

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

Legislative Fiscal Note

BILL NUMBER: Senate Bill 677 (First Edition)

SHORT TITLE: Corporate Income Tax Reduction & Reform.

SPONSOR(S): Senators Rucho and Rabon

Please see the fiscal impact table on the following page.

FISCAL IMPACT

(\$ in millions)

State Impact	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18
General Fund Revenues:					
Reduce corporate tax rate from 6.9% to 6.5% in 2014, to 6.25% in 2015, to 6% in 2016 and after	(28.6)	(83.9)	(131.2)	(162.0)	(169.3)
Increase sales factor apportionment for corporate income tax from 1/2 to 3/5 in 2014, to 5/7 in 2015, and to 100% in 2016	(13.1)	(44.8)	(103.1)	(152.9)	(158.6)
Increase sales factor apportionment for franchise tax from 1/2 to 3/5 in 2014, to 5/7 in 2015, and to 100% in 2016	(4.4)	(14.9)	(34.3)	(50.9)	(52.8)
Conform with federal treatment of losses	(4.2)	(9.4)	(9.8)	(10.2)	(10.6)
Eliminate contributions deduction	3.8	8.5	8.8	9.2	9.6
Eliminate cap on adjustments for expenses related to dividends	6.3	14.2	14.7	15.3	15.9
Eliminate credit for donating real property for conservation purposes	6.8	15.3	15.9	16.5	17.2
Eliminate miscellaneous tax credits, deductions, and exclusions from income	1.8	4.0	4.0	4.0	4.0
STATE IMPACT	(\$31.6)	(\$111.0)	(\$235.0)	(\$331.0)	(\$344.6)
Local Revenues:					
Public School Building Capital Fund	(1.6)	(6.7)	(14.9)	(20.8)	(21.9)
LOCAL IMPACT	(\$1.6)	(\$6.7)	(\$14.9)	(\$20.8)	(\$21.9)

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue

EFFECTIVE DATE: 2014 tax year

TECHNICAL CONSIDERATIONS: None

BILL SUMMARY:

The following is a concise summary of the provisions in this bill. For a more detailed summary, please see the summary prepared by Committee Counsel, Research Division.

Reduce corporate income tax rate over three years from 6.9%:

- 2014 6.5%
- 2015 6.25%
- 2016 and after 6%

Phase in single sales factor apportionment over three years

Multistate businesses apportion income and the franchise tax base to the state using a formula that is the total of the following ratios divided by four: the ratio of payroll in the state to total payroll; the ratio of tangible property in the state to total tangible property; and two times the ratio of sales in the state to total sales. The bill increases the weight of the sales factor in the apportionment formula in 2014 and 2015 and eliminates the property and payroll factor for tax years 2016 and after:

- 2014 triple-weighted sales
- 2015 five times-weighted sales
- 2016 single sales factor

Eliminate the following adjustments, deductions, and credits, effective 2014

- Adjustments for expenses related to dividends: Corporations are required to attribute a portion of their expenses to dividends not taxed. Under current law, the amount of expenses required to be attributed for bank holding companies and electric power holding companies is subject to certain caps. The bill would eliminate this tax preference.
- Charitable contributions deduction: In general, corporations are allowed to deduct charitable contributions up to a maximum of 5% net income. The bill would eliminate the deduction for charitable contributions.
- Tax credits eliminated for expenses incurred for the following:
 - Construction of dwelling units for handicapped persons
 - Construction of cogenerating power plants
 - Construction of poultry composing facility
 - Real property donations for conservation purposes
 - Conservation tillage equipment
 - Gleaned crop
 - Telephone subscriber line charges
 - Savings & Loan supervisory fees

Conform more closely to federal law

- Follow federal treatment of losses. The bill would conform to the federal net operating loss. Under current law, corporations are allowed a net economic loss instead of a net operating loss. The differences between the net economic loss and the net operating loss are that the net economic loss has to be offset by income not taxed and it can only be carried forward to offset income in future tax years. The net operating loss does not have the same limitation and can be carried back and used to offset income in prior years, generally for two years. Additionally, the bill would conform to the federal treatment of capital losses. Under current law, capital losses must be recognized in the year that they are incurred. For federal tax purposes, capital losses in excess of capital gains can generally be carried back two years and forward five years.
- Eliminate the following special deductions and income exclusions allowed in excess of what is allowed for federal purposes:
 - Expenses for reforestation and cultivation of commercially grown trees
 - Income exclusion for an international banking facility
 - Marketing assessments on tobacco
 - Deduction for amortization in excess of depreciation allowed under the Code for air-cleaning devices, waste treatment facilities, and recycling facilities (105-130.10)
 - Deduction for amortization in excess of depreciation allowed under the Code for equipment mandated by OSHA (105-130.10A)
 - Deduction for sale of a manufactured home community to manufactured home owners

Reporting option for intercompany interest expense paid to affiliate

Under current law, related companies with intercompany royalty payments can elect for either the payer or the recipient of the royalty payment to report the royalty income for North Carolina tax purposes. The proposal would expand this reporting option to include interest payments between related members.

Repeal obsolete provisions

- Deduction for payments received from Hurricane Floyd Reserve Fund
- Deduction for payments received from Disaster Relief Reserve Fund
- Special Depreciation Provision for emergency facilities acquired prior to January 1, 1955

ASSUMPTIONS AND METHODOLOGY: The estimate for the impact of the reduction to the corporate tax rate is based on the consensus revenue forecast. To calculate the impact of the transition to single sales factor apportionment, Fiscal Research developed a query of corporate income and franchise tax return data and analyzed what taxpayers would have paid if income and the franchise tax base was apportioned using only the sales factor instead of the current apportionment formula. The impact to conform to the federal treatment of losses, to eliminate the

cap on the adjustment for expenses related to dividends, to repeal the credit for donations of real property, and to eliminate miscellaneous tax credits, deductions, and exclusions from income is based on tax expenditure statistics compiled by the Department of Revenue. The fiscal impact associated with the reporting option for interest expenses between related members is unknown. Fiscal Research made timing adjustments to align the impacts with the State's fiscal year. The local impact is based on the reduction in corporate tax collections that would be transferred to the Public School Building Capital Fund. Under G.S. 115C-546.4, 5/69 of corporate income tax is transferred to this fund.

SOURCES OF DATA: NC Department of Revenue

TECHNICAL CONSIDERATIONS: None

FISCAL RESEARCH DIVISION: (919) 733-4910

PREPARED BY: Jonathan Tart

APPROVED BY:

Mark Trogon, Director
Fiscal Research Division

DATE: April 9, 2013



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