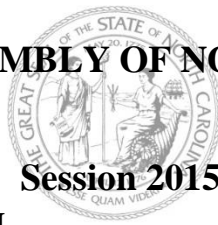


# GENERAL ASSEMBLY OF NORTH CAROLINA



**Session 2015**

## 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:** May 18, 2015

**TO:** House Finance Committee

**FROM:** Jonathan Tart, Rodney Bizzell, Barry Boardman, Brian Slivka, Denise Canada, Anna Cameron, and Bryce Ball  
Fiscal Research Division

**RE:** PCS to H97: Appropriations Act of 2015

<b>FISCAL IMPACT</b>					
(\$ in millions)					
<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No		<input type="checkbox"/> No Estimate Available		
	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20
<b>State Impact</b>					
General Fund Revenues:	(\$34.6)	(\$127.8)	(\$175.9)	(\$176.7)	(\$177.4)
General Fund Expenditures: (Debt Service)		\$22.8	\$28.0	\$28.0	\$28.0
Highway Fund Revenues:	(\$22.9)	(\$21.5)	(\$18.3)	(\$18.0)	(\$17.6)
Highway Fund Expenditures:					
Highway Trust Fund Revenues:	(\$7.6)	(\$7.2)	(\$6.1)	(\$6.0)	(\$5.9)
Highway Trust Fund Expenditures:					
Special Fund Expenditures:	(\$0.5)				
<b>NET STATE IMPACT</b>	<b>See Assumptions &amp; Methodology</b>				
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTE</b> Department of Transportation, Department of Revenue					
<b>EFFECTIVE DATE:</b> Various					
<b>TECHNICAL CONSIDERATIONS:</b>					
None					

### **BILL SUMMARY:**

#### Research and Development Tax Credit

Extends sunset of the research and development tax credit from 1/1/16 until 1/1/20.

#### Renewable Energy Tax Credit

Extends sunset of the solar component of the renewable energy tax credit from 1/1/16 until 1/1/18.

Extends sunset for other components of the renewable energy tax credit from 1/1/16 until 1/1/20.

### Historic Rehabilitation Tax Credit

Enacts new G.S. Chapter 105, Article 3L, Historic Rehabilitation Tax Credits Investment Program, providing for tax credits for a taxpayer allowed a federal income tax credit for making qualified rehabilitation expenditures for a certified income-producing historic structure in the amount of 15 percent for rehabilitation expenditures that range from \$0 to \$10 million, and 10 percent for expenditures that range from \$10 million to \$20 million. Further provides for development tier bonuses and targeted investment bonuses. Establishes a tax credit ceiling, providing that no tax credit for an income-producing certified historic structure can exceed \$4.5 million. Effective January 1, 2015, applying to qualified rehabilitation expenditures and expenses incurred on or after that date.

Establishes a tax credit for a taxpayer not allowed a federal income tax credit for making qualified rehabilitation expenditures for a certified non-income-producing historic structure that has rehabilitation expenses of at least \$10,000, providing that the credit is equal to 15 percent of the rehabilitation expenses. Provides a tax credit ceiling of \$22,500 per discrete property parcel.

### Senior Tax Deduction for Medical Expenses

Amends G.S. 105-153.5, making clarifying changes to itemized deduction amounts, and enacting the new G.S. 105-153.5(a)(2)c, providing for a medical expenses itemized individual income tax deduction. It provides that the deduction is for the amount allowed pursuant to Section 213 of the U.S. Internal Revenue Code for medical expenses incurred for a person who is 65 years old or older before the close of the taxpayer's taxable year. Effective beginning on or after January 1, 2015.

### Extend Sales Tax Preferences for Motorsports for Four Years

Extends the sales tax exemption for service contracts and the sales tax refund for professional motorsports vehicle parts (other than tires and accessories) and aviation fuel for motorsports event travel. Expands the sales tax exemption to related members of a professional motorsports racing team.

### Data Center Infrastructure

Enacts a sales tax exemption for datacenters investing at least \$75M within a 5-year period for sales of datacenter equipment and electricity located and used at the datacenter.

### Exempt Service Contracts on Aircraft

Enacts a sales tax exemption for service contracts applicable to qualifying aircraft or jet engines if it is sold by the manufacturer/related member of the manufacturer of the covered item. A qualifying aircraft has a max take-off weight between 10,000 and 20,000 pounds. A qualifying jet engine is one certified pursuant to 14 CFR, Part 33 (turbofan engine).

### Motor Fuel Excise Tax

Reduces the motor fuel excise tax rate on gasoline to 33 cents per gallon and maintains the motor fuel excise tax rate on diesel at 36 cents per gallon, effective January 1, 2016.

Work-Based Experience Pilot Program

Directs the Department of Commerce to establish a Work-based Experience Pilot Program (Pilot Program) and select one qualifying school for the Pilot Program. A qualifying school is one that has been approved as a cooperative innovative high school; will be operated in a facility owned or leased by the local board of education pursuant to a location waiver approved by the local governing board; is located in a development tier one area; has received at least \$300,000 of value in equipment and other monetary support for a collaborative applied education program from one or more businesses in an eligible industry; and has at least 50% of the business investment matched by a unit of local government.

The Department is directed to use \$500,000 of the unencumbered funds in the Industrial Development Fund Utility Account for capital improvements and renovations to the existing educational buildings of the qualifying school, or to purchase applied technology equipment for the qualifying school, for the purpose of facilitating the implementation of the Pilot Program. The Department is also to study the expansion of the program into a statewide program for the qualifying schools.

Two-Thirds Bond Act of 2015

This bill authorizes the issuance of Two-Thirds Bonds in the amount of \$269,525,200 for the purpose of constructing five projects: a training academy for the Highway Patrol; a new science building at the University of North Carolina – Charlotte; a health sciences building at Appalachian State University; an engineering building at North Carolina State University; and, a Medical Examiner facility for the Department of Health and Human Services at Wake Forest University. Two-Thirds Bonds are a form of General Obligation debt under Article V, Sec. 3(1)(f) of the North Carolina Constitution. The General Assembly is allowed to authorize the issuance of debt subject to two-thirds of the principle reduction of outstanding General Obligation debt, subject to a vote of the people, in the preceding fiscal biennium. The State has \$345 million in available Two Thirds bond capacity under this calculation. If a subsequent General Obligation bond is authorized, this debt not authorized to be issued.

**ASSUMPTIONS AND METHODOLOGY:**

**General Fund Tax Provisions**

Tax provisions are summarized in the table followed by a description of each provision.

<b>General Fund Tax Provisions Fiscal Impact</b>					
<b>(\$ in Million)</b>					
	<b>FY 2015-16</b>	<b>FY 2016-17</b>	<b>FY 2017-18</b>	<b>FY 2018-19</b>	<b>FY 2019-20</b>
Research and Development Credit	0	(44.0)	(44.0)	(44.0)	(44.0)
Renewable Energy Tax Credit	0	(47.0)	(94.0)	(94.0)	(94.0)
Historic Rehabilitation Credit	(8.0)	(8.0)	(8.0)	(8.0)	(8.0)
Senior Tax Deduction for Medical Expenses	(23.6)	(22.9)	(21.9)	(22.6)	(23.2)

Motorsports Parts and Fuel Sales Tax Refund	0	(1.9)	(4.0)	(4.1)	(4.2)
Qualifying Data Centers' Electricity Sales Tax Exemption	(3.0)	(4.0)	(4.0)	(4.0)	(4.0)
Exempt Aircraft Service Contracts	0	0	Unknown	Unknown	Unknown
<b>TOTAL</b>	<b>(34.6)</b>	<b>(127.8)</b>	<b>(175.9)</b>	<b>(176.7)</b>	<b>(177.4)</b>

Research and Development Tax Credit

The estimate is based on the economic incentive reports published by the Department of Revenue.

Renewable Energy Tax Credit

The estimate is based on economic incentive reports published by the Department of Revenue, and on industry information regarding potential projects.

Historic Rehabilitation Tax Credit

The estimate of the fiscal impact is based on historical tax data concerning the cost of the previous historic rehabilitation tax credit obtained from the Department of Revenue. Fiscal Research made adjustments to that data to take into consideration the changes in the percentages of the investment allowed as a tax credit for income-producing and non-income producing property. Additionally, adjustments were made to account for the amount of expenses eligible for the credit as a result of the cap on the amount of credit that can be claimed.

Senior Medical Tax Deduction

Through Tax Year 2016, returns whose primary filer is 65 years of age or older in the given tax year are able to claim, as part of their Federal itemized deduction, medical and dental expenses greater than 7.5% of their adjusted gross income. Beginning in Tax Year 2017, that number increases to 10% of the taxpayer's adjusted gross income. Currently, returns with a primary taxpayer younger than 65 years of age are able to claim medical and dental expenses in excess of 10% of their adjusted gross income as a part of their Federal itemized deduction.

According to Federal data from the IRS Statistics of Income Report for Tax Year 2012, 7.0% of all tax returns claim medical expenses at the Federal level and 21.3% of tax returns, where the primary taxpayer is 65 and over, claim medical expenses at the Federal level.

Fiscal Research employs the use of the BearingPoint North Carolina Individual Income Tax Model to estimate the impact of individual income tax law changes. By including unlimited medical expenses, as allowed under the Federal Form 1040 (Schedule A), in the list of allowable North Carolina itemized deductions for those 65 years of age or older, the impact is estimated to be a \$23.6 Million loss in individual income tax revenue in FY 2015-16. This amount assumes that all medical and dental expenses claimed on a return, where the primary taxpayer is 65 or older, is attributable to a taxpayer 65 or older. By FY 2017-18, when all taxpayers will be subject to the Federal 10% adjusted gross income floor, the revenue impact is an estimated loss of \$21.9 Million.

## Extend Sales Tax Preferences for Motorsports for Four Years

Under current law:

- G.S. 105-164.14A(a)(4) allows a professional motorsports racing team, a motorsports sanctioning body, or a related member of such a team or body to receive a refund of the sales and use tax it pays in North Carolina on aviation fuel used to travel: (i) to or from a motorsports event in North Carolina; (ii) to a motorsports event in another state from North Carolina; or (iii) to North Carolina from a motorsports event in another state.
- G.S. 105-164.14A(a)(5) allows a professional motorsports racing team or a related member of a team to receive a refund of fifty percent (50%) of the sales and use tax it pays in North Carolina on tangible personal property that is part of a professional motorsports vehicle, excluding tires and accessories.

Both of these exemptions expire for purchases made on or after January 1, 2016; the bill extends the sunset until January 1, 2020.

The North Carolina Department of Revenue (DOR) requires tax filers who request refunds under G.S. 105-164.14A(a)(4) or (5) to do so by December 31st for the prior fiscal year. With the current sunset date, DOR would receive final refund requests by December 31, 2016, and these requests would represent six months of tax expenditures (i.e., July 1 – December 31, 2015). Consequently, Fiscal Research estimates that the cost of repealing the sunset would equal six months of expenditures in FY 2016-17 and twelve months of expenditures thereafter.

Fiscal Research used data from the North Carolina Department of Revenue's 2013 Tax Expenditure Report to determine the annual cost of these tax exemptions.

### Qualifying Data Centers' Electricity Sales Tax Exemption

The estimate is based on the Governor's budget. Fiscal Research does not have enough information to confirm or amend the estimated cost. Specifically, there is not sufficient information available to estimate the number of qualifying datacenters that might locate in North Carolina if the bill becomes law, and there is not adequate data and evidence to allow Fiscal Research to determine whether any new qualifying datacenter in North Carolina would have located in the State without the proposed bill language.

### Exempt Aircraft Service Contracts

The provision would exempt service contracts on qualifying aircraft from sales tax beginning July 1, 2017. Because of the effective date, there is no impact for FY 15-16 and FY 16-17. The impact in subsequent years is unknown.

## **Other Provisions**

### Work-Based Experience Pilot Program

The provision directs the Department of Commerce to use \$500,000 of unencumbered funds in the Industrial Development Fund Utility Account for the Pilot Program. Therefore, the provision results in a loss of \$500,000 to the IDF Utility Account.

### Two Thirds Bond Act of 2015

This Bill authorizes the issuance of \$269,525,200 in Two-Thirds bonds. This debt is subject to a General Obligation Bond, which is subject to the approval of the majority of the voters, not being authorized. The analysis below assumes that a prospective General Obligation bond is not authorized and the only debt authorized and issued are Two-Thirds Bonds. This analysis assumes a full debt issuance in the second year of the biennium with a partial payment due during FY 2016-17.

	<b>FY 2015-16</b>	<b>FY 2016-17</b>	<b>FY 2017-18</b>	<b>FY 2018-19</b>	<b>FY 2019-20</b>
Debt Service Increase	\$0	\$22,752,127	\$28,002,618	\$28,002,618	\$28,002,618

Motor Fuel Excise Tax

This bill reduces the motor fuel excise tax rate on gasoline to 33 cents per gallon and maintains the motor fuel excise tax rate on diesel at 36 cents per gallon, effective January 1, 2016.

Distribution of Motor Fuels Tax:

Seventy-five percent (75%) of motor fuels tax revenue is deposited in the Highway Fund and the remaining twenty-five percent (25%) is deposited in the Highway Trust Fund. Three formulaic allocations of revenues from the Highway Fund are impacted by this bill. Powell Bill aid to municipalities is derived from ten and four tenths percent (10.4%) of motor fuel tax revenues. Currently, both the Wildlife Resources Fund and the Shallow Draft Navigational Channel and Lake Dredging Fund receive one sixth of one percent (0.167%) of Highway Fund motor fuels tax revenues. This bill increases the Shallow Draft Navigational Channel and Lake Dredging Fund to one-half of one percent (0.5%).

<b>Statutory Adjustments - FY 2015-16 to FY 2019-20 (in millions)</b>					
	<b>FY 2015-16</b>	<b>FY 2016-17</b>	<b>FY 2017-18</b>	<b>FY 2018-19</b>	<b>FY 2019-20</b>
Powell Bill		\$ (2.4)	\$ (2.2)	\$ (1.9)	\$ (1.9)
Wildlife Resources	\$ -	\$ -	\$ -	\$ -	\$ -
Dredging	\$ (0.1)	\$ (0.1)	\$ (0.1)	\$ (0.1)	\$ (0.1)

Fee Provisions

The PCS contains several fee provisions which are outlined in an attached chart.

**SOURCES OF DATA:** NC Department of Revenue, NC Department of Transportation, BearingPoint North Carolina Individual Income Tax Model, IRS Statistics of Income, Moody’s Analytics

**TECHNICAL CONSIDERATIONS:** None