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## The 1985 General Assembly Enacts Broad Based Tax Relief for North Carolina Citizens

In 1985 the North Carolina General Assembly made major changes in the tax code that will affect virtually every North Carolina citizen. Although many of the amendments do no more than clarify or simplify prior statutes,<sup>1</sup> a substantial number of amendments were added to give broad-based tax relief to individuals, ranging from major changes in the estate and gift tax sections<sup>2</sup> to minor changes concerning which individuals must file a state tax return.<sup>3</sup> The amendments primarily effect the following individuals: those with low or moderate incomes, the elderly and disabled, working people with dependent child-care expenses, divorced couples, couples making inter-vivos gifts, and decedents leaving estates to either their spouses or descendants. There are also a number of amendments affecting North Carolina businesses.<sup>4</sup> This Note analyzes these changes in the tax code and the effect the amendments will have on individuals and businesses in North Carolina.<sup>5</sup>

For individuals with low or moderate income, the general assembly passed several amendments effectively decreasing taxable income. Foremost among these amendments is a new credit for individuals having a net taxable income of 15,000 dollars or less.<sup>6</sup> Effective for taxable years beginning on or after January 1, 1986, the credit ranges from 25 dollars for individuals with a net taxable income of 5,000 dollars or less to 15 dollars for individuals with a net taxable income of 15,000 dollars. The credit may not exceed the tax imposed,<sup>7</sup> however, and certain individuals are not eligible for the credit.<sup>8</sup>

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1. See, e.g., Act of April 23, 1985, ch. 114, 1985 N.C. Sess. Laws 95, 95-104 (codified at N.C. GEN. STAT. §§ 105-113.68 to .89 (1985)) (entire section rewritten to simplify the alcoholic beverage tax statute); Act of July 10, 1985, ch. 667, §§ 1-3, 1985 N.C. Sess. Laws 865, 865-66 (codified at N.C. GEN. STAT. § 105-277.2 (1985)) (amendment clarifies the type of land—agricultural, forestland, and horticultural—that qualifies for taxation under the present-use value system).

2. See *infra* text accompanying notes 38-63.

3. Act of July 9, 1985, ch. 656, § 36, 1985 N.C. Sess. Laws 830, 838 (codified at N.C. GEN. STAT. § 105-214 (1985)) (no return is required for taxpayers whose tax liability does not exceed \$15). Prior to this amendment the minimum amount of tax due needed to meet the filing requirements was in excess of \$5. Act of June 19, 1980, ch. 1131, § 1, 1979 N.C. Sess. Laws 37, 37-38, *amended by* Act of July 9, 1985, ch. 656, § 36, 1985 N.C. Sess. Laws 830, 838 (codified at N.C. GEN. STAT. § 105-214 (1985)).

4. See *infra* text accompanying notes 64-87.

5. Because North Carolina does not have any recorded legislative history the analysis is limited to a reading of the prior statute and the effect the amendments have on these statutes. Some insight into the legislative purpose of the amendments can be garnered, however, by noting the titles to the various acts. For example, the amendments to the estate and gift tax sections appear under the title of "An Act to Provide Broad-Based Tax Relief to North Carolina Citizens." Act of July 9, 1985, ch. 656, 1985 N.C. Sess. Laws 830.

6. Act of July 9, 1985, ch. 656, § 12, 1985 N.C. Sess. Laws 830, 832 (codified at N.C. GEN. STAT. § 105-151.16 (1985)).

7. N.C. GEN. STAT. § 105-151.16(a) (1985).

8. The following individuals are denied this credit:

- (1) An individual who was not a resident of this State and did not live in this State for at least half the taxable year;
- (2) An individual who received assistance under the Food Stamp Program, 7 U.S.C. § 51, for the entire taxable year;

A second amendment significantly affecting low income groups is the exemption from sales tax on items purchased with food coupons.<sup>9</sup> Because North Carolina counties charge either four or four and one-half percent sales tax on food and other items at the time of purchase,<sup>10</sup> this exemption from sales tax has the effect of immediately increasing the purchasing power of the poor by a like amount.

The general assembly also passed amendments giving tax relief to low income elderly and disabled persons. One amendment increases the maximum amount of income such a person must earn before his or her property is subject to a property tax assessment.<sup>11</sup> The amended section<sup>12</sup> applies to individuals who are over sixty-five years of age or totally and permanently disabled. The amendment increases both the amount exempted from property tax assessments and the income level for eligibility.<sup>13</sup> For the taxable year beginning on or after January 1, 1986, the exempt amount is 10,000 dollars and the income level is 10,000 dollars.<sup>14</sup> For subsequent taxable years beginning on or after January 1, 1987, the amounts are increased to 12,000 dollars and 11,000 dollars respectively.<sup>15</sup>

In addition to the property tax exemption for the disabled, the general assembly also passed several amendments relating to persons with specific identifiable diseases. The sections added give an additional 1,100 dollars personal exemption to an individual who has, or whose dependent has, multiple sclerosis,<sup>16</sup> an open neural tube defect,<sup>17</sup> or severe head injuries causing the person to

(3) An individual who was an inpatient at a hospital facility, as defined in G.S. 131E-16, for at least half the taxable year;

(4) An individual who was in jail or in other official detention for at least half the taxable year; and

(5) An individual who may be claimed as a dependant by another under G.S. 105-149(a)(5).

N.C. GEN. STAT. § 105-151.1(b) (1985).

9. Act of July 9, 1985, ch. 656, § 25, 1985 N.C. Sess. Laws 830, 836 (codified at N.C. GEN. STAT. § 105-164.13(38) (1985)). This amendment becomes effective October 1, 1985.

10. The sales tax levied in North Carolina is 4%. N.C. GEN. STAT. § 105-164.4 (1985) (3% state sales tax); N.C. GEN. STAT. § 105-467 (1985) (1% county sales tax). Each county, however, is granted the power to charge an additional one-half percent. N.C. GEN. STAT. § 105-490 (1985). To prevent the cities and counties from being adversely affected by a decrease in revenue due to this new sales tax exemption, the legislature enacted a bill that requires a reimbursement from the state to the cities and counties for the amount of sales taxes that would have been collected but for the exclusion. Act of July 9, 1985, ch. 656, § 31, 1985 N.C. Sess. Laws 830, 837 (codified at N.C. GEN. STAT. § 105-164.44C (1985)).

In July 1986 the general assembly enacted a statute enabling each county or city to charge an additional ½ % sales tax. H.B. 1542, § 1, N.C. Gen. Assembly, 1985 Session (to be codified at N.C. GEN. STAT. § 105-498). This authority to increase the sales tax is effective immediately. *Id.* § 3.

11. Act of July 9, 1985, ch. 656, §§ 44, 45, 48, 49, 1985 N.C. Sess. Laws 830, 839-40 (codified at N.C. GEN. STAT. § 105-277.1 (1985)).

12. N.C. GEN. STAT. § 105-277.1 (1985).

13. Act of July 9, 1985, ch. 656, §§ 44, 45, 48, 49, 1985 N.C. Sess. Laws 830, 839-40 (codified at N.C. GEN. STAT. § 105-277.1 (1985)).

14. *Id.*

15. *Id.* Prior to this amendment the amount of real property tax assessment was \$8,500 and the exemption was available to individuals having income of \$9,000 or less. Act of October 10, 1981, ch. 1052, 1981 N.C. Sess. Laws 830, 839-40 (codified at N.C. GEN. STAT. § 105-277.1 (1985)).

16. Act of July 1, 1985, ch. 513, § 1, 1985 N.C. Sess. Laws 581, 581 (codified at N.C. GEN.

be in a continuing vegetative state.<sup>18</sup> Because the effective date of these amendments is January 1, 1985,<sup>19</sup> an extra exemption is available to handicapped persons upon filing their 1985 tax returns.

For working persons who incur employment related child-care expenses the general assembly increased the maximum amount on which to apply the seven percent tax credit.<sup>20</sup> Effective for taxable years beginning on or after January 1, 1986, the maximum child-care expenses incurred subject to the seven percent credit is increased to 4,800 dollars for individuals having two or more qualifying dependents and is increased to 2,400 dollars for individuals having one qualifying dependent.<sup>21</sup> Because the maximum amounts previously allowed were 4,000 dollars and 2,000 dollars respectively,<sup>22</sup> the credit potential increases by a maximum of 56 dollars.<sup>23</sup> The amendment also defines employment related child-care expenses to include expenses incurred for services provided outside the taxpayer's home so long as these services are provided for a qualified dependent<sup>24</sup>

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STAT. § 105-149(a)(8g) (1985)). To be eligible for this exemption a taxpayer must attach to his or her tax return a statement from a physician stating that he or she has multiple sclerosis. *Id.*

17. Act of May 13, 1985, ch. 174, § 1, 1985 N.C. Sess. Laws 146, 146 (codified at N.C. GEN. STAT. § 105-149(a)(8f) (1985)). To claim this exemption a taxpayer must obtain from his or her physician a statement stating that he or she has an open neural tube defect. This statement must then be submitted to the Division of Health Services of the Department of Human Resources, which then will issue a verification form that the taxpayer must attach to his or her tax return. *Id.*

18. Act of July 2, 1985, ch. 568, § 1, 1985 N.C. Sess. Laws 640, 640 (codified at N.C. GEN. STAT. § 105-149(a)(8h) (1985)). To claim this exemption a taxpayer must attach to his or her tax return a statement from a physician stating that the taxpayer's dependent has a severe head injury resulting in a continuous vegetative state or is in a severely disabled condition. This determination of the dependent's condition must be assessed under the Glasgow Outcome Scales. *Id.*

19. Act of July 1, 1985, ch. 513, § 2, 1985 N.C. Sess. Laws 581, 582; Act of May 13, 1985, ch. 174, § 2, 1985 N.C. Sess. Laws 146, 146; Act of July 2, 1985, ch. 568, § 1, 1985 N.C. Sess. Laws 640, 640.

20. N.C. GEN. STAT. § 105-151.11(a) (1985) provides heads of households with a tax credit of 7% on certain work related child-care expenses. Once taxable income has been determined and the amount of taxes has been computed, a taxpayer is then allowed to deduct from taxes owed the applicable credit; a credit is thus a direct reduction of taxes. See M. CHIRLSTEIN, FEDERAL INCOME TAXATION 2 (1985).

21. Act of July 9, 1985, ch. 656, § 10, 1985 N.C. Sess. Laws 830, 832 (codified at N.C. GEN. STAT. § 105-151.11(b1) (1985)).

22. Act of July 9, 1981, ch. 899, 1981 N.C. Sess. Laws 1335, 1335-36, amended by Act of July 9, 1985, ch. 656, § 10, 1985 N.C. Sess. Laws 830, 832 (codified at N.C. GEN. STAT. § 105-151.11(b1) (1985)).

23. To determine the allowable credit under this statute the amount of employment related child-care expenses, subject to the limitation, is multiplied by 7%. N.C. GEN. STAT. § 105-151.11(a) (1985). Thus, the difference in the prior maximum amount of child-care expenses and the amount currently allowed is \$800, and when multiplied by 7% yields a potential credit increase of \$56. This increase in child care credit will affect a substantial number of North Carolina citizens because more than 500,000 children in North Carolina require some type of day care. N.C. CHILD ADVOCACY INST., THE STATE OF THE CHILD IN NORTH CAROLINA 32 (1984). Although the Internal Revenue Code has the same limitations on child care expenses incurred (\$2,400 for individuals with one child and \$4,800 for individuals with two children), the credit potential under federal tax law is much greater due to the applicable percentage rate allowed. The credit is 30% of expenses incurred for taxpayers having adjusted gross income of \$10,000 or less, with the credit decreasing by 1%, to a minimum of 20%, for each \$2,000 in excess of \$10,000 adjusted gross income. I.R.C. § 21(a)(2) (Supp. 1984).

24. A qualified dependent is defined as a child under 15 years of age or any dependent or spouse of a taxpayer who is physically or mentally incapable of caring for himself or herself. N.C. GEN. STAT. § 105-151.11(b)(1)(a)-(c) (1985).

who spends at least eight hours each day in the taxpayer's home.<sup>25</sup>

The general assembly passed several amendments affecting divorced couples. Two of the amendments<sup>26</sup> added make North Carolina's tax treatment of alimony payments and property transfers made incident to divorce conform with the tax treatment of these items under the Internal Revenue Code. The first amendment relates to alimony payments. Generally, alimony payments are regarded as taxable income to the recipient and as a deductible expense by the payor under the Internal Revenue Code<sup>27</sup> and under North Carolina law.<sup>28</sup> Under certain circumstances, however, the Internal Revenue Code reverses this scheme, and a portion of the alimony payments will be regarded as taxable income to the payor.<sup>29</sup> For separation agreements and divorce decrees entered into after December 31, 1984, North Carolina will follow the Internal Revenue Code treatment of excess alimony payments.<sup>30</sup>

Under the second amendment, when a property transfer is made incident to divorce, a gain or loss will be recognized only to the extent recognizable under the Internal Revenue Code, unless the basis as determined under the Internal Revenue Code is different from the basis as determined under North Carolina law.<sup>31</sup> If there is such a difference then the basis used must be the basis as determined under North Carolina law. This amendment is effective for all property transferred pursuant to agreements made on or after July 18, 1984.<sup>32</sup> This amendment also applies to transfers made after July 18, 1984, but pursuant to a prior instrument, if both parties elect such treatment.<sup>33</sup> A similar election is available to any transfer of property made between December 31, 1983, and July

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25. Act of July 9, 1985, ch. 656, § 9, 1985 N.C. Sess. Laws 830, 832 (codified at N.C. GEN. STAT. § 105-151.11(b)(2) (1985)).

26. The first amendment deals with the tax treatment of excess alimony payments. Act of June 21, 1985, ch. 444, § 1, 1985 N.C. Sess. Laws 377, 377 (codified at N.C. GEN. STAT. § 105-141.2 (1985)). The second amendment aligning North Carolina law with that of the Internal Revenue Code relates to property transfers made incident to divorce. Act of June 21, 1985, ch. 444, § 3, 1985 N.C. Sess. Laws 377, 377 (codified at N.C. GEN. STAT. § 105-145 (d1) (1985)).

27. I.R.C. § 71(a) (Supp. 1984) (gross income includes amounts received as alimony or under separate maintenance agreements); *id.* § 215(a) (alimony payments are deductible by payor).

28. N.C. GEN. STAT. § 105-141.2 (1985) (gross income includes payments made for support and maintenance pursuant to a separation agreement or to a court decree); *id.* § 105-147(21)(a) (support payments includable as taxable income to the recipient under § 105-141.2 are deductible by the payor).

29. Under the Internal Revenue Code a certain amount of alimony payments will be regarded as income to the payor if alimony payments decrease by more than \$10,000 during any of the first six post-separation years. I.R.C. § 71(f) (West 1985). For a more detailed explanation of the alimony recapture under the Federal Code, see M. CHIRELSTEIN, *supra* note 20, at 197-99.

30. Act of June 21, 1985, ch. 444, § 1, 1985 N.C. Sess. Laws 377, 377 (codified at N.C. GEN. STAT. § 105-141.2 (1985)).

31. Act of June 21, 1985, ch. 444, § 3, 1985 N.C. Sess. Laws 377, 377 (codified at N.C. GEN. STAT. § 105-145(d1) (1985)). Under the Internal Revenue Code property transfers made incident to a divorce are treated as acquisitions by gift, and the basis in the hands of the transferee is the same basis as that of the transferor provided the property transfer occurs within one year after the marriage ends and the transfer is related to the termination of the marriage. I.R.C. § 1041(a)-(c) (Supp. 1984). Basis of property transferred under North Carolina law may be affected in several ways, including involuntary conversions, N.C. GEN. STAT. § 105-144.1 (1985), stock distributions, *id.* § 105-144.4 (1985), and the general exchanges-of-property statute. *Id.* § 105-145 (1985).

32. Act of June 21, 1985, ch. 444, § 5, 1985 N.C. Sess. Laws 377, 377.

33. *Id.* at 378.

18, 1984.<sup>34</sup>

Two other amendments affect divorced couples with dependent children. The first amendment involves deductible medical expenses incurred by a parent on behalf of his or her child. Effective January 1, 1985, a deduction is allowed to the parent actually incurring the medical expense, regardless of whether this parent is able to list his or her child as a dependent for income tax purposes.<sup>35</sup> The other amendment empowers the state to attach income tax refunds of persons owing child support payments to an individual who has received services through the North Carolina Department of Human Resources.<sup>36</sup> The effective date of this amendment is October 1, 1985,<sup>37</sup> thus enabling the state to attach refunds payable for the 1985 tax year.

Probably the most important changes made by the general assembly affecting a majority of North Carolina citizens are the amendments to the estate and gift tax sections. Effective August 1, 1985, all property passing to a surviving spouse of a decedent is exempt from inheritance tax.<sup>38</sup> Prior to this amendment, when real property was held by a husband and wife as tenants by the entirety, the surviving spouse paid inheritance taxes on half the value of such property.<sup>39</sup>

A second major change in the inheritance tax section is an amendment increasing the tax credit available to offset the inheritance tax imposed. The credit is initially decreased to 2,350 dollars for decedents dying on or after August 1, 1985.<sup>40</sup> This initial decrease, however, must be analyzed in light of the amendment exempting from taxation all property passing to the surviving spouse.<sup>41</sup> Prior to the amendment a total credit of 3,150 dollars was available, and the surviving spouse had first use of the credit.<sup>42</sup> If there was no surviving spouse or if the surviving spouse did not use the total credit, the remaining credit could be used to offset inheritance taxes imposed on property passing to the decedent's heirs in the following order: first, on a pro rata basis, by the decedent's minor children or to the decedent's mentally or physically handicapped children; sec-

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34. *Id.*

35. Act of April 12, 1985, ch. 88, 1985 N.C. Sess. Laws 58 (codified at N.C. GEN. STAT. § 105-147(11)(b)(3) (1985)).

36. Act of July 15, 1985, ch. 747, 1985 N.C. Sess. Laws 58 (codified at N.C. GEN. STAT. § 105A-2(d) (1985)). This bill was mandated by the Child Support Enforcement Amendments of 1984, 42 U.S.C. 666 (Supp. 1984). States must intercept state income tax refunds for welfare and non-welfare families. If child support money is collected on behalf of a custodial parent receiving welfare, the state must retain the obligor's state income tax refund and this money, up to the amount that the state has spent on the obligor's dependents, goes to the state. If, instead, the state is retaining the income tax refund on behalf of a non-welfare custodial parent (when the obligor is in arrears in a court ordered child support case), this money is sent directly to the custodial parent. *Id.*

37. Act of July 15, 1985, ch. 747, § 2, 1985 N.C. Sess. Laws 58, 58.

38. Act of July 9, 1985, ch. 656, § 2, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-3(10) (1985)).

39. Act of June 29, 1984, ch. 1035, 1983 N.C. Sess. Laws 205, 205-06, *repealed by* Act of July 9, 1985, ch. 656, § 1, 1985 N.C. Sess. Laws 830, 830-31.

40. Act of July 9, 1985, ch. 656, § 3, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-4(b) (1985)).

41. *See supra* text accompanying note 38.

42. Act of June 6, 1979, ch. 801, § 21, 1979 N.C. Sess. Laws 927, 931, *amended by* Act of July 9, 1985, ch. 656, § 3, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-4(b)(1) (1985)).

ond, by Class A Beneficiaries, including lineal ancestors of the decedent.<sup>43</sup> Because of the new spousal exemption,<sup>44</sup> however, the beneficiaries in line to use this credit now have moved up one level; the decedent's children now will have access to the full credit, with the balance of the credit going to the other Class A beneficiaries.<sup>45</sup>

Although the credit for decedents is initially decreased to 2,350 dollars, the credit increases to 8,150 dollars for decedents dying on or after July 1, 1986, and thereafter increases annually to a maximum credit of 26,150 dollars for decedents dying on or after January 1, 1989.<sup>46</sup> Thus, with the spousal exemption and the increase in the tax credits, a decedent now can leave a substantial tax-free estate to his or her descendants.<sup>47</sup>

Another change in the inheritance tax laws involves the minimum value of

43. Act of June 23, 1980, ch. 1183, 1979 N.C. Sess. Laws 110, 110 (codified as amended at N.C. GEN. STAT. § 105-4(b)(2) (1985)). Class A beneficiaries are defined as the "lineal issue, or lineal ancestor, or stepchild, . . . or child adopted by the decedent, . . . or a son-in-law or a daughter-in-law whose spouse is not entitled to any beneficial interest in such property." N.C. GEN. STAT. § 105-4(a) (1985).

44. See *supra* note 38 and accompanying text.

45. Act of July 9, 1985, ch. 656, § 3, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-4(b)(1)-(2) (1985)).

46. Act of July 9, 1985, ch. 656, § 3, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-4(b) (1985)). Because of a difference in effective dates, estates of decedents dying during July 1985, are allowed a credit of \$4,650. Act of June 29, 1984, ch. 1032, 1984 N.C. Sess. Laws 128, 128, amended by Act of July 9, 1985, ch. 656, § 3, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-4(b) (1985)). The 1985 amendment is effective for decedents dying on or after August 1, 1985, Act of July 9, 1985, ch. 656, § 57, 1985 N.C. Sess. Laws 841, 842, whereas the 1984 amendment was effective for decedents dying on or after July 1, 1985, Act of June 29, 1984, ch. 1032, § 2, 1984 N.C. Sess. Laws 128, 128, thus leaving one month when the credit will be that as dictated by the 1984 law.

47. The equivalent tax-free estate derived from the increased tax credits is shown in the following table:

<u>For Decedents Dying on or after</u>	<u>Amount of Credit</u>	<u>Equivalent Tax-Free Estate</u>
August 1, 1985	\$ 2,350	\$ 80,000
July 1, 1986	8,150	200,000
January 1, 1987	14,150	300,000
January 1, 1988	20,150	400,000
January 1, 1989	26,150	500,000

The amount of credit is equivalent to the amount of tax imposed on the corresponding estate. To get the equivalent tax-free estate it is necessary to compute the applicable inheritance tax as imposed under the following schedule for Class A beneficiaries:

<u>Taxable Amount</u>	<u>Percentage Imposed</u>
First \$10,000 . . . . .	1 percent
Over \$10,000 and to \$25,000 . . . . .	2 percent
Over \$25,000 and to \$50,000 . . . . .	3 percent
Over \$50,000 and to \$100,000 . . . . .	4 percent
Over \$100,000 and to \$200,000 . . . . .	5 percent
Over \$200,000 and to \$500,000 . . . . .	6 percent
Over \$500,000 and to \$1,000,000* . . . . .	7 percent

N.C. GEN. STAT. § 105-4(a) (1985). Estates are taxed at increased rates on increments of \$500,000. If an estate is valued over three million dollars the effective rate is 12 percent.

Using the numbers and rates from the previous table one can compute the inheritance tax due on an estate valued at \$80,000:

an estate for which a filing is required.<sup>48</sup> Although property passing to a surviving spouse is now exempt from taxation,<sup>49</sup> one-half of the fair market value of real property owned by a husband and wife as tenants by the entirety or as joint tenants with a right of survivorship is included in the gross estate of the decedent.<sup>50</sup> Similiar rules apply to one-half of the money in joint bank accounts and one-half the value of corporate stock or investment securities held by a husband or wife as joint tenants with a right of survivorship.<sup>51</sup> Because of the substantial increase in the tax credits due to take place over the next four years,<sup>52</sup> it is foreseeable that the general assembly will also increase the minimum value an estate must reach before requiring a filing, particularly when a decedent's beneficiaries are either lineal descendants or lineal ancestors.<sup>53</sup> If this minimum level is not increased, a substantial number of returns will be filed even though no tax will be owed.<sup>54</sup>

The general assembly also amended the estate tax statutes to allow faster access to safety deposit boxes so that beneficiaries may collect life insurance proceeds faster. Once the clerk of court has inventoried the assets in a decedent's

	Estate Value (in increments)		Rate of Tax	Tax Imposed
First	\$10,000	X	.01	\$ 100
Next	\$15,000	X	.02	\$ 300
Next	\$25,000	X	.03	\$ 750
Next	<u>\$30,000</u>	X	.04	<u>\$1,200</u>
Totals	\$80,000			\$2,350

Thus, the credit of \$2,350 offsets the tax imposed of \$2,350 for an estate valued at \$80,000. Similar computations can be done for the other equivalent tax-free estates in the first example.

48. For all estates of a decedent valued at \$75,000 or more, the executor or administrator must file a detailed listing of the assets with the county clerk. See N.C. GEN. STAT. § 105-22 (1985). During the publishing stage of this Note, the North Carolina General Assembly amended the inheritance tax return statute exempting from the filing requirement estates whose value is below a certain minimum. H.B. 1467, § 2, N.C. Gen. Assembly, 1985 Session (to be codified at N.C. GEN. STAT. § 105-23(b)). A return is not required to be filed for decedents dying between July 1, 1985, and August 1, 1985, who leave an estate with a gross value of \$100,000 or less. *Id.* The gross value of an estate exempt from the filing requirements then decreases to \$75,000 for persons dying on or after August 1, 1985, *id.*, increasing to \$150,000 for persons dying on or after July 1, 1986, *id.*, and then increasing to \$250,000 for decedents dying on or after January 1, 1987. *Id.*

49. See *supra* text accompanying note 38.

50. Act of July 9, 1985, ch. 656, § 1, 1985 N.C. Sess. Laws 830, 830 (codified at N.C. GEN. STAT. § 105-2(b)(1) (1985)).

51. Act of July 9, 1985, ch. 656, § 1, 1985 N.C. Sess. Laws 830, 830-31 (codified at N.C. GEN. STAT. § 105-2(b)(2) (1985)).

52. See *supra* text accompanying notes 44-47.

53. Estates of less than \$75,000 are exempt from filing requirements. Act of July 9, 1985, ch. 656, § 3.1, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-22 (1985)). This legislation is one of two 1985 amendments affecting the filing requirements. The first amendment increased the minimum value an estate must meet before a filing is required from \$75,000 to \$100,000. Act of April 12, 1985, ch. 82, § 1, 1985 N.C. Sess. Laws 55, 55, amended by Act of July 9, 1985, ch. 656, § 3.1, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-122 (1985)). The second amendment, however, returned the exemption to the \$75,000 minimum value of an estate before a filing is required. The first amendment became effective July 1, 1985. Act of April 12, 1985, ch. 82, § 4, 1985 N.C. Sess. Laws 55, 56. The second amendment became effective August 1, 1985. Act of July 9, 1985, ch. 646, § 57, 1985 N.C. Sess. Laws 841, 841. Because of the difference in effective dates, the \$100,000 level remains in force for decedents dying during July 1985.

54. See *supra* note 47 and accompanying text. See also *supra* note 48 (discussing the July 1986 amendment increasing the minimum value of estates for which a filing is required).

lock box, the bank now must turn over, upon request, any life insurance policy to the named beneficiary.<sup>55</sup> Because most insurance companies require the surrender of the policy before payment of the proceeds, this amendment makes it easier for the beneficiary to collect the proceeds.

A final amendment to the estate tax statute involves death benefits of a self-employed individual.<sup>56</sup> Amounts up to 5,000 dollars received by the estate or heirs of a self-employed person are now exempt if the payments are made by a trust or are otherwise exempt under the Internal Revenue Code.<sup>57</sup>

In the area of gift taxes, the general assembly increased the lifetime exclusion to 100,000 dollars<sup>58</sup> effective January 1, 1986.<sup>59</sup> Also, spouses may elect to share annual gift tax exclusions provided both spouses are residents of North Carolina<sup>60</sup> and the consent of the non-donor spouse is in writing; once given, this consent is irrevocable.<sup>61</sup> A final amendment affecting estate and gift taxes provides that all interspousal gifts made on or after January 1, 1986,<sup>62</sup> are exempt from the gift tax.<sup>63</sup>

Although the general assembly passed several amendments affecting businesses,<sup>64</sup> the major change in the code affects the tax treatment of inventories. Effective January 1, 1986,<sup>65</sup> every North Carolina manufacturer, individual or corporate, is allowed a credit equal to twenty percent of local property taxes paid on the manufacturer's inventories.<sup>66</sup> For taxable years beginning on or after January 1, 1987, the credit increases to forty percent of the property tax paid.<sup>67</sup>

A similar tax break was created for wholesalers' and retailers' tangible personal property inventories. These inventories are designated a special status, and for property tax purposes the inventories will be assessed at ninety percent

55. Act of April 19, 1985, ch. 106, 1985 N.C. Sess. Laws 75 (codified at N.C. GEN. STAT. § 105-24 (1985)).

56. Act of April 12, 1985, ch. 84, 1985 N.C. Sess. Laws 56 (codified at N.C. GEN. STAT. § 105-141(b)(11) (1985)).

57. For death benefits of a self-employed person to be exempt from taxation, the benefits must be paid or distributed by a trust as defined by I.R.C. § 401(a) (1982) and exempt from federal taxation under *id.* § 501(a) or be paid or distributed under a plan as described in *id.* § 403(a). Act of April 12, 1985, ch. 84, 1985 N.C. Sess. Laws 56 (codified at N.C. GEN. STAT. § 105-141(b)(11) (1985)).

58. Act of July 9, 1985, ch. 656, § 6, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-188(g) (1985)). Under the prior statute the amount of the lifetime exclusion was \$30,000. Act of May 15, 1973, ch. 505, 1973 N.C. Sess. Laws 716, *amended by* Act of July 9, 1985, ch. 656, § 6, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-188(g) (1985)).

59. Act of July 9, 1985, ch. 656, § 57, 1985 N.C. Sess. Laws 830, 841.

60. Act of April 12, 1985, ch. 86, 1985 N.C. Sess. Laws 57 (codified at N.C. GEN. STAT. § 105-188(d) (1985)).

61. *Id.*

62. Act of July 9, 1985, ch. 656, § 57, 1985 N.C. Sess. Laws 830, 841.

63. Act of July 9, 1985, ch. 656, § 4, 1985 N.C. Sess. Laws 830, 831 (codified at N.C. GEN. STAT. § 105-188(h)(4) (1985)).

64. See *infra* text accompanying notes 65-87.

65. Act of July 9, 1985, ch. 656, § 57, 1985 N.C. Sess. Laws 830, 841-42.

66. Act of July 9, 1985, ch. 656, § 13, 1985 N.C. Sess. Laws 830, 833 (codified at N.C. GEN. STAT. § 105-163.06(a) (1985)).

67. Act of July 9, 1985, ch. 656, § 23.1, 1985 N.C. Sess. Laws 830, 835 (codified at N.C. GEN. STAT. § 105-163.06(a) (1985)).

of the rate levied on other tangible personal property.<sup>68</sup> The ninety percent rate is effective for taxable years beginning on or after January 1, 1986,<sup>69</sup> and decreases to eighty percent<sup>70</sup> for taxable years beginning on or after January 1, 1987.<sup>71</sup>

The general assembly also gave an inventory tax break to North Carolina farmers. Any individual farmer or corporation engaged in farming that has elected to be treated as a "Subchapter S" corporation, as defined under the Internal Revenue Code,<sup>72</sup> is allowed up to a 1,000 dollar tax credit for property taxes paid on farm machinery, including attachments and repair parts.<sup>73</sup>

A taxpayer who is a member of a partnership doing business in North Carolina is also allowed the credits for property taxes paid on manufacturers' inventories and for property taxes paid on farm machinery.<sup>74</sup> The credit available to a partner is equal to the tax credit available to the partnership multiplied by the percentage of a partner's interest in the profits of the partnership.<sup>75</sup>

The general assembly also passed several amendments that appear to give preferential treatment to North Carolina businesses or to North Carolina products. For insurance companies with their corporate headquarters or principal place of business in North Carolina, the general assembly passed an amendment, effective January 1, 1985,<sup>76</sup> granting a tax credit against the tax on gross premiums.<sup>77</sup> Although the overall effect is the same as under the prior statute,<sup>78</sup> it

68. Act of July 9, 1985, ch. 656, § 44, 1985 N.C. Sess. Laws 830, 840 (codified at N.C. GEN. STAT. § 105-277(i) (1985)).

69. Act of July 9, 1985, ch. 646, § 57, 1985 N.C. Sess. Laws 830, 841-42.

70. Act of July 9, 1985, ch. 646, § 52.1, 1985 N.C. Sess. Laws 830, 840 (codified at N.C. GEN. STAT. § 105-277(i) (1985)).

71. Act of July 9, 1985, ch. 646, § 57, 1985 N.C. Sess. Laws 830, 841-42.

72. A corporation with less than 35 members may elect tax treatment as a Subchapter S corporation. I.R.C. § 1362(a) (1982). The effect of this election is that certain items of corporate income and expense will flow through directly to each individual shareholder, each of whom will be individually liable for taxes rather than the corporation reporting the income and paying corporate taxes. I.R.C. § 1366 (1982).

73. Act of July 9, 1985, ch. 656, § 13(3), 1985 N.C. Sess. Laws 830, 833 (codified at N.C. GEN. STAT. § 105-163.07 (1985)). This amendment is effective for taxable years beginning on or after January 1, 1986. Act of July 9, 1985, ch. 656, § 57, 1985 N.C. Sess. Laws 830, 841-42.

74. Act of July 9, 1985, ch. 656, § 13(3), 1985 N.C. Sess. Laws 830, 833-34 (codified at N.C. GEN. STAT. § 105-163.09(c) (1985)).

75. Act of July 9, 1985, ch. 656, § 13(3), 1985 N.C. Sess. Laws 830, 833-34 (codified at N.C. GEN. STAT. § 105-163.09(c) (1985)). For example, if Partner A has a one-fourth interest in the profits and losses of a partnership, and if the partnership has a \$1,000 tax credit, one-fourth of this credit, or \$250, will flow through to Partner A, who will be allowed this credit on his or her individual tax return.

76. Act of July 12, 1985, ch. 719, § 4, 1985 N.C. Sess. Laws 946, 947 (codified at N.C. GEN. STAT. § 105-228.5 (1985)).

77. Act of July 12, 1985, ch. 719, § 1, 1985 N.C. Sess. Laws 946, 946 (codified at N.C. GEN. STAT. § 105-228.5 (1985)).

78. Under the prior statute, foreign (out-of-state) insurance companies were taxed on their gross premiums at a rate ranging from 2.5% to 4%, whereas North Carolina based insurance companies were taxed at a rate ranging from 1% to 1.6% per cent. Act of May 25, 1955, ch. 1313, § 5, 1955 N.C. Sess. Laws 1352, 1359, *amended by* Act of July 12, 1985, ch. 719, 1985 N.C. Sess. Laws 946 (codified at N.C. GEN. STAT. § 105-228.5 (1985)). Under the new statute domestic and foreign insurance companies are equally taxed at rates ranging from 2.5% to 4%. North Carolina based companies, however, are allowed a credit ranging from 1% to 2.4%. During the publishing stage of this Note, the North Carolina General Assembly amended the insurance premium statute. H.B.

appears that the general assembly rewrote the section in response to a recent United States Supreme Court case challenging the constitutionality of a state giving preferential treatment to domestic insurance companies.<sup>79</sup> An insight into the general assembly's purpose in adopting this amendment can be garnered by reading the preamble to the statute averring that insurance companies having their principal place of business in North Carolina provide better services to North Carolina residents due to, for example, the "greater accessibility of records, offices and personnel."<sup>80</sup>

Similar preferential treatment is given to some producers of North Carolina tobacco. An income tax deduction is allowed for the amount paid as marketing assessments on tobacco grown by a corporation in North Carolina.<sup>81</sup> This

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2103, § 1, N.C. Gen. Assembly, 1985 Session (to be codified at N.C. GEN. STAT. § 105-228.5). Domestic and foreign insurance companies are now equally taxed at rates ranging from .5% to 1.75%. *Id.* § 3. The preferential tax treatment by way of a credit, previously given North Carolina insurance companies has been eliminated. Act of July 12, 1985, ch. 719, 1985 N.C. Sess. Laws 946, amended by H.B. 2103, § 3, N.C. Gen. Assembly, 1985 Session (to be codified at N.C. GEN. STAT. 105-228.5). The action of the North Carolina General Assembly apparently resulted from the General Assembly's desire to avoid a multi-million dollar lawsuit that had been filed against the State of North Carolina by out of state insurance companies. See *Durham Morning Herald*, July 16, 1986, at 1C, col. 1.

79. The Supreme Court case involved an out-of-state insurance company that challenged, on equal protection grounds, the constitutionality of an Alabama statute that gave preferential treatment to domestic insurance companies. See *Metropolitan Life Ins. Co. v. Ward*, 105 S. Ct. 1676 (1985). In a statute similar to North Carolina's, Alabama taxed domestic insurance companies at a rate of 1% on gross premiums whereas foreign insurance companies were taxed at rates ranging from 3% to 4%. ALA. CODE §§ 27-4 to 27-5 (1975). By investing a certain percentage of its assets in Alabama, however, a foreign insurance company could decrease its gross premium tax rate by 2%. *Id.* § 27-4-4(b).

The trial court in *Ward* had ruled that the Alabama statute did not violate the equal protection clause because the statute had the legitimate purposes of encouraging the formation of new domestic insurance companies within the state and encouraging the investment of capital within the state. *Ward*, 105 S. Ct. at 1679. In reversing the trial court, the United States Supreme Court held that the purpose of Alabama's statute favoring domestic insurance companies was the "very sort of parochial discrimination that the Equal Protection Clause was intended to prevent." *Id.* at 1681-82. The Court did not address the issue, however, whether or not a state would have other reasons that could be legitimate. *Id.* at 1680 n.5. Although the state had advanced 15 additional purposes for the preferential treatment, because the lower courts did not rule on these other purposes, the Supreme Court expressed no view on their legitimacy. *Id.* Among the 15 additional purposes advanced by the state for promoting the growth of domestic insurance companies were:

[e]xtending the range of customer choices among alternative insurance companies, making it economically feasible for young, relatively small domestic companies to compete on a more equal footing with large, well-established out-of-state companies; and promoting the greater use of insurance of all types in rural and sparsely populated sections of Alabama that are usually ignored by large foreign companies.

Hellerstein & Leegstra, *Supreme Court in Metropolitan Life Strikes Down Discriminatory State Insurance Tax*, in *J. TAX'N* 108, 111 (Aug. 1985).

By rewriting the statute and adding a preamble to the amendment, the North Carolina General Assembly apparently felt that preferential treatment based on a rational business purpose will survive a constitutional challenge. See *infra* text accompanying note 80.

80. Act of July 12, 1985, ch. 719, 1985 N.C. Sess. Laws 946, 946.

81. Act of July 12, 1985, ch. 720, § 1, 1985 N.C. Sess. Laws 947, 947 amended by Act of July 18, 1985, ch. 791, § 43, 1985 N.C. Sess. Laws 1321, 1333 (codified at N.C. GEN. STAT. § 105-130.5(b)(15) (1985)). The original bill allowed the credit for the amount of tobacco "stored" in North Carolina. Act of July 12, 1985, ch. 720, § 1, 1985 N.C. Sess. Laws 947, 947. This language was later amended to apply to tobacco "grown" in North Carolina. Act of July 18, 1985, ch. 791, § 43, 1985 N.C. Sess. Laws 1321, 1333 (codified at N.C. GEN. STAT. § 105-130.5(b)(15) (1985)).

amendment is effective for taxable years beginning on or after January 1, 1985.<sup>82</sup>

A final amendment giving preferential tax treatment to North Carolina products is one concerning wine made from domestic grapes. Effective January 1, 1985,<sup>83</sup> any North Carolina corporation<sup>84</sup> or individual<sup>85</sup> distributing North Carolina wine is allowed a credit of twenty cents per liter against the excise tax.<sup>86</sup> This credit is available if the wine distributed contains at least sixty percent of fruits or berries grown in North Carolina.<sup>87</sup>

There were several minor amendments passed by the general assembly affecting either individuals or businesses or both. In the sales and use tax area, the general assembly exempted from sales tax all prescription medicine bought from veterinarians,<sup>88</sup> subjected to the three percent sales tax goods sold by dealers at flea markets,<sup>89</sup> increased the exemption for funeral expenses,<sup>90</sup> and eliminated the sales tax on certain supplies used in printing free advertising circulars.<sup>91</sup>

For individuals and for businesses the general assembly eliminated from the intangibles tax base the following: funds on deposit with a bank<sup>92</sup> or insurance company,<sup>93</sup> cash on hand held by businesses<sup>94</sup> and any accounts receivable balances on account with investment or security dealers.<sup>95</sup> The general assembly also rewrote the estimated tax statutes to align the North Carolina payment and penalties for failure to pay these taxes with that of the Internal Revenue Code.<sup>96</sup>

82. Act of July 12, 1985, ch. 791, § 43, 1985 N.C. Sess. Laws 1321, 1333 (codified at N.C. GEN. STAT. § 105-130.5(b)(15) (1985)).

83. Act of July 4, 1985, ch. 790, § 3, 1985 N.C. Sess. Laws 761, 762.

84. Act of July 4, 1985, ch. 590, § 1, 1985 N.C. Sess. Laws 761, 761 (codified at N.C. GEN. STAT. § 105-130.38 (1985)).

85. Act of July 4, 1985, ch. 590, § 2, 1985 N.C. Sess. Laws 761, 761 (codified at N.C. GEN. STAT. § 105-151.15 (1985)).

86. Act of July 4, 1985, ch. 590, § 1, 1985 N.C. Sess. Laws 761, 761 (codified at N.C. GEN. STAT. § 105-130.38(a) (1985)) (corporations); Act of July 4, 1985, ch. 590, § 2, 1985 N.C. Sess. Laws 761, 762 (codified at N.C. GEN. STAT. § 105-151.15(a) (1985)) (individuals).

87. Act of July 4, 1985, ch. 590, § 1, 1985 N.C. Sess. Laws 761, 761 (codified at N.C. GEN. STAT. § 105-130.38(b)(1) (1985)) (corporations); Act of July 4, 1985, ch. 590, § 2, 1985 N.C. Sess. Laws 761, 762 (codified at N.C. GEN. STAT. § 105-151.15(b)(1) (1985)) (individuals).

88. Act of July 1, 1985, ch. 555, 1985 N.C. Sess. Laws 625 (codified at N.C. GEN. STAT. § 105-164.13(13) (1985)).

89. Act of July 11, 1985, ch. 704, § 1, 1985 N.C. Sess. Laws 935, 935 (codified at N.C. GEN. STAT. § 105-164.4(4b) (1985)). Individuals selling their own personal household goods, however, are not subject to the tax. *Id.*

90. Act of July 9, 1985, ch. 656, § 24, 1985 N.C. Sess. Laws 830, 836 (codified at N.C. GEN. STAT. § 105-164.13(18) (1985)) (raising the exemption to \$1,500). The amount exempt from sales tax under the prior statute was \$150. Act of April 1, 1974, ch. 1076, 1973 N.C. Sess. Laws 214, amended by Act of July 9, 1985, ch. 656, § 24, 1985 N.C. Sess. Laws 830, 836 (codified at N.C. GEN. STAT. § 105-164.13(18) (1985)). The exemption increases to \$1,500, effective July 1, 1986. Act of July 9, 1985, ch. 656, § 57, 1985 N.C. Sess. Laws 830, 841-42.

91. Act of July 9, 1985, ch. 656, § 25, 1985 N.C. Sess. Laws 830, 836 (codified at N.C. GEN. STAT. §§ 105-164.13(39) (1985)). Exempt from tax are sales of ink, paper, and other supplies to commercial printers of periodic free circulars. *Id.*

92. Act of July 9, 1985, ch. 656, § 32, 1985 N.C. Sess. Laws 830, 837-38. This repeal became effective for taxable years beginning on or after January 1, 1985. *Id.* § 57, at 841-42.

93. *Id.* § 32, at 837-38.

94. *Id.*

95. *Id.* at 839. This amendment became effective for taxable years beginning on or after January 1, 1985. *Id.* § 57, at 841-42.

96. Act of June 21, 1985, ch. 443, §§ 2-3, 1985 N.C. Sess. Laws 374, 374-76 (codified at N.C.

Finally, in a miscellaneous category the general assembly granted ordained ministers the right to elect to be considered self-employed and thus not liable for withholding taxes.<sup>97</sup>

While some people question the wisdom of the general assembly granting substantial tax relief to the citizenry of North Carolina,<sup>98</sup> others feel that the general assembly did not go far enough.<sup>99</sup> Arguably the North Carolina General Assembly considered basic economics when deciding to give such broad-based tax relief to North Carolina citizens and businesses. A state having lower taxes could conceivably attract more people and more industry, thus adding to state coffers by having more businesses upon whom to assess taxes.<sup>100</sup> Nonetheless, the general assembly did pass a substantial number of amendments with the overall effect of decreasing taxes for the majority of North Carolina individuals and businesses.

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GEN. STAT. §§ 105-163.15-.16 (1985)) This act is effective for taxable years beginning on or after January 1, 1986. *Id.* § 4, at 376.

97. Act of June 14, 1985, ch. 394, § 2, 1985 N.C. Sess. Laws 318, 318 (codified at N.C. GEN. STAT. § 105-163.1A (1985)) (effective upon ratification).

98. See Liner, *State Taxes*, NORTH CAROLINA LEGISLATION 1985, 296 (N.C. Inst. of Gov't) (questioning the granting of tax relief when there is a substantial need for increased funds in the area of education). The North Carolina State Board of Education has called for an increase over the next several years of over \$600,000,000 to implement a new educational program for primary and secondary schools in North Carolina. N.C. STATE BD. OF EDUC., THE BASIC EDUCATION PROGRAM FOR NORTH CAROLINA'S PUBLIC SCHOOLS 73 (rev. Feb. 1985).

99. Governor James G. Martin had placed priority on the elimination of property taxes on business inventories and on intangible personal property as well as the elimination of taxes on food and nonprescription drugs. Liner, *supra* note 98, at 296.

100. See generally Campbell & Ferrell, *1985 Legislation Affecting Property and Privilege License Taxes*, in PROPERTY TAX BULLETIN, Aug., 1985, at 1, 8-9 (N.C. Inst. of Gov't) (some legislators contended that the presence of inventory taxes was preventing North Carolina from attracting industry).