

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 143 (First Edition)

SHORT TITLE: IRC Update

SPONSOR(S): Senators Kerr, Dalton, Hartsell, Hoyle, and Webster

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$million)				
	<u>FY 2001-02</u>	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>
REVENUES					
General Fund	(\$3.37)	(\$3.82)	(\$3.40)	(\$3.59)	(\$5.13)
EXPENDITURES					
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue					
EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2001.					

BILL SUMMARY: Section one of the bill updates the reference to the Internal Revenue Code used in state tax provisions from January 1, 2000 to January 1, 2001. Section two repeals an obsolete statute dealing with foreign sales corporations. Section three clarifies that any changes that increase North Carolina taxable income for the 2000 taxable year become effective for taxable years beginning on or after January 1, 2001.

ASSUMPTIONS AND METHODOLOGY: Since North Carolina individual and corporate income tax law tracks the federal income tax law, it is necessary each year to update state statutory references to the Internal Revenue Code (IRC). Congress enacted four bills in calendar year 2000 that have a potential revenue impact on the state General Fund.

Public Law 106-230

HR 4762 was enacted to require 527 organizations to disclose their political activities. If an organization does not comply with the disclosure provisions of this act, then their exempt function income becomes taxable. This fiscal note assumes no fiscal impact for North Carolina from this provision.

Public Law 106-554

This 2001 appropriations act (HR 4577) for the Departments of Labor, Health and Human Services, and Education contains numerous tax provisions taken from other introduced legislation.

- Low Income Housing Tax Credit - P.L. 106-554 increases the annual low-income housing tax credit amount allocated to each state from \$1.25 per capita to \$1.50 per capita in 2001 and \$1.75 per capita in 2002. Beginning in 2003, the per capita allocation will be adjusted by the Consumer Price Index (CPI). North Carolina has a state low-income housing tax credit that is equal to 1) 75% of the federal low-income housing credit in Tier 1 and 2 counties and in counties damaged by hurricanes in 1999, and 2) 25% in all other counties. The state credit is taken over five years.

		<u>Prior Law</u>	<u>Prior Law</u>	<u>Current Law</u>	<u>Current Law</u>	
	<u>Population</u>	<u>Per capita</u>	<u>Federal Credit</u>	<u>Per capita</u>	<u>Federal Credit</u>	<u>Difference</u>
2000	7,323,000	\$1.25	\$9,153,750	\$1.25	\$9,153,750	\$0
2001	8,049,313	\$1.25	\$10,061,641	\$1.50	\$12,073,970	\$2,012,328
2002	8,221,568	\$1.25	\$10,276,960	\$1.75	\$14,387,745	\$4,110,784
2003	8,397,510	\$1.25	\$10,496,887	\$1.79	\$14,989,555	\$4,492,668
2004	8,577,217	\$1.25	\$10,721,521	\$1.82	\$15,647,159	\$4,925,638
2005	8,760,769	\$1.25	\$10,950,961	\$1.87	\$16,365,576	\$5,414,615
2006	8,948,249	\$1.25	\$11,185,312	\$1.92	\$17,150,410	\$5,965,099

In calendar year 2000, the North Carolina Housing Finance Agency reported that 70% of the projects (25 of 36) receiving the federal low-income housing tax credit also requested the state low-income housing tax credits. All seven projects in Tier 1 and 2 counties and all six projects in Tier 3 and 4 flood relief counties utilized 100% of their 75% state tax credits. Ten of the eleven projects rejecting the state tax credit were in Tier 5 counties such as Guilford, Wake, Buncombe, and Forsyth. Officials with the North Carolina Housing Finance Agency believe the 70% participation rate in the state tax credit will not increase because the state income standards for rental units, which are more stringent than federal guidelines, are too difficult for developers to meet in the higher tiered counties.

The North Carolina credit is a percentage of the federal tax credit allocation (shown above) times ten, because the credit is granted to a taxpayer each year for ten years. This increased federal allocation will increase the General Fund revenue loss for the state credit each year until the credit sunsets in 2006. Based on recent experience with the housing credit program in North Carolina, this fiscal estimate assumes that 70% of the investors using the federal low income housing tax credit will also utilize the NC tax credit.

	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>
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Previous law	\$2,402,859	\$5,844,993	\$9,423,089	\$13,077,756	\$16,810,633
Current law	\$2,402,859	\$6,373,229	\$11,206,485	\$16,400,171	\$21,819,136
Additional Cost	\$0	\$528,236	\$1,783,396	\$3,322,415	\$5,008,503

- Renewal Communities - P.L. 106-554 allows the Secretary of Housing and Urban Development (HUD) to designate up to 40 renewal communities that will be eligible for tax incentives. There is currently no fiscal impact from this provision. If HUD chooses a site in North Carolina, then there would be a General Fund revenue loss.
- Empowerment Zones - This act allows HUD to designate nine additional empowerment zones across the country. There will be no fiscal impact from this provision unless HUD selects North Carolina for an empowerment zone.
- Environmental Remediation – This act expands the number of sites eligible for expensing of environmental remediation costs and extends the use of this expensing method from 2002 to 2004. Based on data from the Department of Environment and Natural Resources, there are over 1,000 potential brownfields sites across the state that are currently underutilized or idle due to real or perceived environmental contamination. Since it is unknown how many North Carolina taxpayers will take advantage of this expensing method to cleanup brownfield sites, this fiscal note uses .542% of the national estimated revenue loss. (This percentage represents North Carolina corporate tax collections as a percentage of the national tax collections.)
- Corporate Donations – This act extends the enhanced corporate tax deduction for the donation of computer equipment until 2003. This provision also expands the deduction to include donations 1) to public libraries, 2) of property reacquired by a computer manufacturer, and 3) of equipment acquired up to three years before the donation is made. Since North Carolina specific data is unavailable, this fiscal note uses .542% of the national estimated revenue loss. (This percentage represents North Carolina corporate tax collections as a percentage of the national tax collections.)
- Medical Savings Accounts – This act extends the Medical Savings Account program from 2000 to 2002 and renames the accounts as the Archer MSAs. There is no fiscal impact of this provision because North Carolina taxpayers have not utilized these accounts in the four years of the program’s existence.

Public Law 106-573

HR 3594, the Installment Tax Correction Act of 2000, reversed a prohibition of accrual method taxpayers using the installment method for reporting income from dispositions of property. It was reported that this prohibition had a direct impact on the sale of S corporations. When the General Assembly approved the IRC update in HB 1559, the fiscal

note listed a revenue gain for prohibiting the installment method for accrual method taxpayers. This fiscal note removes the anticipated gain from future year budgets.

Public Law 106-591

With the passage of HR 4986, FSC Repeal and Extraterritorial Income Exclusion Act of 2000, Congress repealed foreign sales corporations (FSCs) due to the protest of the World Trade Organization. To provide corporations with tax benefits that mirror FSC provisions, HR 4986 enacted extraterritorial income exclusion. This act allows companies to exclude foreign trade income from their US taxable income. Both the Department of Revenue and the Internal Revenue Service feel that this change in tax policy is revenue neutral.

Summary

Federal Tax Changes - Impact on NC General Fund							
	Effective Date	Fiscal Years (\$ Millions)					
		<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>	<u>2004-05</u>	<u>2005-06</u>	<u>2006-07</u>
<u>Public Law 106-230</u>							
Political Organizations	7/1/2000	No fiscal impact unless future violation					
<u>Public Law 106-554</u>							
Low income housing credit	12/31/2000	0	-.53	-1.78	-3.32	-5.01	-6.86
Renewal communities	12/15/2000	No estimate available - communities not yet established					
Empowerment zones	12/15/2000	No estimate available - new zones not yet selected					
Environmental remediation	12/15/2000	-0.53	-1.22	-0.89	-0.21	-0.01	0.03
Computer Donation	12/31/2000	-0.64	-0.68	-0.34	-0.02	-	-
Medical Savings Accounts	12/15/2000	No fiscal impact					
<u>Public Law 106-573</u>							
Accrual method	12/28/2000	-2.20	-1.39	-0.39	-0.04	-0.11	-0.19
<u>Public Law 106-591</u>							
Foreign sales corporation	9/30/2000	No fiscal impact					
Total G.F. Impact		-3.37	-3.82	-3.40	-3.59	-5.13	-7.02

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