



NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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Memorandum # 2010-38

TO: Local Government Officials and Certified Public Accountants

FROM: Sharon Edmundson, Director, Fiscal Management Section

SUBJECT: Unauthorized Substance Tax

DATE: June 25, 2010

A representative from the North Carolina Department of Revenue recently brought to our attention that local governments may not be pursuing their share of the unauthorized substance tax revenue. Our Memorandum #766, issued June 9, 1992 initially addressed this issue. This new memorandum provides the most current information available regarding this revenue along with the instructions so that local governments have the opportunity to collect the revenue.

Unauthorized substance tax is an excise tax imposed on controlled substances (marijuana, cocaine etc...), illicit spirituous liquor ("moonshine"), mash, and illicit mixed beverages (G.S. 105-113.106). State and local law enforcement agencies can generate revenue from their narcotics investigations if during the investigation, a taxable quantity of drugs are discovered and the agency submits the appropriate referral form to the NC Department of Revenue within 48 hours after making a threshold drug arrest or seizure (tax rates, thresholds and forms attached-Appendix 1). These rates and quantities are established pursuant to G.S. 105-113.107 and 105-113.108. G.S. 105-113.108(b) requires that law enforcement agencies complete either a BD-4 (Controlled Substances) or BD-4L (Illicit Liquor) form within 48 hours after making a threshold drug arrest or seizure.

Once completed, the form must be submitted via e-mail or fax to the appropriate tax enforcement agent (based on the attached county assignments, tax enforcement agent list attached-Appendix 2). Funds are remitted via electronic payment to the account specified by the law enforcement agency (payment form attached-Appendix 3).

The State accounts for this tax in a special non-reverting account until the tax proceeds are unencumbered. G.S. 105-241.22 states that the proceeds are unencumbered when they are collectible - when either of the following occurs:

1. The tax has been fully paid and the taxpayer has no current right to seek a refund, or
2. The taxpayer has been notified of the final assessment of the tax and has neither fully paid nor timely contested the tax.

Once unencumbered, seventy-five percent (75%) of the tax proceeds collected by this assessment and paid to the State **shall be remitted to the State or local law enforcement agency that conducted the investigation of the dealer who was found guilty of possessing the (not previously assessed) controlled substance that led to the tax**

assessment. If more than one State or local law enforcement agency conducted the investigation, the NC Secretary of Revenue shall determine the equitable share for each agency based on the contribution each agency made to the investigation. The Secretary shall credit the remaining unencumbered twenty-five percent (25%) of the tax proceeds to the State's General Fund.

The US Department of Justice operates an Asset Forfeiture – Equitable Sharing Program, separate and apart from the State's program. The program is open to any State, County or Local Law enforcement agency that participates in a case that results in a federal forfeiture. The law enforcement agency can apply for an equitable share of the proceeds which is based on the law enforcement agencies degree of participation. The revenue received by this program must be used for law enforcement purposes.

NCDOR prefers that whenever possible, assets discovered during an investigation be released to NCDOR pursuant to a warrant for collection of taxes because the assets can then be liquidated in a manner that benefits the NC local government law enforcement agency and the State's General Fund. The local unit will receive its share 90-120 days after the funds are collected. The only exception to this would be when the taxpayer (defendant) requests an administrative review of his or her tax assessment. Ultimately it is the choice of the local government law enforcement agency that participated in the investigation, drug arrest and seizure, as to which governing body, federal or state, it submits the seized assets.

Cale R. Johnson, Director of the Tax Enforcement Division of the North Carolina Department of Revenue has received questions regarding how Unauthorized Substances Tax revenue can be spent by local governments who have received it. In a letter dated July 28, 2008 from W. Dale Talbert, Special Deputy Attorney General to Sheriffs and Local Law Enforcement Agency Heads, Mr. Talbert states that the purpose of this tax is to "generate revenue for State and local law enforcement agencies and the General Fund" (G.S. 105-113.105).

The State Unauthorized Substances Act does not place specific spending restrictions on the use of these proceeds shared with law enforcement agencies. The clear and unequivocal language of the statute, however, requires the stated portion of the tax to accrue directly to the law enforcement agency to "generate revenue" for the agency. Thus, the proceeds must be used for law enforcement purposes and not for the general operations or activities of the city or county of which the law enforcement agency is a part.

The Legislature clearly intended the monies to "enhance the ability of law enforcement agencies to deter and investigate crimes, especially drug offenses" (Strickland & Talbert). However, this intent does not circumvent the controls in place on public funds as set forth in G.S. 159. The monies are public funds and therefore are subject to the requirements of the Local Government Budget and Fiscal Control Act. Accordingly, the law enforcement agency receiving the cash proceeds must deliver them to the custody of the finance officer or deposit them in an official depository as authorized and supervised by the finance officer.

The monies are included in the local governments or public authority's budget in the General Fund and expended as appropriated in the budget. Again, G.S. 105-113.105 requires that those funds be used to enhance the ability of law enforcement agencies to deter and investigate crimes,

especially drug offenses.” The local government is not free to spend these funds on anything but law enforcement. At fiscal year end, any such moneys left unappropriated must be reserved for the purpose of drug crime prevention. Once a unit of government implements GASB Statement No.54, any of these funds held in fund balance will be reported as restricted. Since these are not annual revenues, the LGC recommends that monies be used for nonrecurring expenditures.

Per our Memo #949 published on August 24, 2001, the accounting for the Unauthorized Substance Tax revenue is as follows: payments are recorded when received; at June 30 - record a receivable for the estimated receipts after year end for awards made, but not yet received prior to June 30. Recognize the revenue for amounts received within 60 days of year end and defer revenue amounts received after 60 days. The memorandum can be found on our website as follows:

<http://www.nctreasurer.com/Dsthome/StateAndLocalGov/AuditingAndReporting/Memos>

The revenue from the Asset Forfeiture – Equitable Sharing Program should be accounted for in the same manner.

If a unit needs additional information not provided in this memo on Unauthorized Substance Tax please contact:

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For more information on the specifics of the Asset Forfeiture – Equitable Sharing Program operated through the US Department of Justice go to their website at www.justice.gov/criminal/afmls/. In the section at the bottom of the page, under related topics for interested agencies, click on “New to the Equitable Sharing Program?”. The page will give you information as well as contact names and numbers that can help you get started.

For additional questions or for more information on the Federal program please contact:

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