

THE BUSINESS JOURNAL

Publisher

Douglas W. Copeland, Jr.

Editorial**Editor**

Mark Sutter

Executive Editor

Justin Catanoso

Associate Editor

Lloyd Whittington

Design Editor

Dale Edwards

Reporters

Matt Evans

Steve Ivey

Michelle Cater Rash

Laura Youngs

Washington Bureau

Kent Hoover

Research Director

Stephanie Nickell

Advertising**Director of Advertising**

Timothy C. Harris

Advertising Promotions**Coordinator**

Grace Johnston

Advertising Account Managers

Laura Cicerone Busse

Bill Ingram

Tammy Tierney

Administration**Business Manager/Circulation**

Pat Fromen

Business Assistant

Donna Takase

Circulation Assistant

Pat Epley

Circulation Sales

Gary Marschall

Production**Production Director**

Debbie Forrest O'Connor

Greensboro Office

100 S. Elm St., Suite 400

Greensboro, NC 27401

Phone: (336) 271-6539

Toll-free: (800) 723-2977

News fax: (336) 370-2899

Advertising fax: (336) 370-2900

General fax: (336) 574-3607

Winston-Salem Office

305 W. Fourth St. Suite 2B

Winston-Salem, NC 27101

Phone: (336) 725-1163

Fax: (336) 725-1154

triad.bizjournals.com

The Business Journal

is a publication of

American City**Business Journals Inc.**

120 West Morehead Street,

Charlotte, NC 28202

Ray Shaw, Chairman

Reprints

Scoop ReprintSource

(800) 767-3263, ext. 307

NORTH
CAROLINA

Press Association



COMMENTARY



Wholesale silliness or purposeful policy?

The deadline has passed in the General Assembly for bills that will not affect the state budget. One of the bills that didn't make it would have expanded the ability of small brewers to distribute their own beers to retail outlets.

Currently, a brewer can self-distribute only if it produces less than 25,000 barrels per year. The proposed bill, designated S918 in the Senate, would have raised that to 60,000 barrels. The bill had one major supporter, Whitsett's Red Oak Brewery, which sees it as a key to its long-term expansion. Red Oak claims that its preservative-free craft beers need to be treated with greater care than beer distributors can give.

It's not surprising that S918 died. Opposing the bill was the N.C. Beer and Wine Wholesalers Association. As the number of beer distributors has declined around the country (from roughly 6,000 in 1950 to fewer than 600 today), the industry has become easier to organize and is known as a powerful lobby. In addition, the N.C. Brewers Guild, of which Red Oak is a member, declined to support S918, saying it had other legislative priorities such as a proposed increase in the excise tax on beer.

At issue is the so-called three-tier distribution system: brewer to distributor to retailer. State laws created the system after Prohibition ended in 1933 in order to insulate retailers from brewers. Since then, brewers have been required to market their products through distributors.

The current 25,000-barrel cap for self-distribution is an exception to the three-tier system, and S918 would widen that loophole. But although S918 wouldn't eliminate the three-tier system, it's worth asking whether the system has outlived its usefulness. It was created in a time when distributors were small relative to the brewers they served. Consolidation among distributors and the emergence of microbreweries has turned that relationship at least partly on its head.

If the three-tier system were eliminated, beer distributors would still be

profitable. As in other industries, however, they'd have to attract business by the value of their services, not by force of law. For many brewers, the value would still be there. Budweiser would still be distributed by Greensboro's R.H. Barringer, for example. But craft brewers like Red Oak could decide for themselves.



VIEWPOINT
ANDREW BROD

Of course distributors defend the legal system that protects their place in the supply chain. They say it provides for efficient tax collection and ensures product safety. But we manage to collect taxes and protect consumers in numerous industries that aren't subject to such tight state control.

The most revealing claim in defense of the three-tier system is that it promotes moderate consumption of alcohol. Of course moderation is a good thing, but the issue is whether it should be achieved by state control or individual choice. Like a number of other states, North Carolina has chosen the former. The state monopoly on hard liquor drives prices up and consumption down. It's designed to minimize consumer welfare, not maximize it.

This is why further exceptions to the three-tier system, such as S918, will be hard to achieve. The three-tier system is of dubious value from an economic perspective, but it's consistent with the demand-suppressing objectives of North Carolina's alcohol laws.

The three-tier system applies to wine as well. A recent study by UNC-Greensboro and N.C. A&T State University found that Yadkin Valley wineries strongly prefer self-distribution to the current law. Perhaps the next challenge to the three-tier system will come from wineries rather than brewers.

ANDREW BROD is the director of UNCG's Center for Business and Economic Research and a member of The Business Journal's Editorial Board of Contributors. Reach him at (336) 334-4867 or Andrew.Brod@uncg.edu. An archive of Dr. Brod's columns is available at <http://cber.uncg.edu>.

Wal-Mart ruling makes the state less attractive

A pending bill in the N.C. General Assembly announces the goal of "reducing uncertainty" in how multistate corporations determine what amount of their income is subject to tax in North Carolina. This is an admirable goal. Taxpayers deserve certainty when it comes to calculating their tax obligations.

Unfortunately, a recent decision by the state Court of Appeals undermines the General Assembly's goal. While the decision reached the right result, it did so for the wrong reasons, and in the process introduced further uncertainty into North Carolina's already-complicated corporate tax system.

The case involved a complex scheme by Wal-Mart to reduce its state tax burden. Wal-Mart tried to do this by transferring all of its North Carolina stores into a Delaware real estate investment trust. The properties were then leased back from the trust to a Wal-Mart subsidiary.

Why do this? Because Delaware imposes practically no tax on real estate investment trusts. Therefore Wal-Mart escaped tax on the "rents" received by the trust. Meanwhile, the operating company was able to deduct the "rents" it paid to the trust, thereby reducing North Carolina taxes. The bottom line was that, by moving the stores to the Delaware trust, Wal-Mart reduced its North Carolina taxes by about \$24 million over a five-year period.

Clearly, the transfer of the stores had no business purpose other than to avoid state taxes. As such, it was a tax sham and should have been struck down for this reason. The Court of Appeals, however, declined to decide the case on the straight-forward basis that Wal-Mart's purpose in transferring its stores was tax avoidance. Instead, the Court ruled against Wal-Mart based on an interpretation of the North Carolina corporate tax statutes that significantly expands the Department of Revenue's authority to require affiliated entities (like the real estate trust and the operating company) to combine their income for tax purposes.

In North Carolina, separate entities (even if affiliated) generally must file separate tax returns. According to the Court's decision, however, any time related companies engage in a "unitary business," the Department of Revenue has the authority to require them to combine their income for tax purposes.

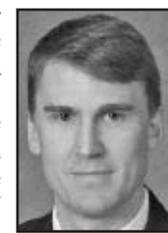
The problem is that the Court gave no clear guidance, and there is none in the statutes, as to when the Department of Revenue will exercise its new-found authority.

Compounding this uncertainty is the fact that until instructed otherwise by the Department of Revenue, corporate taxpayers are required as a matter of statute to file separate returns for separate entities. By the time a corporation receives the instruction that it must file a combined return for multiple entities, the corporation may be subject to interest and penalties, as Wal-Mart was to the tune of over \$4 million.

North Carolina has made considerable efforts to make the state a more attractive home for businesses. These efforts include the creation of the N.C. Business Court, which has issued consistent and well-reasoned opinions, as well as a current bill in the General Assembly to reduce the corporate tax rate.

But businesses seek certainty. The uncertainty created by the Court's decision in the Wal-Mart case undermines the efforts to attract and retain businesses in North Carolina.

ANDREW HAILE is an assistant professor at Elon University School of Law and a member of The Business Journal's Editorial Board of Contributors.



VIEWPOINT
ANDREW HAILE