

# GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2009

## Legislative Fiscal Note

**BILL NUMBER:** Senate Bill 1171 (Second Edition)

**SHORT TITLE:** Keeping NC Competitive Act.

**SPONSOR(S):** Senator Clodfelter

| <b>FISCAL IMPACT (\$ In Millions)</b>                         |                                      |                          |                                  |                          |                          |
|---|--------------------------------------|--------------------------|----------------------------------|--------------------------|--------------------------|
|   | <b>Yes (X)</b>                       | <b>No ( )</b>            | <b>No Estimate Available ( )</b> |                          |                          |
|   | <b><u>FY 2010-11</u></b>             | <b><u>FY 2011-12</u></b> | <b><u>FY 2012-13</u></b>         | <b><u>FY 2013-14</u></b> | <b><u>FY 2014-15</u></b> |
| <b>REVENUES</b>   | <b>(8.85)</b>                        | <b>(13.70)</b>           | <b>(10.04)</b>                   | <b>(5.58)</b>            | <b>(0.64)</b>            |
| <b>EXPENDITURES</b>   |                                      |                          |                                  |                          |                          |
| <b>POSITIONS (cumulative):</b>                                |                                      |                          |                                  |                          |                          |
| <b>PRINCIPAL DEPARTMENT(S) &amp;<br/>PROGRAM(S) AFFECTED:</b> | North Carolina Department of Revenue |                          |                                  |                          |                          |
| <b>EFFECTIVE DATE:</b>  | July 1, 2010                         |                          |                                  |                          |                          |

**BILL SUMMARY:** Senate Bill 1171 provides various tax incentives requested by the Department of Commerce to aid it in its recruitment initiatives. The bill offers these incentives through the following statutory changes:

- Section 1: Amends GS 105-164.3(8e) to provide additional criteria for designating a facility as an eligible internet datacenter. The change also expands the sales and use tax exemption for machinery, equipment, and electricity sold to eligible internet datacenters under G.S. 105-164.13 (55).
- Section 4: Amends G.S. 105-164.14(j) making a facility eligible for an annual refund of sales and use taxes under the subsection if the facility primarily performs paper-from-pulp manufacturing or manufactures turbine and/or turbine generator set units, creates at least 200 additional jobs, and pays an average weekly wage equal to or greater than the average wage in the county. This refund would apply to taxes paid in purchasing building materials, supplies, fixtures, and equipment.
- Section 6: Amends G.S. 105-187.51C replacing the general sales and use tax rate applicable to property purchased for use in a datacenter with the 1%, \$80 per article cap excise tax under Article 5F. The Article 5F excise tax applies to machinery and equipment purchased by an eligible internet datacenter.

- Provides that a facility owner loses eligibility and must forfeit all refunds if the facility fails to maintain the required number of created jobs.

**ASSUMPTIONS AND METHODOLOGY:** Using data provided by the North Carolina Department of Commerce (Commerce), Fiscal Research estimates that enacting SB 1171 will reduce General Fund availability by \$8.85 million in FY 10-11 and by \$ 13.70 million in FY 11-12. The data from Commerce represents the most accurate information currently available. However, if enacted, the North Carolina Department of Revenue will have data on the actual value of the sales and use tax refund created in Section 4 of the bill and the tax incentive available in Section 6 one year after the incentive has been in effect. The estimate above represents the fiscal impact of three types of tax incentives. The following paragraphs describe each incentive in detail.

**Section 1:** The tax incentive, amending the definition of an eligible internet datacenter, expands the types of companies eligible for a sales tax exemption on machinery and electricity purchases. As shown in Table 1 below, the electricity and machinery tax exemption totals \$8.2 million in the 2010-11 fiscal year. If enacted, eligible manufacturers will receive a sales and use tax exemption certificate, which will exempt all eligible internet datacenter purchases from the sales tax. Since exempted purchases are not reported to the Department of Revenue, the true cost of this tax incentive will be unverifiable after enactment.

| <b>Fiscal Year</b> | <b>Qualified Investment (Machinery and Equipment)</b> | <b>Cost Estimate per Fiscal Year (4.75-5.75% Rate)</b> | <b>Qualified Investment (Electricity)</b> | <b>Cost Estimate per Fiscal Year (3% Rate)</b> | <b>Total Cost Estimate per Fiscal Year</b> |
|--------------------|---|--|---|--|--|
| 2010-11            | \$148,750,000   | \$7,864,063  | \$10,725,000                              | \$321,750                                      | \$8,185,813                                |
| 2011-12            | \$197,812,500   | \$10,085,156   | \$21,450,000                              | \$643,500                                      | \$10,728,656                               |
| 2012-13            | \$125,000,000   | \$6,587,500  | \$26,325,000                              | \$789,750                                      | \$7,377,250                                |
| 2013-14            | \$65,000,000  | \$3,737,500  | \$31,200,000                              | \$936,000                                      | \$4,673,500                                |
| 2014-15            | \$0   | \$0  | \$21,450,000                              | \$643,500                                      | \$643,500                                  |
| <b>Total</b>       | <b>\$536,562,500</b>                                  | <b>\$28,274,219</b>                                    | <b>\$111,150,000</b>                      | <b>\$3,334,500</b>                             | <b>\$31,608,719</b>                        |

By expanding the definition of eligible Internet datacenters, the bill also expands the types of facilities entitled to a sales and use tax exemption on electricity purchases. Commerce estimates that the definition change will reduce General Fund availability by \$321,750 during the 2010-11 fiscal year and by \$600,000 to \$900,000 in subsequent years. Table 1 provides additional detail. Under current law, these companies are subject to the general sales tax rate on electricity of 3%. Modifying the definition under G.S. 105-164.3 expands the number of facilities eligible for sales and use tax exemptions under G.S. 105-164.13(55). If successful, the newly attracted companies will create an additional 38-60 jobs at an approximate wage of \$50,000 per job. These companies are expected to invest more than \$830 million in industrial related property (i.e. buildings and machinery).

**Section 4:** According to Commerce, providing sales and use tax incentives to construct facilities utilized in paper-from-pulp, turbine, or turbine generator set unit manufacturing will generate refunds of \$1.1 million during the 2011-10 fiscal year. The Department of Revenue, if the law is enacted, will verify the true cost of this tax incentive through the processed refunds beginning in the year following enactment.

Table 2 describes the amount of qualified investments and expected sales and use tax refunds per fiscal year. Purchases made during the 2010-11 fiscal year are reflected in the 2011-12 refunds. Companies eligible for sales and use tax incentives under G.S. 105-164.14 (j) apply and receive

| <b>Table 2. Sales and Use Tax Refund for the Construction of Manufacturing Plants</b> |  |   |
|---|--|---|
| <b>Fiscal Year</b>  | <b>Qualified Investment (Construction Materials)</b> | <b>Cost Estimate per Fiscal Year (Refunds Lag Purchases by a Fiscal Year)</b> |
| 2010-11   | \$19,750,000   | \$0   |
| 2011-12   | \$15,750,000   | \$1,135,625   |
| 2012-13   | \$5,500,000  | \$905,625   |
| 2013-14   | \$0  | \$316,250   |
| 2014-15   | \$0  | \$0   |
| <b>Total</b>  | <b>\$41,000,000</b>                                  | <b>\$2,357,500</b>  |

tax refunds six months after the end of the fiscal year in which the purchases are made. The sales tax refund provided under G.S. 105-164.14 (j) applies to purchases made on or before January 1, 2013. The January 2013 sunset limits the fiscal impact of this statutory change to three fiscal years.

If the recruitment efforts are successful, the \$2.36 million tax incentive will create 1,025 jobs and generate \$348 million in industrial investments. The average wage in

the paper manufacturing facility is estimated at \$37,897 per job. Wages at the turbine manufacturer are expected to pay an average annual wage of \$64,400 per job.

**Section 6:** Amends G.S. 105-187.51C replacing the general sales and use tax rate applicable to property purchased for use in a datacenter with the 1%, \$80 per article cap excise tax under Article 5F. The tax incentive, amending the definition of an eligible datacenter, expands the types of companies eligible for a sales tax exemption on machinery. Machinery purchased by a datacenter as tax exempt under Article 5 is subject to the 1%/\$80 excise tax under Article 5F. For each piece of machinery purchased, companies must remit 1% of the purchase price to the Department of Revenue.

| <b>Table 3. Datacenter Machinery and Equipment under Article 5F</b>  |   |   |
|--|---|---|
| <b>Fiscal Year</b>   | <b>Qualified Investment (Machinery and Equipment)</b> | <b>Cost Estimate per Fiscal Year (1%/\$80 Tax Rate)</b> |
| 2010-11  | \$12,500,000  | \$664,063   |
| *2011-12   | \$37,500,000  | \$1,835,938   |
| 2012-13  | \$37,500,000  | \$1,757,813   |
| 2013-14  | \$12,500,000  | \$585,938   |
| 2014-15  | No Data   | \$0   |
| <b>Total</b>   | <b>\$100,000,000</b>                                  | <b>\$4,843,750</b>                                      |
| *Sales tax rate changes from 5.75% to 4.75% effective July 1, 2011. The tax for purchases made in the later portion of 2010-11 will be remitted in FY 2011-12. |   |   |

The tax due is capped at \$80 per piece of equipment. The sales tax exemption is also set to expire July, 1, 2013. As illustrated in Table

3, Commerce estimates that \$12.5 million in equipment purchases will be made during the 2010-11 fiscal year. The fiscal impact of exempting this equipment from the sales tax equals the purchase price of the machinery, multiplied by 4.75% (the North Carolina State sales and use tax rate less 1%). This number is then multiplied by 1.25. The 25% increase in forgone sales tax revenue represents the fiscal impact of the \$80 cap per piece of machinery. For each piece of machinery with a purchase price exceeding \$1,391, a cap of \$80 per piece of equipment is imposed. Table 1 above also reflects a reduction in the State sales and use tax rate of 1%, which is set to expire July 1, 2011. Purchases made on or after that date will only be subject to a 4.75% sales and use tax rate. The sales and use tax exemption for mill machinery purchased by an eligible datacenter sunsets on July 1, 2015.

Should the bill become law, the Department of Revenue will be able to verify the tax incentive's true cost through self-reported information provided by the eligible companies. Under the 1%/\$80 excise tax, companies are exempt from the sales tax by the seller. The businesses (the exempt purchasers) then self-report to the Department the amount of machinery and equipment purchased and remit the due tax. The \$4.8 million sales and use tax incentive for datacenters is expected to create 20-25 new jobs at an average wage of \$60,000 per job.

**SOURCES OF DATA:** NC Department of Commerce

**TECHNICAL CONSIDERATIONS:** None

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**DATE:** May 28, 2010



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