GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

Legislative Fiscal Note

BILL NUMBER: Senate Bill 308 (Second Edition)

SHORT TITLE: Endangered Manufacturing and Jobs Act.

SPONSOR(S): Senator Jacumin

FISCAL IMPACT

Yes (x) **No** ( ) **No Estimate Available** ( )

	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
REVENUES					
General Fund	***See Assumptions and Methodology***				
EXPENDITURES	**$55,450**	**$16,336**	**$17,322**	**$18,366**	**$19,435**

POSITIONS (cumulative):

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue, Department of Commerce, Secretary of State's Office

EFFECTIVE DATE: Article 3J and sales tax refund changes are effective January 1, 2009. All other parts are effective when law.

BILL SUMMARY:
Effective beginning with the 2009 tax year, S.B. 308 enacts G.S. 105-129.83(m) to provide that for purposes of Article 3J (Tax Credits for Growing Businesses) of G.S. 105, an establishment whose primary activity is one of the following is treated as if it were in development tier one county: apparel manufacturing, furniture and related product manufacturing, textile mills, or textile product mills, as defined by the North American Industry Classification System. The bill extends the following incentives and tax reductions to these establishments: (1) the annual sales tax refund in G.S. 105-164.14(h), effective July 1, 2009; (2) a reduced job creation threshold in G.S. 143B-437.53 in order to qualify for a Job Development Investment Grant (JDIG); and (3) the exemption from the JDIG reduction in G.S. 143B-437.56 that otherwise applies to grants for positions in development tier two or three counties. Finally, the bill amends G.S. 57C-1-03 to define a low-profit limited liability company as a limited liability company that is organized for a business purpose but significantly furthers charitable or educational purposes, does not have the production of income or appreciation of property as a significant purpose, and does not have a

significant political or legislative purpose. The bill also makes a conforming change to G.S. 55D-20(a).
Source: Bill Digest S.B. 308 (02/25/0200).

ASSUMPTIONS AND METHODOLOGY:

Part I. Economic Development Incentives

Summary

Part I of the bill would treat establishments in the textile, apparel, and furniture manufacturing industry subsectors as if they were located in a development tier one area regardless of the actual tier designation of the location. Location in a development tier one area has the following benefits.

- Taxpayers are not required to meet a wage standard.
- The job creation threshold is five before any credit may be taken. The threshold in tiers two and three are 10 to 15 jobs, respectively.
- The job creation credit is equal to $12,500 per job. The credit amount in tiers two and three are $5,000 per job and $750 per job, respectively.
- The credit for investing in business property does not require the taxpayer to meet a threshold before taking the credit. In tiers two and three the thresholds are $1,000,000 and $2,000,000, respectively. The amount of the credit is equal to 7% of the eligible investment amount. In the higher-tiered areas, the credit for the eligible investment amount is 3.5% for tier three and 5% for tier two.
- There is also a credit for investment in real property, which is not available in higher-tiered areas.

This Part would also extend the sales and use tax refund to similar equipment used in a furniture, textile, or apparel manufacturing facility regardless of the actual tier designation of the particular location. The General Assembly has provided for a sales and use tax refund for purchases of machinery and equipment that are subject to the general rate of tax and put into service in a development tier one area. Because mill machinery and equipment is generally exempt from the sales and use tax (and subject to a lower excise tax instead), this refund applies to a limited category of machinery and equipment.

Assumptions and Methodology

The Article 3J economic development incentive program became effective January 1, 2007. As such, representative data of how firms will respond to the new streamlined incentives is not available. Therefore, tax incentive data from 2002 to 2005 provided by the Department of Revenue's Tax Research Division was used to approximate the potential impacts of this bill. Since there is no historical data on Article 3J incentives with which to estimate a fiscal impact from this bill, a fiscal simulation model was developed using the data compiled under the William S. Lee (WSL) Act.

General Fiscal Impact. The overall effect of expanding tier one designation to furniture, textile, and apparel manufacturers will be to reduce General Fund tax revenues. The tax credits allowed in tier one are greater than the other two tiers. Therefore the number of credits generated and of credits actually taken will increase. Additionally, Article 3J allows firms to combine their income,

franchise, and insurance tax liability to calculate the amount of credits they are eligible to take in the following tax year (up to 50% of total combined liability). This should increase the amount of credits companies will be able to take. Below is the general fiscal impact of four key components of Part 1 of the bill.

1. Job credits will increase because a tier one firm may take $12,500 credit per job, $11,750 more per job than is typically allowed in a tier three location.
2. Business equipment credits will increase by removing the investment threshold and raising the credit percent. The magnitude of the increase may not be as great as the increase in job credits. For example, in 2005, three of the four tier five (WSL Act designation) establishments that generated a Machinery & Equipment (M&E) credit were located in a Development Zone (DZ). A DZ designation under the expiring WSL Act includes more geographic areas than the equivalent designation under the new legislation. M&E thresholds for any firm in a DZ were $0 regardless of the tier designation. This would be the same threshold as establishments located in tier one areas.
3. The real property investment credit is available to all tier one designated firms. It is not possible to know the number of firms that will be able to take advantage of this credit nor what the magnitude of the credit might be. Eligible taxpayers must invest at least $10 million in real property within a three-year period and create at least 200 new jobs. The credit is equal to 30% of eligible property investment. Over the past four years, five firms generated credits for 200 or more jobs. However, it is not possible to determine whether any of these firms had real property investment of $10 million or more.
4. Extending the Sales and use tax refund to all the firms in these subsectors will have a minimal impact because much of the equipment is already exempt from the tax. All eligible firms will be able to take the refund, and some impact on sales tax collections will occur. For example, if 10% of all M&E investment generated by eligible establishments would have also been eligible for the refund in 2005, then sales tax revenues would have been reduced by an estimated $200,000.

Fiscal Simulation. The following simulations will model the expected change to the job and business equipment credits. To perform the simulation, tax credit data was obtained from the North Carolina Department of Revenue for the years 2002 to 2005. The data was for all business establishments with the NAICS manufacturing subsector codes of 313, 314, 315, and 337. The tax credit data included tax credits generated under the WSL Act for jobs created and machinery and equipment investments.

The first table shows the result if no stimulative impact occurs. Thus, the only impact from the legislation is from assigning a tier one designation to all the appropriate manufacturing subsectors. Note that tax credits are taken in the year following the year in which they are earned. It was assumed that for eligible credits taken for 2007 jobs and investment, 55% would be claimed in the first half of 2008, and the remaining 45% in the second half.

Also based on historical data, plus the presumption that more credit will be taken under Article 3J, it was estimated that 10 percent of credits generated would be taken the following year.

Fiscal Impact Job and Business Investment Credits: No stimulative effect

Credit Taken ($ millions)	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Jobs Created	($0.8)	($2.3)	($3.9)	($5.4)	($6.1)
Business Equipment Investment	($0.1)	($0.4)	($0.7)	($0.9)	($1.0)
Total Credits	($0.9)	($2.8)	($4.6)	($6.3)	($7.1)

If one assumes expanding tier one development status to the entire state will stimulate additional activity by these manufacturers, over and above what has taken place under WSL Act incentives, then expanding and new businesses may be expected to generate even more tax credits. The table below assumes that this stimulative effect is twice the current level of credits generated.

Fiscal Impact Job and Business Investment Credits: With stimulative effect (2x)

Credit Taken ($ millions)	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
Jobs Created	($1.7)	($4.7)	($7.7)	($10.7)	($12.0)
Business Equipment Investment	($0.3)	($0.8)	($1.4)	($1.8)	($2.2)
Total Credits	($2.1)	($5.5)	($9.1)	($12.5)	($14.2)

These simulations were developed with several important assumptions and data limitations.

1. The data used to simulate the fiscal impact of changes to Article 3J economic development incentives comes from tax credits taken under the WSL Act. The simulation model assumes that all WSL Act tier one and two counties in the dataset are tier one counties under Article 3J; all tier three and four counties are tier two; and that all tier five counties are classified as tier three counties. To the extent that counties were misclassified, the impact may be over- or underestimated.
2. This estimate assumes that establishments in Development Zones receiving credits from 2002 to 2005 did not meet the Article 3J Urban Progress Zone classification requirements. This may have had the effect of lowering the fiscal impact of job creation credits.
3. Calculating the amount of credits taken assumes that the percent of job and business equipment credits taken to credits generated would increase relative to those taken under the WSL Act. This is because the amount of credits an establishment may take in a given tax year are now 50% of their combined tax liability from the corporate, franchise, and insurance taxes. This assumption would therefore increase the fiscal impact from the bill.

Part II. Low Profit Limited Liability Companies

Summary

This part clarifies that low-profit limited liability (L^3C) company is a limited liability company (LLC) under North Carolina law. Low-profit limited liability companies (L^3Cs) have been proposed as a means for encouraging investment in struggling business enterprises. Under this theory, non-profit organizations that are required to spend a certain percentage of their assets each year to maintain their non-profit status would invest in L^3Cs that have some social purpose. If structured correctly, it is possible that the IRS could treat this investment as a program-related investment that would count towards the percentage that must be spent in order to maintain non-profit status. Because non-profits do not face the same pressures as for-profit investors, the theory states that non-profits would be willing to accept a lower rate of return than would be required for a for-profit investor. Struggling businesses might then be able to stay in business, providing jobs to employees and other community benefits, because the pressure to produce market-rate profit levels had been removed.

One of the benefits of L^3Cs is that no special legal structure, other than the LLC structure, is needed to establish an L^3C.

Assumptions and Methodology

The Department of the Secretary of State estimates that they will incur $40,000 in one-time start-up costs, including information technology, forms creation, training, and publicity, as a result of this bill. They also estimate that the new legislation would require a one-quarter time Accounting Technician. The position cost is $15,825 in FY 2009-10, increased for each year by standard Fiscal Research inflationary increases. Revenues from filing fees, Annual Report fees, and Articles of Amendment fees would total $375. These receipts have been subtracted from the estimated expenditures each year.

SOURCES OF DATA: NC Department of Revenue, Secretary of State's Office
TECHNICAL CONSIDERATIONS: None
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