

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

Legislative Fiscal Note

BILL NUMBER: House Bill 998 (Fifth Edition)

SHORT TITLE: Tax Reduction Act.

SPONSOR(S): Representatives Lewis, Setzer, Moffitt, and Szoka

| FISCAL IMPACT | | | | | |
|--|-------------------|---------------------|---------------------|---------------------|---------------------|
| (\$ in millions) | | | | | |
| State General Fund Revenues: | FY 13-14 | FY 14-15 | FY 15-16 | FY 16-17 | FY 17-18 |
| Income, Franchise, and Estate Taxes | | | | | |
| Flat Tax of 5.75% in 2014 on Federal Adjusted Gross Income, \$15,000 zero bracket MFJ, \$12,000 HOH, \$7,500 single; allow greater of standard deduction or itemized deduction of mortgage interest, property taxes, capped at \$15,000 plus all charitable contributions allowed for Federal tax purposes; child; keeps current child credit \$100; eliminates the \$50k business exemption in 2014 | (242.7) | (693.5) | (723.3) | (754.4) | (788.2) |
| Eliminate the corporate income tax in 2017, 6.4% in 2014, 5.0% in 2015, 4.0% in 2016, 2.0% in 2017, eliminated in 2018 | (21.0) | (174.3) | (423.3) | (694.8) | (801.9) |
| End transfer to public school capital fund | 85.9 | 78.2 | 64.7 | 49.8 | 47.0 |
| Workforce Housing Credit in Tier 1 and Tier 2 Counties | | 10.5 | (15.0) | (10.0) | (5.0) |
| Repeal excise tax on piped natural gas | | (31.5) | (32.0) | (32.5) | (32.9) |
| Repeal franchise tax on electricity | | (157.0) | (159.0) | (160.6) | (162.2) |
| Modify franchise tax, create new privilege tax | | (45.0) | (80.0) | (150.0) | (156.0) |
| Eliminate wholesaler's discount | | 6.0 | 6.0 | 6.0 | 6.0 |
| Repeal estate tax | (52.0) | (57.0) | (60.0) | (62.0) | (65.0) |
| TOTAL INCOME, FRANCHISE, ESTATE TAX | \$ (229.9) | \$ (1,063.7) | \$ (1,422.0) | \$ (1,808.5) | \$ (1,958.2) |
| Sales and Privilege License Taxes | | | | | |
| Warranties and service contracts (07/01/2014) | | 29.2 | 31.2 | 33.2 | 35.2 |
| Make electricity subject to combined general sales tax rate | | 417.1 | 427.7 | 440.5 | 453.8 |
| Make piped natural gas subject to combined general sales tax rate | | 102.3 | 103.9 | 105.4 | 107.0 |
| Distribution to municipalities for franchise tax and piped natural gas State and local cap on non-profit refunds, \$10.5 M cap 2014, \$7.0 M 2015, \$5.0 M in 2016, 2.85 M in 2017 and thereafter | | (207.1) | (209.4) | (211.6) | (213.8) |
| Repeal refunds for local governments, excludes university system (01/01/2016) | | | 35.0 | 125.1 | 139.0 |
| End transfer of real estate conveyance (07/01/2013) | 37.1 | 37.4 | 39.0 | 39.0 | 39.0 |
| End transfer of scrap tire disposal (07/01/2013) | 5.4 | 5.5 | 5.6 | 5.7 | 5.7 |
| Repeal exemption for chiropractor's nutritional supplements (10/01/2013) | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Repeal Energy Star sales tax holiday (07/01/2014) | | 1.6 | 1.7 | 1.8 | 1.8 |
| Repeal sales and use tax holiday (07/01/2014) | | 14.7 | 15.1 | 16.1 | 17.1 |
| Repeal food sold in dining rooms operated by educational institutions (07/01/2014) | | 34.0 | 35.0 | 36.1 | 37.1 |
| Repeal exemption for certain bakery items (07/01/2014) | | 3.9 | 4.1 | 4.2 | 4.4 |
| Vending machines, phase-out exemption (40%, 30%, 20%, 10% beginning 10/01/2013) | 1.6 | 4.7 | 7.2 | 9.9 | 12.8 |
| Repeal exemption for certain sales of newspapers (10/01/2013) | 5.0 | 7.8 | 8.0 | 8.3 | 8.6 |
| Repeal gross receipts tax on live entertainment and movies and other amusements (10/01/2013), include admission fees in tax base (07/01/2014) | 9.3 | 16.5 | 17.2 | 17.9 | 18.6 |
| Extend until 7/1/2014 Motorsport refunds for aviation fuel and vehicle parts | | (0.2) | | | |
| Add a gross receipts requirement for farmers of \$10,000 for the purpose of receiving tax exemptions and refunds (1/1/2015) | | 8.3 | 16.8 | 17.2 | 17.5 |
| Change various exemptions to refunds and phase-out over 4 years | | 17.1 | 46.8 | 72.4 | 99.4 |
| Repeal preferential rate for manufactured homes (07/01/2014) | | 7.2 | 7.2 | 7.2 | 7.2 |
| Tax modular homes at state rate (07/01/2014) | | 3.0 | 3.0 | 3.0 | 3.0 |
| TOTAL SALES and PRIVILEGE LICENSE TAXES | \$58.5 | \$562.6 | \$662.3 | \$819.7 | \$1,002.7 |
| STATE IMPACT | \$ (171.4) | \$ (501.1) | \$ (759.6) | \$ (988.8) | \$ (955.5) |
| Highway Fund and Highway Trust Fund | | | | | |
| Cap Motor Fuels tax for FY 2013-14 at \$0.375 | \$ (5.0) | | | | |

| FISCAL IMPACT | | | | | |
|---|-----------------|-----------------|-----------------|------------------|-----------------|
| (\$ in millions) | | | | | |
| | FY 13-14 | FY 14-15 | FY 15-16 | FY 16-17 | FY 17-18 |
| Local Revenues | | | | | |
| Warranties and service contracts (07/01/2014) | | 12.3 | 13.1 | 14.0 | 14.8 |
| Repeal franchise tax on electricity | | (187.0) | (189.0) | (190.9) | (192.8) |
| Repeal excise tax on piped natural gas | | (20.1) | (20.4) | (20.7) | (21.0) |
| Distribution to municipalities for electric and piped natural gas | | 207.1 | 209.4 | 211.6 | 213.8 |
| State and local cap on non-profit refunds, \$10.5 M cap 2014, \$7.0 M 2015, \$5.0 M in 2016, 2.85 M in 2017 and thereafter | | 25.1 | 28.3 | 37.2 | 88.1 |
| Repeal refunds for local governments, excludes university system (01/01/2016) | | | (35.0) | (125.1) | (139.0) |
| Repeal exemption for chiropractor's nutritional supplements (10/01/2013) | | 0.0 | 0.0 | 0.0 | 0.0 |
| Repeal Energy Star sales tax holiday (07/01/2014) | | 0.7 | 0.7 | 0.7 | 0.8 |
| Repeal sales and use tax holiday (7/01/2014) | | 6.2 | 6.4 | 6.8 | 7.2 |
| Vending machines, phase-out exemption (40%, 30%, 20%, 10% beginning 10/01/2013) | 0.7 | 2.0 | 3.0 | 4.2 | 5.4 |
| Repeal exemption for certain sales of newspapers (10/01/2013) | 2.1 | 3.3 | 3.4 | 3.5 | 3.6 |
| Extend until 07/1/2014 motorsport refunds for aviation fuel and vehicle parts | | (0.1) | | | |
| Repeal gross receipts tax on live entertainment and movies and other amusements (10/01/2013), include admission fees in tax base (07/01/2014) | 3.9 | 7.0 | 7.2 | 7.5 | 7.8 |
| Add a gross receipts requirement for farmers of \$10,000 for the purpose of receiving tax exemptions and refunds (1/1/2015) | | 3.5 | 7.1 | 7.2 | 7.4 |
| Change various exemptions to refunds and phase-out over 4 years | 0.0 | 7.2 | 19.7 | 30.5 | 41.9 |
| LOCAL IMPACT | \$ 6.7 | \$ 67.1 | \$ 53.9 | \$ (13.5) | \$ 37.9 |

BILL SUMMARY:

PERSONAL INCOME TAX

The bill makes the changes described below to the personal income tax. Unless otherwise indicated, the changes are effective for the 2014 tax year.

- Eliminates the \$50,000 business income deduction
- Increases the standard deduction from \$6,000 to \$15,000 for married filing jointly taxpayers (\$12,000 for head of household and \$7,500 for single and married filing separately)
- Allows taxpayer to choose between standard deduction or itemized deduction, consisting of mortgage interest and property taxes (capped at \$15,000 married filing jointly) as well as unlimited charitable contributions
- Establishes a flat 5.75% tax rate
- Eliminates the personal exemption
- Eliminates deduction for severance wages
- Eliminates deduction for other retirement benefits
- Eliminates deduction for contributions to the Parental Savings Trust Fund of the State Education Assistance Authority
- Eliminates deduction for an eligible firefighter or an eligible rescue squad worker
- Eliminates deduction for educator expenses
- Eliminates deduction for compensation for erroneous conviction and imprisonment

- Eliminates deduction for amount paid from the Hurricane Floyd Reserve Fund
- Eliminates deduction for amount paid from the Disaster Relief Reserve Fund
- Repeals tax credit for construction of dwelling units for handicapped persons
- Repeals tax credit for child care and certain employment-related expenses
- Repeals tax credit for certain real property donations
- Repeals tax credit for conservation tillage equipment
- Repeals tax credit for gleaned crop
- Repeals tax credit for the disabled
- Repeals tax credit for non-itemizer charitable contributions
- Repeals tax credit for partial refund for tax paid on certain federal retirement benefits
- Repeals tax credit for property taxes paid on farm machinery
- Repeals tax credit for construction of a poultry composting facility
- Repeals tax credit for education expenses

CORPORATE INCOME TAX

Reduces the corporate income tax rate from 6.9% to 6.4% in 2014, to 5% in 2015, to 4% in 2016, to 2% in 2017, and eliminates the tax in 2018. It repeals earmarking of corporate income tax revenues for the Public School Building Capital Fund. It repeals the following corporate income tax credits:

- Repeals tax credit for construction of dwelling units for handicapped persons
- Repeals tax credit for certain real property donations
- Repeals tax credit for conservation tillage equipment
- Repeals tax credit for gleaned crop
- Repeals tax credit for construction of a poultry composting facility

FRANCHISE/PRIVILEGE TAX

Eliminates Secretary of State annual report fees for all business types and eliminates franchise tax on S corporations, effective for fees or taxes otherwise due to be paid in 2015. It imposes a privilege tax on S corporations, and on LLCs and similar types of unincorporated entities with limited liability protection. The tax is due on the 15th day of the fourth month of the income year, and is for the privilege of doing business for the income year in which the tax is due. The business privilege tax is \$400 for tax due in 2015, and \$500 for tax due in 2016 and after.

The bill reduces the franchise tax rate on C corporations from \$1.50/1,000 to \$1.25/1,000 for tax due in 2015, to \$1.00/1,000 for tax due in 2016, and to \$.75/1,000 for tax due in 2017 and after. It increases the minimum franchise tax on C corporations from \$35 to \$500 for tax due in 2015, and to \$1,000 for tax due in 2016 and after.

SALES AND USE TAX

- Subjects electricity to the combined general sales tax rate, 7%; July 1, 2014
- Taxes piped natural gas at the combined general sales tax rate, 7%; July 1, 2014
- Preserves the municipal distribution of franchise taxes and piped natural gas taxes; July 1, 2014
- Repeals the following sales tax exemptions within G.S. 105-164.13:
 - Nutritional supplements sold by chiropractors (13c),
 - Newspapers (28), and
 - Vending machines (30) and (50).
- Repeals the following sales tax exemptions within G.S. 105-164.13:
 - Meals sold to students in dining halls operated by educational institutions (27)
 - Bread sold at a bakery thrift store (27a)
 - Back-to-school sales tax holiday (-164.13C)
 - Energy star sales tax holiday (-164.13D)
- Makes the following changes to the taxation of entertainment:
 - Repeals the 3% gross receipts tax on live entertainment
 - Repeals the 1% gross receipts tax on movies
 - Imposes a sales tax on admission charges to live entertainment and movies
 - Imposes a sales tax on admission charges to an attraction
- Exempts the following events from sales tax:
 - Events held at elementary and secondary schools,
 - Agricultural fairs,
 - Nonprofit fund-raising events, and
 - Youth (under 20) athletic contests sponsored by a nonprofit.
- Makes the following changes to the eligibility of sales tax refunds:
 - Repeal sales tax refund for local governments,
 - Caps the State and local sales tax refund for nonprofit entities as follows:
 - 2014 – \$10.5M
 - 2015 – \$7M
 - 2016 – \$5M
 - 2017 – \$2.85MChanges the refund time period from 3 years to 1 year.
- Increases the State sales tax rate on manufactured homes from 2%, with a \$300 cap to the State general rate (4.75%) without a cap.
- Increases the State sales tax rate on modular homes from 2.5% to the State general rate (4.75%).
- Extends sunset of tax refunds for motorsports sales tax refunds on fuel and parts for six months.
- Eliminates the wholesaler's discount on cigarettes and other tobacco products effective July 1, 2014.

ESTATE TAX

Repeals the estate tax for decedents dying on or after January 1, 2013

MOTOR FUELS EXCISE TAX

Caps the tax at the current rate beginning September 1, 2013 until July 1, 2014

ASSUMPTIONS AND METHODOLOGY:

Personal Income, Corporate Income, Estate and Franchise Taxes

The estimated impact of the individual income tax changes is based on the North Carolina BearingPoint Individual Income Tax Model and on information obtained from the Department of Revenue.

The estimated impact of the corporate income and franchise tax changes is based on queries of tax collection data obtained from the Department of Revenue, the Consensus Forecast, on the Tax Expenditure Report, and on Economic Incentive Reports.

Sales and Use and Privilege License Taxes

Fiscal Research utilized data from the North Carolina Department of Revenue's 2011 Tax Expenditure Report as well as the information provided in the 2010 Statistical Abstract to calculate the impact of repealing various tax exemptions. The estimated impact of the sales and use tax base expansion is based on industry sales data compiled from the 2007 Economic Census, as reported by the US Census Bureau.

| Repeal Sales Tax Exemption convert to a Refund: Phase out over 4 years. 75% refund in FY 2014, 50% in FY 2015, 25% in FY 2016, repealed in FY 2017. | Statute |
|--|----------------|
| Items Used by Laundries and Dry Cleaning Businesses | 164.13(10) |
| Tangible Property Purchased for Commercial Fishing | 164.13(9) |
| Radio and Television Broadcast Equipment | 164.13(5c) |
| Refund for Passenger Air Carrier | 164.14A(a)(1) |
| Commercial Logging Machinery | 164.13(4f) |
| Components of Free Distribution Periodicals | 164.13(39) |
| Manufactured Facilities, Building Materials and Related Equipment for Commercial Housing of Animals | 164.13(4c) |
| Containers and Certain Storage Facilities Sold to a Farmer | 164.13(1a) |
| Cable Service Broadcast Equipment | 164.13(5d) |
| Telephone Equipment | 164.13(5b) |
| Packaging Items for Manufacturers, Producers and Retailers | 164.13(23)a |
| Wood Chippers for Out-of-State Use | 164.13(4g) |
| Diesel Fuel for Railroads | 164.13(44) |

SOURCES OF DATA: NC Department of Revenue, North American Industry Classification System, U.S. Census Bureau, North Carolina BearingPoint Individual Income Tax Model

TECHNICAL CONSIDERATIONS: None

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