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Local Government and Local Finance

For counties and cities, the dominant concerns during the 2002 session were the efforts to protect existing sources of revenue from state interception and to advance the authorization for an additional one-half percent local sales and use tax.

Local Government Finance

Last year's General Assembly took a number of steps intended to bolster state revenues without causing long-term damage to local government revenue sources. The 2001 General Assembly temporarily increased the *state* sales and use tax by one-half percent, effective until June 30, 2003. At that time, counties were to be permitted to levy an additional one-half percent *local* sales and use tax, in effect replacing the temporary state tax. In addition, the reimbursement payments (compensation to local governments for tax revenues that were lost when the General Assembly removed important categories—including business inventories and intangible personal property—from the property tax base) were to terminate on June 30, 2003. Thus, local governments were losing their reimbursement payments in return for an additional one-half percent local sales and use tax.

Unfortunately, it became clear almost as soon as the 2001 budget was enacted that the state's economy was in worse shape than had been thought and that state revenues would not meet the predictions upon which the 2001 budget was based. The Governor began taking a variety of steps to conform state expenditures to actual revenues collected, and he directed the Secretary of Revenue not to distribute to local governments various payments due in March and June of 2002. It was clear when the General Assembly began its 2002 session that there would be some further erosion of state payments to local governments. Therefore, local governments' efforts during the 2002 session were undertaken in reaction to the Governor's strategies to balance the state budget and the indications of how the General Assembly might bring the 2002–2003 state budget into balance.

Protection of State-Shared Taxes

One line of effort by local governments was to seek legislation restricting the Governor's ability to withhold payments to local governments of tax moneys levied by the General Assembly. This effort succeeded, resulting in S.L. 2002-120 (H 1490).

When the Governor directed the Secretary of Revenue not to make scheduled payments to cities in the spring of 2002, he acted pursuant to Article III, section 5(3), of the North Carolina Constitution. That provision directs the Governor to monitor state revenue collections and to "effect the necessary economies in State expenditures" whenever he determines that receipts will not be sufficient to meet budgeted expenditures. S.L. 2002-120 begins by characterizing several payments made by the state to local governments from the proceeds of taxes levied by the state as "local revenue, not a State expenditure." Therefore, the legislation states, "the Governor may not reduce or withhold the distribution" of these revenues to local governments. The payments so characterized are the distributions of beer and wine taxes, the electric utility franchise tax, the piped natural gas tax, the telecommunications tax, and state street assistance (Powell Bill). The local government sales and use taxes are not included in this characterization, because it is clear that these are local, not state, revenues; the taxes are levied by counties and merely collected by the state on behalf of local governments.

Although the sections of S.L. 2002-120 that amend the various payment provisions noted above state that the Governor "may not reduce or withhold the distribution" of these payments, another section of the act seems to modify that statement. Section 7 amends G.S. 143-25, a part of the Executive Budget Act, and sets forth procedures regulating the Governor's exercise of his constitutional responsibility to keep the state budget in balance. The amendment states that the Governor is not to withhold from distribution funds "that have been collected by the State on behalf of local governments" *unless* he has first "exhausted all other sources of revenue of the State." Once he has done so, however, the rewritten G.S. 143-25 appears to permit the Governor to withhold distribution of the payments listed above. It is to be hoped that the state's fiscal situation does not deteriorate enough to require a court to sort out the precise interrelationship of these various provisions or to consider the General Assembly's authority to define "State expenditures" or otherwise restrict the Governor's direct constitutional authority in these matters.

City Electric Franchise Taxes

The electric utility franchise tax is levied by G.S. 105-116, and subsection (e) of that section provides that as long as "there is a distribution to cities from the tax imposed by this section," cities may not levy such taxes themselves. When the Governor withheld the March and June payments from the proceeds of this tax, cities began examining the question of whether they could levy such a tax themselves because there had been no distribution of the state-levied tax. The Attorney General's office issued an opinion in July arguing that the statutory condition had not in fact been triggered, but a few cities went ahead and levied the taxes (although no city has begun collecting them). Chapter 2002-120 settles this issue by adding a new provision to G.S. 105-116 stating that as long as an electric utility has paid the state tax, no city may levy a local franchise tax against that utility, regardless of whether the state has withheld distribution of the tax proceeds from cities.

Loss of Reimbursements

Since the 1980s, the state has made reimbursement payments to counties and cities to compensate local governments for tax revenues that were lost when the General Assembly removed sources of revenue from the property tax base. As noted above, these payments, which have totaled about \$330 million annually, were scheduled to end in July 2003, with local governments receiving authority for an additional one-half percent sales and use tax in return. Because of the worsening of North Carolina's economy, the 2002 appropriations act ended these

reimbursement payments effective July 2002 rather than July 2003, thereby making \$330 million available to help balance the state's budget.

Additional Sales and Use Tax

Counties and cities were aware from the beginning of the 2002 session that the reimbursement payments were likely to be ended this fiscal year rather than next, and so they immediately sought to advance the date upon which counties could levy the additional one-half percent sales and use tax intended as compensation for loss of the reimbursements. The Senate passed such legislation fairly readily, initially permitting counties to levy the tax as of August 2002. The proposal ran into difficulty in the House, however, due to opposition to keeping the temporary state sales tax in effect after counties began levying their taxes, and the measure was defeated on the House floor. The House voted instead to allow the local taxes effective January 1, 2003, and to repeal the temporary state tax at the same time. Because this would have cost the state about \$250 million, the Senate was unwilling to agree, and the proposal was set aside for several weeks. However, after the legislature enacted the state budget bill—which included discontinuation of the reimbursements—local governments were able to persuade enough House members to change their votes to enact S.L. 2002-123 (S 1292), which permits counties to levy the additional one-half percent local sales and use tax effective as early as December 1, 2002, with the temporary state tax remaining in effect until July 1, 2003.

The 2001 legislation that originally authorized counties to levy this additional local sales and use tax included provisions intended to hold local governments harmless from the exchange of reimbursements for additional sales tax revenues. Those hold-harmless provisions are still scheduled to take effect next summer, but they were not extended to the current fiscal year. Therefore, local governments will experience a net loss this year because of the exchange of sales tax for reimbursements.

Public School Capital Facility Appropriations

G.S. 115C-489.1 establishes the Critical School Facilities Needs Fund, and G.S. 115C-546.1 establishes the Public School Building Capital Fund. Both funds receive continuing support from collections of the state's corporate income tax and provide assistance to local governments in meeting schools' capital facility needs. The 2002 appropriations act suspends state payments to those two funds for the 2002–2003 fiscal year, mandating instead that the moneys be used to support public schools' current operations.

Changes in the Local Government Budget and Fiscal Control Act

The 2002 appropriations act [S.L. 2002-126 (S 1115)] includes two changes to the Local Government Budget and Fiscal Control Act, both results of the state's economic problems and local and state government responses to those problems.

Reducing school appropriations. G.S. 159-13(b) prohibits a county from amending its budget ordinance to reduce appropriations to school administrative units unless the administrative unit agrees or unless "a general reduction in county expenditures is required because of prevailing economic conditions." A number of counties considered reductions in school appropriations in the spring of 2001 because of the loss of state funds. In response, apparently, the General Assembly added two procedural requirements that a county must meet before reducing a public school appropriation because of an economic downturn. First, the board of commissioners must hold a public meeting at which the board of education is permitted to testify as to the impact of any reduction on school operations. Second, the board of commissioners must take a public vote on the decision to reduce appropriations to the school unit.

Amending the tax rate. G.S. 159-15 previously prohibited a local government from changing its tax rate once it had adopted the budget ordinance. The 2002 appropriations act amends that section to permit a local governing board to reduce or increase the property tax rate following

adoption of the budget ordinance, at any time before January 1, if the local government has received budgeted revenues that “are substantially more or less than the amount anticipated.”

Scrap Tire Tax Sunset

One final financial action taken by the 2002 General Assembly was not related to the state’s fiscal problems. Since its enactment, the scrap tire tax has always had a sunset, and each time the sunset approached, the General Assembly extended it. The latest sunset would have terminated the tax on June 30, 2002. This year, rather than extending the sunset, the General Assembly removed it altogether. Therefore, the tax will continue in effect until and unless it is repealed.

Other Legislation of Interest to Local Governments

The 2002 General Assembly enacted a variety of other acts of interest to local governments. Some of them are discussed below, while others are covered more completely elsewhere in the book. The reader interested in local government should also consult Chapter 4, “Community Development and Housing,” Chapter 7, “Elections,” Chapter 14, “Land Use, Community Planning, Code Enforcement, and Transportation,” and Chapter 16, “Local Taxes and Tax Collection.”

Hazard Mitigation Plans Deadline

S.L. 2002-24 (H 1584) amends 166A-6.01(b)(2)a.3. to give local governments until November 1, 2003, to put in place a hazard mitigation plan approved pursuant to the federal Stafford Act or else become ineligible for state disaster relief in the form of public assistance grants. This conforms the state’s deadline to that in federal law. The previous deadline was August 1, 2002.

Crimes Involving Government Computers

The use of computers by local governments has created not only opportunities for greater service to citizens but also opportunities for criminal acts. S.L. 2002-157 (H 1501) deals with unauthorized access and damage to government computer hardware and software. In general, the act makes it unlawful to use government computers for fraudulent or other unauthorized purposes; to access educational testing material or grades in government computers without authorization; to alter, damage, or destroy government computers; and to deny use of government computers without authorization, including by introduction of self-replicating or self-propagating computer programs (that is, viruses). S.L. 2002-157 is discussed in detail in Chapter 6, “Criminal Law and Procedure.” The act became effective December 1, 2002, and applies to offenses committed on or after that date.

Public Records Exception for Domestic Violence, Sexual Offense, and Stalking Victims’ Addresses

S.L. 2002-171 (H 1402) establishes a program to provide alternative addresses for victims of domestic violence, sexual offense, or stalking, while keeping their actual addresses confidential. The program, found in new G.S. Chapter 15C, will have an impact on local governments because of its effect on public records. In general, the actual addresses of persons enrolled in the program are not considered public records and may not be disclosed. Rather, the alternative addresses provided to local governments by the Attorney General’s office must be used.

The act does require that the actual address be used in certain circumstances (property tax listing and assessing, for example), and the Attorney General may grant local government agencies waivers for specific statutory or program purposes. However, even when certain local officials know the actual address, the local government is still required to keep it confidential.

Criminal penalties are imposed for knowingly and intentionally obtaining or disclosing information in violation of Chapter 15C.

S.L. 2002-171 is effective January 1, 2003. The act is discussed in detail in Chapter 5, "Courts and Civil Procedure."

Preemption of Local Government Firearms Lawsuits

In recent years, a few local governing boards have discussed suing gun or ammunition manufacturers in an attempt to hold them liable for injuries or fatalities caused by persons using firearms in their communities, despite a state law preempting direct local regulation of firearms in most circumstances [G.S. 14-409(4a)]. Probably in reaction to these activities, the General Assembly enacted S.L. 2002-77 (H 622).

This act declares that the lawful design, marketing, manufacture, distribution, sale, or transfer of firearms or ammunition to the public is not an unreasonably dangerous activity and does not constitute a nuisance per se. It instructs the courts that, with respect to lawsuits brought under new G.S. 14-409(g), it is the *unlawful use* of firearms and ammunition, rather than their *lawful design, marketing, and so on*, that is the proximate cause of injuries arising from their unlawful use. New G.S. 14-409(g) *reserves exclusively to the state* the authority to bring suit and to recover against any firearms or ammunition marketer, manufacturer, and so forth, by or on behalf of governmental units, for injuries resulting from or relating to the lawful design, marketing, manufacture, distribution, sale, or transfer of firearms or ammunition to the public. The Attorney General is to bring all actions on behalf of the state. However, local governments are still allowed to bring breach of warranty and breach of contract actions. S.L. 2002-77 applies to any action filed on or after August 15, 2002.

Criminal Background Checks for Taxi Permittees and Others

S.L. 2002-147 (H 1638) authorizes cities to obtain criminal history background checks from the North Carolina Department of Justice as part of the process of issuing taxi permits or licenses. The act requires that if a background check is to be national in scope, the applicant must be fingerprinted. The city is to provide to the department the request, the applicant's fingerprints, any additional information required by the department, and a form signed by the applicant consenting to the check of the criminal record and to the use of the fingerprints and other identifying information required by the state or national repositories. Both the State Bureau of Investigation and the Federal Bureau of Investigation perform checks using the fingerprints. The Department of Justice may charge each applicant a fee for conducting the checks of criminal history records. The city must keep all background check information confidential.

Consistent with confidentiality requirements, the legislation declares that background check information is not a public record under G.S. Chapter 132. Presumably, this means that in addition to being nonpublic, the information is not subject to the North Carolina Department of Cultural Resources' Records Retention Schedules published pursuant to Chapter 132 and can be disposed of as the city wishes unless otherwise restricted by state or federal law.

S.L. 2002-147 also gives similar authority to a variety of other agencies, including local law enforcement agencies that issue permits under G.S. 66-165 to dealers in precious metals.

Secondary Road Paving and Maintenance Projects

An act passed this session may result in additional paving or maintenance on rural roads in many of North Carolina's counties. Part of S.L. 2002-86 (H 1492) makes it easier for the state Department of Transportation to condemn land for secondary road paving and maintenance projects desired by most of the owners of property adjacent to the project. The act provides that the owners of *a majority of the road frontage* adjacent to the project (rather than the owners of 75 percent of the frontage, as previously required) must dedicate the necessary right-of-way and

provide the required funds to condemn the remaining property. (*Seventy-five percent of the owners of property adjacent to the project must still dedicate right-of-way and provide funds.*)

Liability of Local Governments Operating Passenger Railroads

S.L. 2002-78 (S 759) anticipates the day when there may be local intercity rail transit in North Carolina. It amends the city and county enabling acts to require local governments that operate passenger railroad service to secure liability insurance with a policy limit of not less than \$200 million per accident. They are permitted to self-insure up to \$5 million and to contract with railroads to allocate financial responsibility for passenger rail services claims. The act covers regional passenger transportation authorities, counties, cities with a census population over 500,000 (presently, only Charlotte), and cities contracting with Charlotte. The act limits recovery to \$200 million or any proceeds available under any insurance policy secured by the local government, whichever is greater, for property damage, personal injury, bodily injury, and death claims arising from a single accident or incident related to passenger rail services.

Adding Nonprofit Corporations to Water and Sewer Authorities

S.L. 2002-76 (H 148) amends G.S. 162A-3(a1) and G.S. 162A-3.1(a1), which deal with the organization of water and sewer authorities, to allow an authority organized by three or more political subdivisions to include any number of nonprofit water corporations in its organization. Prior law limited the number of nonprofit water corporation members to two.

Incorporation of Red Cross and Ossipee

Acts relating to the incorporation of two new municipalities were passed this session. S.L. 2002-56 (H 1525) directly incorporates the town of Red Cross in Stanly County, effective August 1, 2002. S.L. 2002-137 (H 1670) creates the town of Ossipee in Alamance County and simultaneously dissolves the Ossipee Sanitary District, pursuant to G.S. 130A-81(l), as approved by the new town's voters in a referendum on November 5, 2002. The Ossipee incorporation took effect December 9, 2002. The sanitary district must take all steps necessary to ensure that all of its assets and liability are transferred to the town. Both towns operate under the mayor-council form of government, with four-year staggered terms for their board members. Red Cross elects its mayor separately and has four board members, while Ossipee's charter calls for five board members, one of whom is elected as a voting mayor. The acts also provide budget rules for the towns to follow during the first, abbreviated fiscal year and other rules for a smooth transition.

Moore County Board of Commissioners

The General Assembly occasionally uses its plenary authority over local governments to restrict, rather than permit, local actions. S.L. 2002-122 (H 1619) is an example of such limiting legislation. The act, which by its own terms is no longer in effect, forbade the five-member Moore County Board of Commissioners to take any action, including adoption of ordinances and resolutions, except with the affirmative vote of at least four members of the board. It applied from September 25, 2002 (the date S.L. 2002-122 became law), until new board members took the oath of office in December 2002. Presumably, this was intended to prevent last-minute actions during the period immediately prior to any changes in the board's composition, unless the actions were favored by a supermajority of the old board.

A. Fleming Bell, II

David M. Lawrence