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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, 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 to minor changes concerning which individuals must file a state tax return. 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. This Note analyzes these changes in the tax code and the effect the amendments will have on individuals and businesses in North Carolina.

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. 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, however, and certain individuals are not eligible for the credit.


2. See infra text accompanying notes 38-63.


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.


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. 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, 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. The amended section 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. 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. For subsequent taxable years beginning on or after January 1, 1987, the amounts are increased to $12,000 dollars and $11,000 dollars respectively.

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, an open neural tube defect, or severe head injuries causing the person to

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(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 dependent by another under G.S. 105-149(a)(5).


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, §§ 44, 45, 48, 49, 1985 N.C. Sess. Laws 830, 839-40 (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 1/2% sales tax. H.B. 1542, § 1, N.C. Gen. Assembly, 1985 Session (to be codified at N.C. Gen. Stat. § 105-164-498). This authority to increase the sales tax is effective immediately. Id. § 3.


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)).

be in a continuing vegetative state. Because the effective date of these amendments is January 1, 1985, 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. 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. Because the maximum amounts previously allowed were 4,000 dollars and 2,000 dollars respectively, the credit potential increases by a maximum of 56 dollars. 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.

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.


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).


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(g) (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.25

The general assembly passed several amendments affecting divorced couples. Two of the amendments26 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 Code27 and under North Carolina law.28 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.29 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.30

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.31 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, 1984.32 This amendment also applies to transfers made after July 18, 1984, but pursuant to a prior instrument, if both parties elect such treatment.33 A similar election is available to any transfer of property made between December 31, 1983, and July

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.
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).
33. Id. at 378.
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. 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. The effective date of this amendment is October 1, 1985, 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. 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.

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. This initial decrease, however, must be analyzed in light of the amendment exempting from taxation all property passing to the surviving spouse. Prior to the amendment a total credit of 3,150 dollars was available, and the surviving spouse had first use of the credit. 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-

34. Id.
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.
41. See supra text accompanying note 38.
ond, by Class A Beneficiaries, including lineal ancestors of the decedent.\textsuperscript{43} Because of the new spousal exemption,\textsuperscript{44} 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.\textsuperscript{45}

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.\textsuperscript{46} 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.\textsuperscript{47}

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

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|}
\hline
For Decedents Dying & Amount of Credit & Equivalent Tax-Free Estate \\
\hline
on or after & & \\
\hline
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 \\
\hline
\end{tabular}
\caption{Equivalent Tax-Free Estate Derived from Increased Tax Credits}
\end{table}

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:

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
Taxable Amount & Percentage Imposed \\
\hline
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 \\
\hline
\end{tabular}
\caption{Inheritance Tax Rates for Class A Beneficiaries}
\end{table}

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:

\begin{align*}
\text{Taxable Amount} & = 80,000 \\
\text{Percentage Imposed} & = 2 \text{ percent} \\
\text{Inheritance Tax} & = 80,000 \times 0.02 = 1,600 \text{ dollars}
\end{align*}
an estate for which a filing is required. \textsuperscript{48} Although property passing to a surviving spouse is now exempt from taxation, \textsuperscript{49} 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. \textsuperscript{50} Similar 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. \textsuperscript{51} Because of the substantial increase in the tax credits due to take place over the next four years, \textsuperscript{52} 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. \textsuperscript{53} If this minimum level is not increased, a substantial number of returns will be filed even though no tax will be owed. \textsuperscript{54}

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

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

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.


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. 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. 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.

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

Although the general assembly passed several amendments affecting businesses, the major change in the code affects the tax treatment of inventories. Effective January 1, 1986, 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. For taxable years beginning on or after January 1, 1987, the credit increases to forty percent of the property tax paid.

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
of the rate levied on other tangible personal property. The ninety percent rate is effective for taxable years beginning on or after January 1, 1986, and decreases to eighty percent for taxable years beginning on or after January 1, 1987.

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, is allowed up to a $1,000 dollar tax credit for property taxes paid on farm machinery, including attachments and repair parts.

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. 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.

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, granting a tax credit against the tax on gross premiums. Although the overall effect is the same as under the prior statute, it

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).
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.
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. 79 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.” 80

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. 81 This

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:

[extending 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]


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.


amendment is effective for taxable years beginning on or after January 1, 1985.82

A final amendment giving preferential tax treatment to North Carolina products is one concerning wine made from domestic grapes. Effective January 1, 1985,83 any North Carolina corporation84 or individual85 distributing North Carolina wine is allowed a credit of twenty cents per liter against the excise tax.86 This credit is available if the wine distributed contains at least sixty percent of fruits or berries grown in North Carolina.87

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,88 subjected to the three percent sales tax goods sold by dealers at flea markets,89 increased the exemption for funeral expenses,90 and eliminated the sales tax on certain supplies used in printing free advertising circulars.91

For individuals and for businesses the general assembly eliminated from the intangibles tax base the following: funds on deposit with a bank,92 or insurance company,93 cash on hand held by businesses94 and any accounts receivable balances on account with investment or security dealers.95 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.96

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

While some people question the wisdom of the general assembly granting
substantial tax relief to the citizenry of North Carolina,98 others feel that the
general assembly did not go far enough.99 Arguably the North Carolina Gen-
eral 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.100 Nonethe-
less, 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.

MARGARET CREASY CIARDELLA

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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 second-
dary schools in North Carolina. N.C. STATE BD. OF EDUC., THE BASIC EDUCATION PROGRAM
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, 1983 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).