NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

REVISED

BILL NUMBER: House Bill 1656 (First Edition)

SHORT TITLE: Reduce and Eliminate Cigarette Credits.

SPONSOR(S): Representatives Luebke and Weiss

FISCAL IMPACT ($MILLION)

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

	FY 2004-05	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09
REVENUES					
State General Fund	+8.7	+6.9	+11.6	+16.0	+16.0

PRINCIPAL DEPARTMENT AFFECTED: The corporate income tax is administered by the Department of Revenue. The enactment of the bill is not expected to affect the Department's budget requirements.

ISSUE BACKGROUND: **1999 Legislation**. Provided for a corporate income tax credit for manufacturing cigarettes for exportation to a foreign country. The credit is based on the amount of export volume in the tax year, compared to a base year (1998). The credit may not exceed $6 million per taxpayer, or 50% of the taxpayer's tax liability. Any unused credit can be carried forward for five years. However, the $6 million limit applies to the credit taken for a tax year and any carryforward. The credit became effective for the 1999 tax year and expires on January 1, 2005.

2003 Special Session. (1) Credit sunset moved to January 1, 2018; (2) the base year for determining the amount of the credit was changed to 2003, effective January 1, 2005; (3) required the taxpayer to export cigarettes through the state ports beginning January 1, 2005; (4) allowed a successor business to claim the credit, effective January 1, 2005; and, (5) allowed the credit for the exportation to a possession or commonwealth of the U.S., effective January 1, 2004.

In addition, the 2003 legislation created a new cigarette export tax credit equal to 40 cents per 1,000 cigarettes exported. To be eligible for the credit, the taxpayer must maintain an employment level that exceeds its level at the end of 2004 by at least 800 full-time jobs. In addition, the taxpayer must export cigarettes and other tobacco products through the state ports. The credit would become effective for tax years beginning on or after January 1, 2006, and would expire January 1, 2018. The credit may not exceed the lesser of 50% of tax liability, including prior year carryforwards, or $10 million. A 10-year carryforward is allowed for unused credits. The credit may be taken against the income, the franchise tax, or a combination of the two taxes. A partial credit is allowed for a taxpayer who formerly qualified but no longer qualifies. The ratio for the partial credit is based on the relationship of new jobs to the 2004 base year.

A taxpayer may not take both the regular export credit and the enhanced credit for the same export activity.

BILL SUMMARY: (1) Reduces taxpayer cap on regular cigarette export credit from $6 million to $3 million, effective January 1, 2004 and moves credit sunset from January 1, 2018 to January 1, 2007 and (2) lowers enhanced cigarette exportation credit limit from $10 million to $5 million, effective when the credit begins on January 1, 2006 and moves credit sunset from January 1, 2018 to January 1, 2007

ASSUMPTIONS AND METHODOLOGY: Discussions with industry representatives indicate that practically all of the current tobacco export credits are taken by two major manufacturers in the state. Based on recent production trends in the industry and a merger announced last November, it is expected that the maximum amount of credits will be taken under the change adopted during the 2003 special session. Under the new law, one company would take the maximum $6 million regular export credit and the other company would use the full amount of the $10 million enhanced export credit.

On an annual basis, the impact of HB 1656 would be to reduce the regular export credit usage from $6 million to $3 million and to lower the enhanced credit amount from $10 million to $5 million. This is a total increase in General Fund revenues of $8 million per year once the change is fully implemented. The analysis takes into account the prohibition against a single taxpayer taking both credits for the same export activity comes into play.

The 2004-05 fiscal year revenue gain is equal to 100% of the 2004 tax year amount ($6 million) plus 45% of the 2005 tax year impact (.45 times $6.0 mil. equals $2.7 mil.). The 2005 tax year impact that occurs during the 2004-05 fiscal year is due to higher estimated tax payments that will be made in April and June 2005 for the 2005 tax year.

For the 2005-06 fiscal year, the impact is equal to the remaining 55% of the 2005 tax year impact (equals $3.3 million) plus 45% of the 2006 tax year impact (equals $3.6 million).

The higher fiscal effect amount for 2006-07 is due to the fact that the new credits under the 2003 session change become effective for this fiscal year. The new January 1, 2007 sunset for both credits means that the impact for 2007-08 and future years is equal to the total cost of the existing credits.

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