

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 719 (First Edition)

SHORT TITLE: Phase Down Income Tax Rates

SPONSOR(S): Senator Forrester

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
			(\$ Million)		
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>
REVENUES					
General Fund					
Ind. Income Tax		(181.1)	(613.9)	(1,117.1)	(1,699.0)
Corp. Income Tax		(17.1)	(56.9)	(100.9)	(148.8)
Reduced Fund Transfer		<u>1.2</u>	<u>1.4</u>	<u>1.5</u>	<u>1.6</u>
Net General Fund		(197.0)	(669.4)	(1,216.5)	(1,846.2)
Public School Bldg Fund		(1.2)	(1.4)	(1.5)	(1.6)
EXPENDITURES					
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue					
EFFECTIVE DATE: Section 1 (individual income tax) becomes effective for taxable years beginning on or after January 1, 2005. The remaining sections are effective when the bill becomes law.					

BILL SUMMARY: Section 1 of the bill reduces the individual income tax rates for all tax filers beginning in 2005. The new rates are as follows:

Married Filing Jointly

<u>Tax Brackets</u>	<u>Current Law</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008+</u>
0 - \$21,250	6%	5.75%	5.5%	5.25%	5%
\$21,250 - \$100,000	7%	6.75%	6.5%	6.25%	6%
\$100,000 >	7.75%	7.5%	7.25%	7%	6.75%

Head of Household

<u>Tax Brackets</u>	<u>Current Law</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008+</u>
0 - \$17,000	6%	5.75%	5.5%	5.25%	5%
\$17,000 - \$80,000	7%	6.75%	6.5%	6.25%	6%
\$80,000 >	7.75%	7.5%	7.25%	7%	6.75%

Married Filing Separately

<u>Tax Brackets</u>	<u>Current Law</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008+</u>
0 - \$10,625	6%	5.75%	5.5%	5.25%	5%
\$10,625 - \$50,000	7%	6.75%	6.5%	6.25%	6%
\$50,000 >	7.75%	7.5%	7.25%	7%	6.75%

Single

<u>Tax Brackets</u>	<u>Current Law</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008+</u>
0 - \$12,750	6%	5.75%	5.5%	5.25%	5%
\$12,750 - \$60,000	7%	6.75%	6.5%	6.25%	6%
\$60,000 >	7.75%	7.5%	7.25%	7%	6.75%

Section 2 reduces the corporate income tax rate from 6.9% to 6.65% in 2005, 6.4% in 2006, 6.15% in 2007, and then 5.9% in 2008. Section 3 changes the percentage of corporate income tax revenue distributed to the Public School Capital Fund each year.

ASSUMPTIONS AND METHODOLOGY:

Individual Income Tax

Beginning in Tax Year 2005, Section 1 begins a phase down of the individual income tax rates for all tax filers as illustrated in the Bill Summary above. The bill reduces the rates one quarter of a percent per year for four years. The 2005 impact is calculated using the North Carolina Individual Income Tax Model. The model estimates that taxpayers will save \$402.4 million in individual income tax payments and the state General Fund will lose a like amount of revenue. In 2005, the income tax for 1.3 million single filers would be reduced \$85.8 million, 1.6 million joint filers would save \$280.6 million, and 662,000 head of household filers would save \$36 million.

Since the Income Tax Model does not extend beyond 2005, future year revenue changes are estimated using projections provided by consultant Economy.com. The General Assembly's Fiscal Research Division contracts with Economy.com for assistance in economic and revenue forecasting. For salaries and wages, Economy.com estimates 6.3% growth in 2006 and 6.1% growth in 2007. For interest, dividends, capital gains, IRA distributions, pensions, unemployment benefits, and partnerships, Economy.com estimates the combined growth rate for these income sources will be

7.5% in 2006 and 7.6% in 2007. For tax year 2008, this fiscal note assumes the 2007 growth rates will repeat.

While the growth rates from Economy.com measure the future earnings of North Carolina citizens, they do not accurately account for the fiscal impact of the state revenue code on taxpayer income. Because of the state's progressive rate structure and the fact that personal exemptions, standard deductions, and tax brackets are not indexed to the Consumer Price Index, growth in income pushes taxpayers into higher tax brackets. To adjust for the state tax code, all growth factors are multiplied by an income elasticity factor of 1.2. That means for every 10% increase in income, the amount of income tax revenue increases 12%. For example, in 2006 the 6.3 % growth rate for wages and salaries is multiplied by 1.2 to yield a rate of 7.56%. This modified growth rate is then multiplied by the 2005 taxable income to determine the 2006 taxable income. These calculations are shown in the chart below. The chart shows a portion of an Excel spreadsheet used to calculate the impact of reduced tax rates in 2006 on single filers. The same process is used for each filing status and each tax year through 2008.

INCOME CLASS Single	2005		2006		2006		2006	
	Taxable Income (\$mil)	2006 Growth Rate	Taxable Income (\$mil)	Current Tax Rates	Current law Revenue (\$mil)	2006 Proposed Rate	2006 Proposed Revenue (\$mil)	2006 Difference (\$mil)
0 < \$10,000	494	7.56%	532	6.00%	32	5.50%	29	3
\$10,000 < \$20,000	3,077	7.56%	3,310	6.00%	199	5.50%	182	17
\$20,000 < \$30,000	4,110	7.56%	4,421	7.00%	309	6.50%	287	22
\$30,000 < \$50,000	9,650	7.56%	10,380	7.00%	727	6.50%	675	52
\$50,000 < \$75,000	6,686	7.56%	7,191	7.00%	503	6.50%	467	36
\$75,000 < \$100,000	3,036	9.00%	3,309	7.75%	256	7.25%	240	17
\$100,000 < \$200,000	3,722	9.00%	4,057	7.75%	314	7.25%	294	20
\$200,000 <	<u>3,586</u>	9.00%	<u>3,909</u>	7.75%	<u>303</u>	7.25%	<u>283</u>	<u>20</u>
TOTALS	34,362		37,108		2,644		2,458	186

The General Fund revenue loss due to section 1 of the bill is shown below by tax year.

Tax Year 2005	(\$402)
Tax Year 2006	(\$872)
Tax Year 2007	(\$1,416)
Tax Year 2008	(\$2,045)

The fiscal year impact differs from the tax year impact as shown below.

FY 2004-05	-\$181.1 mil.
FY 2005-06	-\$613.9 mil.
FY 2006-07	-\$1,117.1 mil.
FY 2007-08	-\$1,699.0 mil.

FY 2004-05 will receive 45% of Tax Year 2005 revenue because of withholding from January through June 2005 and two quarterly estimated payments. High-income taxpayers avoid a penalty if estimated payments during the tax year equal at least 90% of actual liability. In the FY 2005-06,

taxpayers will pay the remaining 55% of the tax due in tax year 2005 and again pay 45% in estimated payments for tax year 2006. This same mechanism is used for the following years.

Corporate Income Tax

Section 2 of the bill reduces the corporate income tax rate from 6.9% to 5.9% over a four-year period from 2005 to 2008. Estimating the impact of these rate changes is dependent on knowing the corporate tax base in 2005 and beyond. Growth rates for corporate income tax revenues are provided by consultant Economy.com (see chart below). These rates are applied to the current tax base to determine the tax bases from 2004 to 2009. The revenue resulting from the proposed tax rates is compared to revenue generated by the current 6.9% tax rate. The chart below shows the General Fund revenue impact by fiscal year.

	(\$ Mill.)			(\$ Mill.)	
	Corporate	Growth	New	New	
	Tax	Rate	Tax	Corporate	(\$ Mill.)
	<u>Base</u>	<u>Rate</u>	<u>Rate</u>	<u>Tax Base</u>	<u>Difference</u>
FY02-03	838.5	8.7%		838.5	
FY03-04	921.3	12.3%		921.3	
FY04-05	1,006.50	7.1%	6.65%	989.4	-17.1
FY05-06	1,072.30	5.9%	6.40%	1,015.40	-56.9
FY06-07	1,131.10	5.0%	6.15%	1,030.20	-100.9
FY07-08	1,186.10	4.7%	5.90%	1,037.30	-148.8
FY08-09	1,241.80	4.7%	5.90%	1,061.90	-180

Public School Capital Fund

Section 3 of the bill changes the percentage of funds transferred each quarter from corporate income tax to the Public School Capital Fund. The fractions proposed in Section 3 are applied to the tax revenues related to Section 2 in the chart above. Based on the projected revenues through 2009, the public school fund would lose between \$1.2 million and \$1.6 million each year.

	Current			New			
	Corporate	Proposed	School	Corporate	Proposed	School	
	<u>Tax Base</u>	<u>Fractions</u>	<u>Fund</u>	<u>Tax Base</u>	<u>Fractions</u>	<u>Fund</u>	<u>Difference</u>
FY03-04	\$921.3			\$921.3			
FY04-05	\$1,006.5	0.072464	\$72.9	\$989.4	0.07246	\$71.7	(\$1.2)
FY05-06	\$1,072.3	0.072464	\$77.7	\$1,015.4	0.07519	\$76.3	(\$1.4)
FY06-07	\$1,131.1	0.072464	\$82.0	\$1,030.2	0.07813	\$80.5	(\$1.5)
FY07-08	\$1,186.1	0.072464	\$85.9	\$1,037.3	0.0813	\$84.3	(\$1.6)
FY08-09	\$1,241.8	0.072464	\$90.0	\$1,061.9	0.08475	\$90.0	\$0.0

SOURCES OF DATA: Economy.Com

FISCAL RESEARCH DIVISION: (919) 733-4910

PREPARED BY: Richard Bostic and David Crotts

APPROVED BY: James D. Johnson, Director, Fiscal Research Division

DATE: April 21, 2003



Signed Copy Located in the NCGA Principal Clerk's Offices