GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2017

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: April 10, 2018
TO: Revenue Laws Committee
FROM: Jonathan Tart
Fiscal Research Division

RE: IRC Update Draft

FISCAL IMPACT
($ in millions)

☑ **Yes** ☐ **No** ☐ **No Estimate Available**

	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	FY 2021-22
State Impact					
General Fund Revenues:		$54.0	$66.0	$89.0	$103.0
General Fund Expenditures:					
Special Fund Revenues:					
Special Fund Expenditures:					
State Positions:					
NET STATE IMPACT	**$0.0**	**$54.0**	**$66.0**	**$89.0**	**$103.0**
Local Impact					
Revenues:					
Expenditures:					
NET LOCAL IMPACT	**$0.0**	**$0.0**	**$0.0**	**$0.0**	**$0.0**

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: NC Department of Revenue

EFFECTIVE DATE: Various Effective Dates

TECHNICAL CONSIDERATIONS:
None

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BILL SUMMARY:

The bill draft would update from January 1, 2017, to February 9, 2018, the reference to the Internal Revenue Code (IRC). This means that to the extent North Carolina follows federal tax provisions in calculating State tax liability, changes made to the IRC by the Federal Tax Cuts and Jobs Act (TCJA) and the Bipartisan Budget Act of 2018 would impact NC revenue collections. However, there have been major tax changes in NC including those listed below that minimize the impact of the federal tax changes:

- NC starts with federal adjusted gross income (AGI) instead of federal taxable income.
- NC does not conform to federal standard deduction or personal exemption amounts.
- NC does not conform to federal itemized deductions.
- NC allows cost of capital asset purchases to be deducted over a five-year period in place of federal law that allows the cost to be deducted in one year.
- NC eliminated tax credits that were based on federal tax credits.

The major federal tax changes include the following:

- Changes in individual and corporate tax rates. – NC sets its own tax rates.
- Elimination of personal exemptions and changes to the standard deduction. – NC does not conform to federal personal exemption amounts or standard deduction amounts.
- Elimination of, and changes to, numerous itemized deductions. – NC does not conform to federal itemized deductions.
- Change to bonus depreciation and Section 179 expensing. – NC does not conform to these federal tax laws.
- Allowance of a deduction against federal taxable income for certain pass-through business income. – NC begins its tax calculation with federal Adjusted Gross Income. The deduction for business income will not change the calculation of Adjusted Gross Income.

The estimated fiscal impact results from the following federal tax provisions:

Estimated Impact of Conforming to IRC Changes	**FY 18-19**	**FY 19-20**
Reduce threshold for deducting medical expenses from 10% to 7.5%, repeal deductions for home equity loan interest, and other miscellaneous deductions and income exclusions	-25	3
Simplify small business accounting methods	-35	-31
Limit net interest deduction	5	7
Disallow active businesses losses in excess of taxable income of $500k MFJ and $250k for others; Allow unlimited loss carryforward deduction up to 80% of income per year. Repeal 2 year loss carryback deduction for most taxpayers	80	63
Repeal like kind exchanges except for real property	4	6
Repeal deduction for various fringe benefits	14	9
Repeal deduction for FDIC premiums	8	6
Reduce corporate dividends received deduction from 80% to 65% from 20% owned corps. Reduce dividends received deduction from 70% to 50% for less than 20% owned corporations	5	5
Total	**54**	**66**

The bill draft decouples from the following provisions:

- Income Exclusion for forgiveness of debt on primary residence
- Deduction for mortgage insurance premiums
- Deduction for tuition and related expenses
- Tax incentives for investments in qualified opportunity zones
- Certain international tax provisions pertaining to income derived outside U.S.

ASSUMPTIONS AND METHODOLOGY:

The fiscal impact to the General Fund is a result of conformity to the IRC enacted as of February 9, 2018, to the extent that North Carolina does not decouple from the Internal Revenue Code in calculating State tax liability. The estimate is prepared by analyzing the US Joint Committee on Taxation (JCT) estimates on changes to federal taxes, IRS Statistics on Income, and North Carolina tax return data. The methodology used for converting federal data to the State level starts by adjusting for differences between the federal fiscal year that ends 9/30 and the State's fiscal year that ends 6/30, Fiscal Research adjusts these numbers to an approximate State fiscal year tax impact. Then, the next step is to prorate the national numbers to the State impact. This adjustment involved two steps: accounting for the relative size of the State based on federal tax collections and then adjusting for the difference in federal marginal tax rates and the State tax rate. Once North Carolina's share of the JCT estimates were determined, State tax liability changes were estimated and allocated to the appropriate fiscal year.

SOURCES OF DATA: NC Department of Revenue, US Joint Committee on Taxation

TECHNICAL CONSIDERATIONS: None