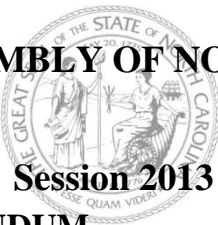


GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2013

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: May 27, 2014

TO: Senate Finance Committee

FROM: Sandra Johnson and Jonathan Tart
Fiscal Research Division

RE: House Bill 1050 (Unknown Edition)

FISCAL IMPACT					
(\$ in millions)					
<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> No Estimate Available					
	FY 2013-14	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18
State Impact					
<i>Corporate Income Tax</i>					
State net loss	0.0	0.0	(5.0)	(5.0)	(5.0)
<i>Tobacco Tax</i>					
Vapor products		0.0	5.0	5.2	5.3
<i>Sales Tax</i>					
Prepaid meal plans					
Newspapers	Minimal Fiscal Impact; Gain of Less than \$50K				
Retailer contractors	Negative Fiscal Impact, General Fund Impact Unknown				
NET STATE IMPACT	\$0.0	\$0.0	\$0.0	\$0.2	\$0.3
Local Impact					
Fair & Flat Tax	Annual reduction of less than \$500K in revenue for all counties and \$62.2M in annual loss of funds for all cities				
Sales Tax Changes					
NET LOCAL IMPACT		\$0.0	\$0.0	\$0.0	\$0.0
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: North Carolina Department of Revenue					
EFFECTIVE DATE: Varies					
TECHNICAL CONSIDERATIONS: None					

BILL SUMMARY:

Corporate Income Tax

Under current North Carolina law, corporations are allowed a deduction for a “net economic loss” instead of the “net operating loss” calculated for federal tax purposes. The primary difference is that a “net economic loss” generally means the amount by which allowable deductions exceed income from all sources including income not taxable, and the federal “net operating loss” generally means the amount by which allowable deductions exceed taxable income. The proposal would replace the “net economic loss” with a “State net loss” that is more closely aligned with the federal “net operating loss” calculation.

The current carryforward period of 15 years to utilize a loss for corporate income tax purposes is not changed by this proposal. The proposal is effective January 1, 2015.

Tobacco Tax

The proposal applies an excise tax to vapor products. The bill modifies G.S. 105-113 creating a definition for vapor products and imposing an excise tax of 5¢ per milliliter on the consumable portion of vapor products. Vapor products are defined as noncombustible products that use a heating element to produce vapor from nicotine in a solution. The consumable portion is the part of the vapor product that contains the nicotine liquid solution. This tax is effective June 1, 2014.

Privilege License Tax

This bill proposes to repeal city and county privilege license taxes (PLTs), effective July 1, 2015.

ASSUMPTIONS AND METHODOLOGY:

Corporate Income Tax

State Net Loss

The estimate for the State net loss provision is based on information from the Department of Revenue regarding audit experience and contested cases resulting from the separate calculation required for North Carolina purposes.

Fiscal impact resulting from the adoption of the federal calculation is not expected to be significant. This is because differences between the state and federal calculation have been reduced due to policy changes that have occurred. Additionally, when a loss is reduced for North Carolina purposes in a carryforward year, a taxpayer has the opportunity to use the loss in a subsequent tax year until the 15-year carryforward period expires. This results in deferral of a loss, not elimination of a loss. Although the fiscal impact is not expected to be significant, Fiscal Research has taken a conservative approach to account for potential impact due to conformity to the federal calculation and to account for timing differences.

Sales Tax

The legislation makes two sales tax changes with an unknown or minimal fiscal impact. Removing the sales tax exemption for newspapers sold through vending machines is expected to be a positive gain for the General Fund, but the estimated fiscal impact is minimal (less than \$50,000).

The second sales tax change with an unknown fiscal impact is modifying the sales tax base for retailer-contractors. This act provides that the sales tax applies to the wholesale price of tangible personal property (in lieu of the retail price) if purchased by a real property contractor that installs the tangible personal property on the retailer's behalf. A "retailer-contractor" is an entity that can act either as a retailer or as a real property contractor. The best example of a retailer-contractor is a home-improvement store that allows customers to purchase tangible personal property alongside contracts for real property improvements. The fiscal impact is expected to be negative, but the magnitude of the impact is unknown.

Vapor Products

Based on industry information, Fiscal Research estimates that the nickel per milliliter tax on vapor products will generate \$5.1 million in General Fund revenue per fiscal year, approximately 50-cents per capita. A similar tax proposal of a nickel per milliliter on e-liquid in South Carolina was estimated to generate \$2.5 million per fiscal year, a revenue amount equivalent to a 52-cents per capita tax levy.

According to Nielson data, the e-cigarette industry grossed \$1.8 billion in 2013. Roughly 45 percent of e-cigarette sales occur online, with the remainder occurring through traditional channels such as convenience stores. Lorillard's vapor product, Blu, is an industry leader representing 45 percent of all e-cigarette convenience store purchases. Despite the decline/leveling off of traditional tobacco products, the e-cigarette sector is expected to continue to grow with refillable cartridges playing a key role.

Effective June 1, 2014 the fiscal estimate assumes that between 2.9 percent and 3.4 percent of all e-liquid product sales occur in North Carolina, and that three billion milliliters of e-liquid are sold nationally. Apportioning this amount to NC, between 87 million and 102 million milliliters of e-liquid is sold in the state annually. A nickel per milliliter excise tax on e-liquid would generate between \$4.4 million and \$5.2 million in General Fund Revenue per fiscal year.

Privilege License Tax

Effective July 1, 2015, enacting this bill would result in an annual \$62.2 million loss for all municipalities. The estimated loss to all 100 North Carolina counties is less than \$500,000 per fiscal year.

SOURCES OF DATA:

- NC Department of Revenue
- North Carolina League of Municipalities: The League of Municipalities surveyed its members in 2013 on the number businesses currently paying a privilege license tax. Members responded to the survey, reporting the number of companies reflected in the 2009-10 fiscal year PLT

collections. Of the 310 cities that levied a PLT tax in FY 09-10, the League received information on the number of businesses taxed from 120 cities.

- U.S. Census County Business Patterns database: NS1100A2: 2011 Nonemployer Statistics: Geographic Area Series: Nonemployer Statistics for the US, States, Metropolitan Areas, and Counties: 2011; CB1100A11: 2011 County Business Patterns: Geography Area Series: County Business Patterns
- Minnesota Department of Revenue
- South Carolina Board of Equalization
- Nicotine and Science Policy, “New Estimates Double Size of US E-cigarette Market; Increasing Importance of Refillable and Modified Devices.” Available at: <http://nicotinepolicy.net/gerry-stimson/1317-wells-fargo-march-2014>

TECHNICAL CONSIDERATIONS: None