

**GENERAL ASSEMBLY OF NORTH CAROLINA**

**Session 2013**

**Legislative Fiscal Note**

**BILL NUMBER:** House Bill 998 (Fourth Edition)

**SHORT TITLE:** Tax Simplification and Reduction Act.

**SPONSOR(S):** Senator Berger

Please see the fiscal impact table on the following pages.

<b>FISCAL IMPACT</b>					
(\$ in millions)					
<b>State General Fund Revenues:</b>	<b>FY 13-14</b>	<b>FY 14-15</b>	<b>FY 15-16</b>	<b>FY 16-17</b>	<b>FY 17-18</b>
<b>Income, Franchise, and Estate Taxes</b>					
Flat Tax of 5.4% in 2014, then 5.25% in 2015 on Federal Adjusted Gross Income[FAGI] - no exemptions, deductions, or credits (01/01/2014); \$15,000 zero bracket MFJ, \$12,000 HOH, \$7,500 single; child credit \$100	(239.1)	(683.0)	(1044.9)	(1089.8)	(1136.7)
Eliminate the corporate income tax in 2017, 6.0% in 2014, 4.0% in 2015, 2.0% in 2016	0.0	(261.5)	(661.7)	(1101.2)	(1210.4)
End transfer to public school capital fund	85.9	71.9	47.4	20.3	17.4
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)
Replace franchise with privilege tax		(23.0)	(4.0)	37.0	98.0
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)
<b>TOTAL INCOME, FRANCHISE, ESTATE TAX</b>	<b>\$ (205.2)</b>	<b>\$ (1,135.2)</b>	<b>\$ (1,908.2)</b>	<b>\$ (2,382.8)</b>	<b>\$ (2,485.8)</b>
<b>Sales and Privilege License Taxes</b>					
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		(207.1)	(209.4)	(211.6)	(213.8)
Nonprofit refunds, \$7.5 M cap 2014, \$5.0 M 2015, \$5.0 M 2016; \$100k in 2017		40.0	59.0	139.5	235.5
		67.8	140.9	146.5	152.4
End transfer of real estate conveyance (07/01/2014)		37.4	39.0	39.0	39.0
End transfer of scrap tire disposal (01/01/2014)	2.7	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 (7/01/2014)		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
Repeal exemption for vending machines (10/01/2013)	7.8	11.6	12.0	12.4	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, include admission fees in tax base (10/01/2013)	9.3	16.5	17.2	17.9	18.6
Add a gross receipts requirement for farmers of \$10,000 for the purpose of receiving tax exemptions and refunds (1/1/2015)		4.5	9.2	9.4	9.6
Change various exemptions to refunds and phase-out over 3 years		44.0	120.8	186.6	203.9
Repeal preferential rate for manufactured homes (10/01/2014)	4.5	7.2	7.2	7.2	7.2
Tax modular homes at state rate (10/01/2014)	1.9	3.0	3.0	3.0	3.0
<b>TOTAL SALES and PRIVILEGE LICENSE TAXES</b>	<b>\$31.4</b>	<b>\$611.9</b>	<b>\$800.1</b>	<b>\$968.0</b>	<b>\$1,103.7</b>
<b>STATE IMPACT</b>	<b>\$ (173.8)</b>	<b>\$ (523.2)</b>	<b>\$ (1,108.1)</b>	<b>\$ (1,414.8)</b>	<b>\$ (1,382.1)</b>

<b>FISCAL IMPACT</b>					
(\$ in millions)					
	<b>FY 13-14</b>	<b>FY 14-15</b>	<b>FY 15-16</b>	<b>FY 16-17</b>	<b>FY 17-18</b>
<b>Local Revenues</b>					
Repeal local food tax ( 11/01/2014, ); local option		(154.8)	(258.0)	(263.2)	(268.4)
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
Nonprofit refunds, \$5 M cap 2014, \$1 M 2015, \$100k in 2016		16.8	24.8	58.7	99.2
Refunds for local governments (01/01/2015)		(67.8)	(140.9)	(146.5)	(152.4)
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
Repeal exemption for vending machines (10/01/2013)	3.3	4.9	5.1	5.2	5.4
Repeal exemption for certain sales of newspapers (10/01/2013)	2.1	3.3	3.4	3.5	3.6
Repeal gross receipts tax on live entertainment and movies and other amusements, include admission fees in tax base (10/01/2013)	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)		6.9	7.3	7.4	7.6
Change various exemptions to refunds and phase-out over 3 years		18.5	50.9	78.6	85.9
<b>LOCAL IMPACT</b>	<b>\$ 9.3</b>	<b>\$ (158.2)</b>	<b>\$ (293.1)</b>	<b>\$ (241.3)</b>	<b>\$ (203.4)</b>

## **BILL SUMMARY:**

### **PERSONAL INCOME TAX**

Part I 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, effective for the 2013 tax year
- Establishes a \$15,000 zero bracket for married filing jointly taxpayers (\$12,000 for head of household and \$7,500 for single and married filing separately)
- Establishes a flat 5.40% tax rate
- Lowers rate to a flat 5.25% tax rate beginning January 1<sup>st</sup> 2015
- Eliminates the NC standard and itemized deductions
- Eliminates the personal exemption
- Eliminates deduction for severance wages
- Eliminates deduction for benefits received under Title II of the Social Security Act
- 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

Part II reduces the corporate income tax rate from 6.9% to 6% in 2014, to 4% in 2015, to 2% in 2016, and eliminates the tax in 2017. It repeals earmarking of corporate income tax revenues for the Public School Building Capital Fund. Part II 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

Part III 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 privilege tax is due on the 15<sup>th</sup> day of the 4<sup>th</sup> month after the close 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, \$600 for tax due in 2016, \$750 for tax due in 2017 and after.

Part III reduces the franchise tax rate on C corporations from \$1.50/1,000 to \$1.20/1,000 for tax due in 2015, to \$.90/1,000 for tax due in 2016, and to \$.60/1,000 for tax due in 2017. It increases the minimum franchise tax on C corporations from \$35 to \$500 for tax due in 2015, to \$1,000 for tax due in 2016, and to \$2,000 for tax due in 2017. It eliminates the franchise tax on C corporations for tax otherwise due in 2018. It imposes privilege tax on C corporations effective for tax due in 2018. The privilege tax amount for C corporations is \$5,000.

<b>TAX PAID IN:</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
LLCs	\$200	\$400	\$600	\$750	\$750
S-Corps	\$1.50/1000	400	\$600	\$750	\$750
C-Corp Franchise Rate	\$1.50/1000	\$1.20/1000	\$0.90/1000	\$0.60/1000	0
C-Corp Minimum Fee (2018 priv. tax)	\$35	\$500	\$1,000	\$2,000	\$5,000

## 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 on October 1, 2013:
  - 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 on July 1, 2014:
  - 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, as of October 1, 2013:
  - Repeals the 3% gross receipts tax on live entertainment, October 1, 2013
  - Repeals the 1% gross receipts tax on movies, October 1, 2013
  - 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 as of October 1, 2013:
  - 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, as of July 1, 2014:
  - Repeal sales tax refund for local governments
  - Caps the sales tax refund for nonprofit entities as follows:
    - 2014 – State = \$7.5m; Local = \$2.25m
    - 2015 – State = \$5.0 m; Local = \$1.5m
    - 2016 – State = \$5.0 m; Local = \$1.5m
    - 2017 and thereafter – State = \$100k; Local = \$30k July 1, 2014
    - Changes 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, October 1, 2014.

- Increases the State sales tax rate on modular homes from 2.5% to the State general rate (4.75%), October 1, 2014.
- Repeals the local sales tax on food, 2% repeal November 1, 2014,
- Authorizes counties to levy a sales tax on food at the full local rate ranging from 2% to 2.75%.
- Eliminates the wholesaler’s discount on cigarettes and other tobacco products effective July 1, 2014.

**ASSUMPTIONS AND METHODOLOGY:**

*Personal Income, Corporate Income, 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.

<b>Repeal Sales Tax Exemption convert to a Refund:</b> Phase out over 4 years. 75% refund in FY 2014, 50% in FY 2015, 25% in FY 2016, repealed in FY 2017.	<b>Statute</b>
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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**DATE:** June 13, 2013

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