



Finance Committee 2015-16 Fiscal Year Highlights

Fiscal Brief

November 2, 2015

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 2015 Session.

Actual and Projected General Fund Revenue Sources Since FY 2013-14¹ (\$ in Millions)

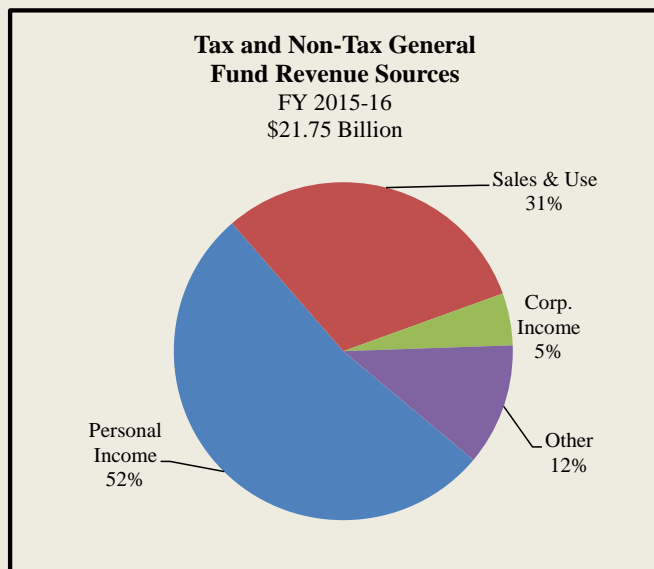
	<u>Actual</u> <u>FY 2013-14</u>	<u>Actual</u> <u>FY 2014-15</u>	<u>Enacted</u> <u>FY 2015-16</u>	<u>Enacted</u> <u>FY 2016-17</u>
Personal Income	10,272	11,079	11,420	11,896
Sales and Use Tax	5,565	6,252	6,707	7,031
Corporate Income Tax	1,357	1,328	1,082	858
Other Revenue Sources¹	2,955	2,789	2,540	2,576
Total	\$20,150	\$21,448	\$21,749	\$22,360

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

Revenue Outlook and Finance Overview

Actual revenue collections for FY 2014-15 were \$446.9 million above projections, predominately due to higher income tax payments and lower refunds from the 2014 tax year.

The actual collections amount triggered the G.S. 105-130.3C mandate that the Corporate Income Tax Rate be reduced if total revenue collections exceeded \$20.2 billion in FY 2014-15; thus, the rate will drop from 5% to 4% in 2016.



The State revenue outlook for the 2015-17 biennium anticipates continued moderate, steady economic growth. Nonetheless, given persistent wage growth weaknesses and ongoing global economic instability, the forecast continued the cautious approach of recent years. At no time during the biennium are baseline tax revenues (i.e., collections adjusted for tax rate and base changes) forecast to grow faster than the long-term average of 5%, even though tax revenue growth is often above this level in an expansionary economy.¹

S.L. 2015-241, 2015 Appropriations Act (H.B. 97), as amended by S.L. 2015-268, General Government Technical Corrections (H.B. 259) and S.L. 2015-264, GSC Technical Corrections 2015 (S.B. 119) decreases FY 2015-16 General Fund availability by \$74.7 million. S.L. 2015-259, NC Competes Act (H.B. 117) further reduces General Fund availability by \$7.1 million in FY 2015-16.

During the 2015 Session, the General Assembly made significant tax law changes through the passage of five legislative acts:

- S.L. 2015-241 (H.B. 97), the 2015 Appropriations Act;
- S.L. 2015-259 (H.B. 117), NC Competes Act;

¹ Average baseline growth since FY 1994-95 calculated by Fiscal Research Division.



- S.L. 2015-11 (S.B. 372), Renewable Energy Safe Harbor;
- S.L. 2015-2 (S.B. 20), IRC Update/ Motor Fuel Tax Changes; and
- S.L. 2015-223 (H.B. 168), Exempt Builders' Inventory.

This Fiscal Brief summarizes these five acts.

2015 Appropriations Act (S.L. 2015-241)

S.L. 2015-241 changes personal income, corporate income, sales & use, and other taxes.

Personal Income Tax Changes

The Act changes personal income tax laws as follows:

- Reduces the personal income tax rate from 5.75% to 5.499% in 2017;
- Raises the standard deduction from \$15,000 to \$15,500 (Married Filing Jointly) starting in 2016; and
- Allows medical deductions as permitted under federal law starting in 2015.

Combined, these tax changes are projected to reduce General Fund revenue by \$117.3 million in FY 2015-16 and by \$437.1 million in FY 2016-17.

Corporate Income Tax Changes

The Act changes corporate income tax laws as follows:

- Repeals the sunset on the tax rate reduction trigger in G.S. 105-130.3C. Prior to the change, the statute authorized the rate to drop to 3% in 2017 if net General Fund tax revenue reached \$20.975 billion in FY 2015-16. Under the revised statute, the tax rate will drop from 4% to 3% after any fiscal year in which the net collections exceed \$20.975 billion.
- Phases in single sales factor apportionment over three years beginning in 2016. "Apportionment" is the process of allocating a multi-state company's income and franchise tax base among the states where it is taxable. "Single sales factor apportionment" means the apportionment percentage is calculated based on the share of the multistate company's receipts that are earned in North Carolina.
- Eliminates obsolete tax law provisions, and

- Requires an informational report to help determine the cost of apportionment using market-based sourcing.

Combined, these tax changes are projected to reduce General Fund revenue by \$1.9 million in FY 2015-16 and by \$23.3 million in FY 2016-17.

Sales & Use Tax Changes

The Appropriations Act expands the sales tax base effective March 1, 2016, by applying sales tax to the installation, repair, and maintenance of tangible personal property whose purchase is currently subject to the sales tax. This change is estimated to generate additional sales tax receipts of \$159.5 million for State government and \$67.2 million for local governments in FY 2016-17, the first full fiscal year in which the base expansion applies.

The Act also changes how local option sales tax revenue levied under Articles 39, 40, and 42 of G.S. 105 is distributed in several ways, by:

- Requiring the State to redirect \$17.6 million of State sales tax revenue annually from the State to local governments, by adding this amount to the local option sales tax revenue that the Department of Revenue distributes to local governments; and
- Directing the Department of Revenue to allocate a portion of local option sales tax revenue (\$84.8 million in FY 2016-17, the first year of implementation) to the State's 100 counties based on allocation percentages specified in the Act.

Other Tax Changes

- Increases the annual minimum franchise tax from \$35 per corporation to \$200 per corporation and simplifies how the tax is calculated. This change is projected to increase General Fund revenue by \$40 million annually, beginning in FY 2016-17.
- Establishes modified Historic Rehabilitation Tax Credit effective 2016. Compared to the previous Historic Rehabilitation Tax Credit, the modified credit has lower rates of credit, requires minimum investment amounts, and limits the amount of credit that can be claimed. The tax credit is effective in 2016 and sunsets in 2020; during that period, it is



projected to reduce General Fund revenue by \$8 million annually.

- Repeals the bank privilege tax effective July 1, 2016. Prior to the change, most commercial, industrial, and savings banks operating in the State were charged an annual privilege tax at a rate of \$30 for each \$1 million in total assets held by the bank. In FY 2016-17 and beyond, this change is anticipated to reduce General Fund revenue by \$12 million per year.

NC Competes Act (S.L. 2015-259)

Sales & Use Tax Changes

The Act changes the sales and use tax’s applicability in certain transactions. These changes include:

- Exempting from sales tax fuel sold to an interstate air business for use in a commercial aircraft; taxing remaining sales of aviation gasoline and jet fuel at 7%; and earmarking the revenue from the tax to the Division of Aviation, Department of Transportation;
- Exempting from sales tax service contracts and repairs, maintenance, and installation services on qualified aircraft and qualified jet engines;
- Increasing the sales tax rate on aircraft and taxing qualified jet engines at 4.75% with a maximum tax of \$2,500; and
- Extending through 2020 the expiring sales tax preferences for motorsports parts and fuel, which allow motorsports racing teams and sanctioning bodies to receive tax refunds on certain motorsports-related expenditures.

Combined, the three aviation-related items are projected to reduce General Fund revenue by \$4 million in FY 2015-16 and by \$10 million in FY 2016-17. Extending the motorsports tax benefits is anticipated to reduce General Fund revenue by an estimated \$4 million annually, although the full-year effect will not be realized until FY 2017-18 due to the current expiration date and the timing of the tax payments.

Renewable Energy Safe Harbor (S.L. 2015-11)

- Extends the sunset of the renewable energy tax credit from January 1, 2016 until January 1, 2017 for taxpayers that meet certain conditions. The credit is projected to reduce

General Fund revenue by \$36.7 million annually from FY 2016-17 through FY 2020-21.

IRC Update/Motor Fuel Tax Changes (S.L. 2015-2)

- Updates General Statute references to the federal Internal Revenue Code from December 31, 2013 to January 1, 2015, conforming to the \$250 teacher expense deduction. Qualified expenses are amounts paid or incurred for books, supplies, computer equipment (including related software and services), other equipment, and supplementary materials used in the classroom. The deduction is effective for the 2014 tax year only and was projected to reduce General Fund revenue by \$1 million in FY 2014-15.

Exempt Builders’ Inventory (S.L. 2015-223)

- Exempts from property tax the increase in value of certain improvements to real property held for sale by a builder. For residential real property, a builder may exclude for 3 years the increase in value due to subdivision, improvements, and buildings that are either a new single-family residence or a duplex. For commercial property, a builder may exclude for 5 years the increase in value due to subdivision and improvements, excluding buildings. This Act is projected to reduce property tax revenue by between \$52.6 and \$65.8 million.

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