the motor carrier tax. To the extent our statutes are silent, the Department follows the IFTA Rules for revocation. These rules differ from the other revocation procedures in the three primary ways: (1) a taxpayer can only request a hearing after revocation; (2) a licensee must request a hearing within 30 days; and (3) 20 days' hearing notice is required. Unlike the procedures for other excise tax schedules, the Department does not perform summary revocations or provide a hearing before revocation. Instead, the Department notifies the motor carrier taxpayer of the intent to revoke the license and then revokes it if the taxpayer does not come into compliance. There is an opportunity for a hearing after the revocation.</p>		
<p><i>SUBPART E: OTHER EXCISE TAX CHANGES</i></p>		
42.13E(a)-(f)	Recodifies various statutes to a more appropriate place and makes technical and conforming changes.	When the act becomes law.
42.13E(g)	Clarifies that non-licensed distributors must file a use tax report when acquiring non-tax-paid cigarettes.	When the act becomes law.
42.13E(h)	Removes unnecessary language. "Vapor products" are included in the definition of "tobacco products" and therefore makes the language being removed redundant and unnecessary.	When the act becomes law.
42.13E(i)	Provides that non-licensed wholesale dealers and non-licensed retail dealers must file a use tax report on non-tax-paid tobacco products, other than cigarettes, and pay the tax due within 96 hours after acquisition. This mirrors the requirements for use tax payments and reports for cigarettes and provides consistency regarding use tax payments and reports for all tobacco products. Currently, the use tax reporting and	When the act becomes law.

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	<p>payment requirements for cigarettes and other tobacco products are different.</p>	
42.13E(j)	<p>Codifies the current practice of the Department and industry and makes a clarifying change. Generally, the wholesaler or importer who first handles the alcoholic beverage in the State is required to pay the excise tax on the product. However, the Department, by policy, authorizes an exception to this rule. The Department authorizes an ABC permitted wholesaler to remit the excise tax when a brewery or winery transfers their product to the wholesaler for distribution and the wholesaler agrees to pay the excise tax on the product. This section would codify this practice.</p> <p>This section also moves language pertaining to wine shipper permittees to a more appropriate place.</p>	When the act becomes law.
42.13E(k)	<p>Requires distilleries to be bonded. Generally, any ABC permittee that can incur excise tax liability must be bonded. Distilleries are authorized to incur excise tax liability but are not currently required to be bonded. This section would require distilleries to be bonded and treat them similarly to other ABC permittees that are authorized to incur excise tax liability.</p>	When the act becomes law.
42.13E(l)	<p>Changes the penalties for engaging in business as a distributor, wholesale dealer, or retail dealer without first obtaining the appropriate license. Currently, the maximum penalty is \$6.25 for failing to obtain a distributor license or wholesale dealer license, and \$5.00 for failing to obtain a retail dealer license. The Department has had some issues with compliance due to the current penalty not providing an effective deterrent.</p> <p>This section would increase the potential penalty to \$1,000 for failing to obtain the respective license, which is on par with the penalties for failing to obtain various motor fuel licenses. To assess the penalty, the Department must provide written notification to the taxpayer of their noncompliance, and the taxpayer must fail to comply after receiving the notification.</p>	Effective January 1, 2022 and applies to penalties assessed on or after that date.
42.13E(m)	<p>Codifies the current authority to assess a failure to pay penalty on motor carriers that fail to pay tax when due under the International Fuel Tax Agreement (IFTA), provides exceptions to the penalty, and authorizes the Department to waive failure to file and failure to pay penalties on motor carriers. IFTA is an agreement between member taxing jurisdictions to assist each other in the collection and administration of taxes paid by interstate motor carriers on their use of motor fuel. North Carolina has been a member of IFTA since 1992.</p> <p>This section codifies the current practice of the Department when assessing failure to pay penalties for motor carriers authorized under IFTA as well as exceptions to the penalty provided for under North</p>	When the act becomes law.

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	<p>Carolina law. The penalty is \$50.00 or 10% of the tax due, whichever is greater.</p> <p>This section also provides authority for the Department to waive any failure to file or failure to pay penalty assessed against a motor carrier.</p>	
42.13E(n)	<p>Creates a definition of "fuel grade ethanol" and adjusts the definition of "gasohol" to continue to capture gasohol in the same manner as it is currently.</p> <p>Currently, there is no definition of "fuel grade ethanol" but it is considered a taxable motor fuel. Without a proper definition of fuel grade ethanol, the Department has had difficulty assessing liability on taxpayers. The Department requested this change to aid in compliance by providing certainty as to what fuel grade ethanol is.</p> <p>The definition of "gasohol" refers to fuel grade ethanol, but currently captures more than what the new definition of fuel grade ethanol would cover. Therefore, the Department requested an update to the definition of gasohol to continue to capture gasohol as it is captured currently.</p>	Effective January 1, 2022.
42.13E(o) and (p)	<p>Aligns the shipping document requirements when transporting motor fuel by railroad tank cars, transport trucks, and tank wagons. This will reduce confusion and aid in compliance when motor fuel is diverted to a state other than the state listed on the shipping document.</p>	Effective January 1, 2022.
42.13E(q)	<p>Changes the penalty for failing to properly mark certain dyed, nontaxable, motor fuel storage facilities. Dyed motor fuel is not for use on the highway and therefore is not taxable. A person who is a retailer of dyed motor fuel or anyone who stores both dyed and undyed motor fuel must properly mark the storage tanks of dyed motor fuel or be assessed a penalty. Currently the penalty is equal to the motor fuel rate multiplied by the inventory held in the storage tank or, if the inventory cannot be determined, the penalty is calculated on the capacity of the storage tank.</p> <p>This section would remove the requirement that the Department determine inventory or capacity and make the penalty a flat \$250.00 per offense. Each inspection resulting in non-compliance would be a separate offense.</p> <p>The Department requested this change to ease administrative burden as it is often difficult to ascertain the tank size and amount of fuel in the tank. The Department estimates this change will decrease the average penalty assessed under this section.</p>	Effective January 1, 2022 and applies to penalties assessed on or after that date.
<i>SUBPART F: LOCAL GOVERNMENT CHANGES</i>		
42.13F(a)	<p>Makes an update to reflect the proper statutory reference. Local planning and development regulation statutes in Chapters 153A and 160A were recodified to Chapter 160D. This section updates the statutory reference as historic landmarks are now designated as such</p>	Effective retroactively to June 19, 2020.

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	under a local ordinance adopted pursuant to G.S. 160D-945 (which was previously G.S. 160A-400.5).	
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