



Finance Committee 2014-15 Fiscal Year Highlights

Fiscal Brief

October 9, 2014

The North Carolina General Assembly House and Senate Finance Committees develop and recommend changes to State tax law. This fiscal brief highlights the tax law changes enacted during the 2014 Session.

Actual and Projected General Fund Revenue Sources Since FY 2011-12 (\$ In Millions)

	<u>Actual</u> <u>FY 2011-12</u>	<u>Actual</u> <u>FY 2012-13</u>	<u>Actual</u> <u>FY 2013-14</u>	<u>Projected</u> <u>FY 2014-15</u>
Personal Income Tax	10,272	10,953	10,272	10,885
Sales and Use Tax	5,258	5,294	5,565	6,246
Corporate Income Tax	1,133	1,192	1,357	1,095
Other Revenue Sources¹	2,577	2,854	2,738	2,521
Total	\$19,239	\$20,293	\$19,933	\$20,747

¹"Other" includes other taxes and non-tax revenue sources

Revenue Outlook and Finance Overview

The consensus revenue forecast reflects a cautious approach to the State's fiscal outlook and slightly lowers forecasted collections for FY 2014-15. The North Carolina economy appears to be returning to the pre-recession employment and population growth levels seen in 2007.

Final collections for FY 2013-14 were 2.1 percent below the original FY 2013-14 forecasts. The decrease in revenue stemmed from lower than expected wages and income tax growth. There were also timing issues related to 2013 tax law changes.

S.L. 2014-100 (S.B. 744), the Current Operations and Capital Improvements Appropriations Act of 2014, increased FY 2014-15 General Fund availability by \$1.29 million. In addition to S.L. 2014-100, the General Assembly also made substantive changes by enacting S.L. 2014-3 (H.B. 1050), Omnibus Tax Law Changes. S.L. 2014-3, a revenue neutral bill during FY 2014-15, made significant changes to the corporate income tax and the tobacco tax. The enacted legislation produced no changes in FY 2014-15, but increases General Fund collections during the 2015-17 biennium by \$0.7 million.

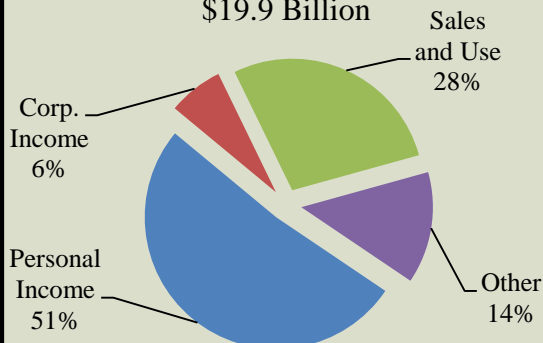
Four pieces of legislation represented the majority of work undertaken by the House and Senate Finance Committees:

- S.L. 2014-100 (S.B. 744), the Appropriations Act of 2014,
- S.L. 2014-3 (H.B. 1050), Omnibus Tax Law Changes, and
- S.L. 2014-20 (H.B. 558), Soil and Water/Regional Jails Refunds, and
- S.L. 2014-39 (S.B. 790), Cape Hatteras/Gas Cities/Infrastructure Land.

This Fiscal Brief provides an overview of these four substantive pieces of legislation.

Tax and Non-Tax General Fund Revenue Sources

FY 2013-14
\$19.9 Billion





The Appropriations Act of 2014

S.L. 2014-100 (S.B. 744) modifies a hold harmless payment to local governments and reduces the sales and use tax paid on manufactured and modular homes.

Local Government Hold Harmless Payment Modification

Section 37.2 of S.B. 744 modifies a hold harmless payment made to counties originally enacted in S.L. 2007-323. Under S.L. 2007-323, the State assumed the county portion of nonfederal Medicaid costs. To provide the financial resources to assume these costs, S.L. 2007-323 phased out one half cent in local sales tax and made a corresponding increase in the State sales tax rate. The legislation also provided for a hold harmless payment to counties equal to the counties forgone or repealed sales tax revenue minus the Medicaid expenses that the State assumed. The payment guaranteed that every county would benefit from these changes by at least \$500,000 annually.

Section 37.2 of S.B. 744, phases out the provision that each county will benefit by \$500,000 annually as follows:

- Effective July 1, 2014, the hold harmless amount is reduced to \$325,000 per county increasing General Fund availability by \$6.0 million in FY 2014-15.
- Effective July 1, 2015, the amount is reduced to \$250,000 per county increasing General Fund availability by \$11.5 million in FY 2015-16.
- Effective July 1, 2016, the hold harmless amount is reduced to \$125,000 per county increasing General Fund availability by \$15.7 million in FY 2016-17.
- Effective July 1, 2017, each county will be held harmless for the exchange of a portion of the local sales and use taxes for the State's agreement to assume responsibility for the administrative costs of Medicaid, but there will not be any supplemental amount provided. This change increases General Fund availability by \$18.6 million in FY 2017-18.

Based on projected sales tax collections and Medicaid expenses, 24 counties will continue to receive a hold harmless payment beginning in FY 2017-18.

Reduction to the Sales and Use Taxes on Modular and Manufactured Homes

Section 37.3 of S.B. 744 reduces the sales tax liability on modular and manufactured homes by exempting 50% of the purchase price from sales tax.

During the 2013 Session, the General Assembly enacted S.L. 2013-316, The Tax Simplification and Reduction Act. The 2013 legislation increased the tax rate on modular homes and manufactured homes to the State general rate of 4.75%, effective January 1, 2014.

Effective July 1, 2014, Section 37.3 applies the 4.75% sales tax rate to 50% of the invoice price instead of the full invoice price for modular and manufactured homes. This change reduces General Fund availability by \$4.7 million in fiscal year FY 2014-15.

Omnibus Tax Law Changes

S.L. 2014-4 (H.B. 1050), makes technical and clarifying changes to the corporate income tax and creates a new tobacco tax on electronic cigarettes/vapor products. H.B. 1050 also repeals the local privilege license tax, which significantly impacts municipal revenues.

Corporate Income Tax Modifications

H.B. 1050 simplifies the calculation of the corporate loss deduction by making the following changes:

- Replaces the corporate net economic loss deduction with a State net loss deduction that is more comparable to the federal net operating loss deduction.
- Removes the requirement that a net economic loss must first be offset by nontaxable income.
- Instructs the Secretary of Revenue to apply the standards under sections 381 and 382 of the Internal Revenue Code when determining the extent to which a loss survives a merger or acquisition.

Effective for taxable years beginning on or after January 1, 2015, this change reduces General Fund availability by \$5.0 million annually beginning in FY 2015-16.



Repeal of the Local Privilege License Tax

Section 12 of H.B. 1050 repeals the local privilege license tax by making the following changes:

- Amends the current privilege license tax statute during FY 2014-15 by limiting the authority to tax only those businesses that are physically located within a city's limits.
- Limits a city to the same privilege license tax schedule that was in place for FY 2013-14, meaning that a city may not increase any tax rate or tax amount for the FY 2014-15. If a city did not have a privilege license tax in FY 2013-14, it may not levy one in FY 2014-15.
- Repeals the both the county and city authority to levy a local privilege license tax effective July 1, 2015. This includes the authority to levy a privilege tax on low-level radioactive and hazardous waste facilities.

Currently, over 300 cities and 30 counties levy a privilege tax, generating \$62.8 million in annual revenue. The majority of privilege license tax revenue is generated at the city level. Section 12 repeals this authority for counties and cities to levy this tax effective for taxable years beginning on or after July 1, 2015.

New Tobacco Tax on Vapor Products

Section 15 of H.B. 1050 imposes an excise tax of five cents per milliliter of the consumable portion of vapor products, commonly referred to as electronic cigarettes.

Effective June 1, 2015, the new tax on the liquid vapor product used in electronic cigarettes generates \$5.2 million in FY 2015-16 and \$5.5 million in FY 2016-17 in General Fund revenue.

Soil and Water/Regional Jails Refunds

S.L. 2014-20 (H.B. 558), Soil and Water/Regional Jails Refunds, adds soil and water conservation districts organized under G.S. 139 to the list of entities eligible for sales tax refunds under G.S. 105-164.14(c)(25). H.B. 558 also creates a sales tax refund under G.S. 105-164.14(c)(26) for regional jails. Effective July 1, 2015, this change is expected to reduce General Fund availability by \$5,000 to \$10,000 annually.

Soil and Water Sales Tax Refunds

G.S. 139 references the 96 soil and water districts that operate as governmental subdivisions of the State. Most of them operate and receive a sales tax refund through their respective county governments.

A smaller percentage of districts operate as stand-alone entities or departments.¹

Regional Jails Sales Tax Refunds

The sales tax refund for regional jails applies to those jails created pursuant to G.S. 153A-219. Two facilities, Albemarle District Jail (a joint project between Camden, Perquimans and Pasquotank counties) and Bertie-Martin Regional Jail (a joint project between Bertie and Martin counties), would qualify for the newly enacted sales and use tax refund.

Cape Hatteras/Gas Cities/Infrastructure Land

S.L. 2014-39 (S.B. 790) phases-in the sales tax on electricity for consumers served by the Cape Hatteras Electric Membership Corporation. The legislation also phases in the seven percent sales tax rate on piped natural gas for consumers served by the eight gas cities.² Effective July 1, 2014, this two year phase-in is expected to reduce General Fund availability by \$2.4 million in FY 2014-15.

S.L. 2013-316 replaced the excise taxes on piped natural gas and electricity, effective July 1, 2014, with a sales tax of 7% equally applicable to all consumers. Prior to the enactment of S.L. 2013-316 consumers served by the Cape Hatteras Electric Membership Corporation or North Carolina's eight gas cities were not subject to an excise tax. S.L. 2014-39 phases-in the sales tax on sales of piped natural and electricity by the Cape Hatteras Electric Membership Corporation and North Carolina's eight gas cities over a two-year period. The sales tax rate on electricity and natural gas in these areas is 3.5%, effective July 1, 2014 and 7%, effective July 1, 2015.

¹Representatives from the North Carolina Association of Soil and Water Conservation Districts estimate that H.B. 558 would apply to approximately 10 districts.

² Defined by G.S. 105-187.40 (1) the eight gas cities are Bessemer City, Greenville, Kings Mountain, Lexington, Monroe, Rocky Mount, Shelby, and Wilson.



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APPENDIX

Table 1. Four-Year Fiscal Impact of Tax Law Changes Occurring During the 2014 Session (\$ In Millions)

	<u>FY 2014-15</u>	<u>FY 2015-16</u>	<u>FY 2016-17</u>	<u>FY 2017-18</u>
S 744				
Section 37.2	\$6.0	\$11.5	\$15.7	\$18.6
Section 37.3	-\$4.7	-\$6.3	-\$6.4	-\$6.6
H 1050				
Section 1	\$0.0	-\$5.0	-\$5.0	-\$5.0
Section 12	No State Impact; Annual Loss of \$62.8 Million for Cities and Counties			
Section 15	\$0.0	\$5.2	\$5.5	\$5.7
H 558	\$0.0	\$0.0	\$0.0	\$0.0
S790	-\$2.4			
S 786		Fiscal Impact Unknown		
TOTAL	-\$1.14	\$5.38	\$9.82	\$12.73