

**NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE**

BILL NUMBER: HB 1326 Third Edition
SHORT TITLE: Update IRC Reference/Conform Gift Tax
SPONSOR(S): Rep. Gray, et al.

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$ Millions)				
	<u>FY 1998-99</u>	<u>FY 1999-00</u>	<u>FY 2000-01</u>	<u>FY 2001-02</u>	<u>FY 2002-03</u>
REVENUES					
GENERAL FUND					
IRC Update	(\$6.97)	(\$4.01)	(\$10.70)	(\$18.53)	(\$33.64)
Net Economic Loss					
Carryforward		(16.00)	(16.00)	(16.00)	(16.00)
Parking Deduction	_____	_____.82	_____.82	_____.82	_____.82
Total	(\$6.97)	(\$20.83)	(\$27.52)	(\$35.35)	(\$50.46)
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue					
EFFECTIVE DATE: Section 4 (Qualified Tuition Programs) becomes effective for taxable years beginning on or after January 1, 1998. Sections 6 and 7 (net loss carryforward) are effective for taxable years beginning on or after July 1, 1998, and apply to losses incurred for taxable years beginning on or after July 1, 1992. Section 8 (parking deduction) is effective for taxable years on or after January 1, 1999. The remainder of the act is effective when it becomes law.					

BILL SUMMARY: The act (1) updates the reference to the Internal Revenue Code used in defining and determining certain state tax provisions (from January 1, 1997 to August 1, 1998), (2) conforms to federal gift tax treatment of contributions to qualified tuition programs, (3) extends the corporate income tax carryforward for net economic losses from five years to twenty years, and (4) allows an income tax deduction for employees' payments to their employers for parking.

BACKGROUND: Each year the General Assembly changes the reference date in the definition of the Internal Revenue Code used in the state individual and corporate income tax statutes. Congress made hundreds of changes in the Code with the passage of the Taxpayer Relief Act of 1997. These changes were reviewed by the Revenue Laws Study Committee and were recommended to the 1998 General Assembly with a few exceptions. Those tax law changes that affect the 1997 tax year cannot be adopted by North Carolina until 1998, because the state constitution prohibits enacting a retroactive tax increase.

Congress recently approved and the president signed the Internal Revenue Service Restructuring and Reform Act of 1998. This act made additional changes in both individual and corporate income tax laws that have a positive impact on the state General Fund.

ASSUMPTIONS AND METHODOLOGY:

IRC Update

North Carolina estimates on updating the Internal Revenue Code reference are based on a percentage of the federal estimate calculated by the Congressional Joint Committee on Taxation. The percentage used is North Carolina's actual tax collections divided by national tax collections. (individual = .723% and corporate = .542%.) The charts on the following pages show the fiscal impact of the major federal tax changes on the state's General Fund.

Qualified Tuition Program

As for the gift tax change on qualified tuition programs, there should be little or no revenue loss to the state. The newly created College Vision Fund, administered by the State Education Assistance Authority, is designed for middle income taxpayers who save an average of \$125 a month for their children's college education. While gifts exceeding \$10,000 may be accepted by the fund, such contributions are not the norm. Those with the means to give more than \$10,000 per year will probably invest in college trust funds bearing interest greater than the interest paid by the State Treasurer on the investments in the College Vision Fund.

Net Economic Loss Carryforwards

The Tax Research Division of the Department of Revenue estimates that extending the corporate income tax carryforward for net economic losses from five years to 20 years will cause a **revenue loss in the General Fund from \$8 million to \$16 million per year**. This estimate was based on corporate income tax returns from 1994 when 36,780 nontaxable corporations had \$10.1 billion in unexpended net economic loss carryforwards. The Department could not be more precise due to the volatility of corporate taxable income and the lack of information concerning "expired" losses. The Department confirmed this estimate by reviewing a small sample of 1996 returns.

Since this section is effective for taxable years on or after July 1, 1998, it is assumed that the majority of corporations will file their annual returns three months and 15 days after the close of their fiscal year on June 30, 1999. This would put the first year revenue loss in FY 1999-00. There will be some short period returns filed due to mergers and other reasons, but there is no data to determine how many might occur in FY 1998-99. For the fiscal note, the high end of the range (\$16 million) is used to be conservative in estimating budget availability in future fiscal years.

Parking Deduction

Section 8 of the bill allows a state income tax deduction for employees payments to their employers for parking. According to a paper (Federal Tax Policy and Employer Subsidized

Parking) written by Don Pickrell for the 1990 Commuter Parking Symposium, 75% of the people who drive to work in US cities use parking provided by their employers and 90% of these workers don't pay to park. Such data is not available on private employee parking for North Carolina commuters. Several city transportation departments reported monthly leases in their municipal parking decks to area employers, but it was not known how these spaces were allocated to employees. An extensive employer survey would have to be performed to obtain this data.

Some information is known about public employee parking. State employees paid the Department of Administration \$1,255,000 in 1997 to park in government lots in Raleigh and Charlotte. Eleven of the 16 University of North Carolina campuses reported \$14 million in parking receipts for 1997-98. Except for UNC-Chapel Hill and NC State University, these receipts included both student and employee parking. For those campuses that did not provide a breakdown between students and employees, it was assumed that 75% of campus parking receipts were for employees. The adjusted parking receipts for university employee parking in 1997-98 is \$10.2 million. Finally, nine cities in the state with the highest parking revenues were asked if they charged employees for parking. Greensboro and Charlotte reported \$290,837 in employee parking receipts. Some Raleigh employees pay for parking in city owned decks, but since their payments are to a private company that operates the decks, they are not eligible for the deduction.

Assuming a 7% state income tax rate, the deduction of parking charges paid by local and state employees will produce a General Fund revenue loss of \$822,639. The General Fund revenue loss for public employees is computed as follows:

State Employees	\$1,255,000
Universities (11 campuses)	\$10,206,148
Greensboro	\$98,837
Charlotte	<u>\$192,000</u>
Deduction from taxable income	\$11,751,985
State Income Tax	<u>X 7%</u>
Value of Deduction	\$822,639

This is the minimum loss for this section of the bill. The actual loss will be higher, but cannot be computed at this time due to lack of information on private employers. Also, it is unknown whether employers in urban areas will restructure their employee parking payment methods to allow their employees to take advantage of this deduction. For example, employers may begin allowing employees to pay the company for leased parking spaces instead of paying directly to private parking operators.

INTERNAL REVENUE CODE UPDATE - STATE IMPACT

	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
IRS Restructuring and Reform Act of 1998						
Individual & Corporate						
Clarify provisions relating to examination and collection activities; Offers-in- compromise	Generally 7/23/98	--	0.07	0.03	0.03	0.03
Authorize the Federal government to offset a Federal Income Tax refund to satisfy a past-due, legally owing state income tax debt	1/1/00		Gain, but no estimate available			
Clarifies the exclusion of meals provided for the convenience of employees on employer's premises	upon enactment	-0.11	-0.18	-0.18	-0.19	-0.20
Overrule <u>Schmidt Baking</u> with respect to vacation pay and severance and other types of compensation, with three year spread	1/1/98	4.55	5.40	2.47	1.67	0.85
Freeze grandfathered status of Stapled or Paired-Share REITS	1/1/98	0.01	0.02	0.03	0.05	0.08
Make certain trade receivables ineligible for Mark-to-Market Treatment	1/1/98	1.72	2.71	1.80	0.63	0.38
Taxpayer Relief Act of 1997						
Affects Individual Income Tax Only						
Exclude capital gain from sale of residence	5-6-97	-3.62	-3.62	-3.62	-4.34	-4.34
Expand deduction for self-employed individuals' health insurance	2000	--	-0.28	-0.87	-1.62	-4.37
Establish Roth IRAs/Expand existing IRAs	1-1-98	-2.49	0.62	-2.50	-6.22	-13.23

Taxpayer Relief Act of 1997 (Continued)	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Affects Individual Income Tax Only						
Establish education IRAs	1-1-98	-4.66	-6.59	-7.66	-8.14	-10.47
Add room and board as qualifying expenses for Prepaid Tuition Programs	8-21-96	No impact - NC already exempts these expenses				
Reenact employer-provided educational assistance	1-1-97	-2.67	-1.81	--	--	--
Allow deduction of interest paid on qualified higher education loans	1-1-98	-0.50	-0.88	-1.47	-2.00	-2.23
Restrict penalty for underpayment of estimated income tax	12-31-97	-0.12	-0.13	-0.14	-0.14	-0.15
Increase standard deduction for individuals claimed as dependent by another	1-1-98	-0.27	-0.25	-0.25	-0.25	-0.25
Change net operating loss carryback and forward periods	1/1/98	0.22	0.26	0.19	0.13	0.10
Increase charitable mileage rate from 12 cents to 14 cents	1/1/98	-0.40	-0.42	-0.44	-0.46	-0.49
Extend deduction for FMV of stock contributed to private foundation	6/1/97	-0.07	-0.03	-	-	-
Expand rules on home office as principal place of business	1/1/99	-0.86	-1.76	-1.83	-1.90	-1.98
Exclude capital gain from sale of qualified small business stock	8/1/97	-0.36	-0.36	-0.36	-0.36	-0.36
Increase maximum amount of self-employed 401(k) contributions	1/1/98	No estimate available				
Modify tax treatment of Employee Stock Ownership Plans (ESOP) in S corporations	12/31/97	-0.17	-0.25	-0.30	-0.32	-0.33
Change tax treatment of rural mail carriers' reimbursed mileage	1/1/98	-0.01	-0.01	-0.01	-0.01	-0.01
Defer gain from sale of livestock due to drought, flood or other weather related event	1/1/97	-0.01	-0.01	-0.01	-0.01	-0.01
Expand business meals/entertainment deduction for air transportation employees, truck drivers, railroad employees, and merchant marines	1/1/98	-0.12	-0.20	-0.27	-0.35	-0.45
Clarify exclusion of the value of employer-provided parking	1/1/98	0.06	0.08	0.09	0.09	0.09
Increase exclusion of income earned by US citizens residing in foreign countries		-0.22	-0.36	-0.48	-0.59	-0.70
Exclude from income the disability payments to former police officers and fire fighters retroactive to 1989, 1990, and 1991		-	-	-	-	-
Exclude from income government survivor annuities to slain public safety officers	1/1/97	-0.01	-0.01	-0.01	-0.01	-0.01
Deny nonrecognition of gain of involuntarily converted property	6/8/97	0.03	0.04	0.06	0.08	0.09
Provide an above the line deduction for state and local officials' expenses	1/1/87	-0.03	-0.03	-0.03	-0.04	-0.04
Change basis recovery method for pension plan payments modified	12/31/97	0.02	0.04	0.07	0.08	0.11
Simplify treatment of personal transactions in foreign currency	12/31/97	-0.01	-0.01	-0.01	-0.01	-0.01
Increase full funding limit with 20 year amortization for pensions	12/31/98	-0.03	-0.09	-0.10	-0.13	-0.14

Taxpayer Relief Act of 1997 (Continued)	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Affects Partnerships (Individual Income Tax)						
Classify sale or exchange of inventory in partnership as ordinary income	8/5/97	No impact - NC already taxes as ordinary income				
Change formula for allocation of basis among distributed assets of partnership	8/5/97	0.38	0.40	0.41	0.43	0.44
Extend period from 5 to 7 years for recognition of precontribution gains	6/8/97	-	-	-	0.01	0.07
Affects both Individual and Corporate Income Tax						
Extend R&D tax credit retroactive to 6/1/97	6/1/97	Costs included in the Bill Lee act				
Restrict income forecast method of depreciation	8/6/97	0.30	0.45	0.56	0.27	0.20
Eliminate short against the box transaction for stock	6/8/97	0.87	0.49	0.53	0.57	0.61
Require immediate accrual of interest on pool of debt instruments	8/5/97	1.99	2.59	2.31	2.05	0.72
Allow expensing of certain environmental remediation costs for brownfields	8/5/97	-0.95	-1.19	-0.46	0.00	0.01
Allow inventory adjustment for estimated shrinkage	8/5/97	-0.15	-0.17	-0.18	-0.20	-0.21
Change gain recognition rules under sections 1233 and 1234A of the Internal Revenue Code	8/5/97	0.20	0.18	0.18	0.18	0.18
Include income from notional principal contracts and stock lending transactions in gross income of U.S. shareholders	8/5/97	0.14	0.15	0.15	0.15	0.15
Restrict like-kind exchanges involving foreign personal property	6/8/97	0.06	0.08	0.09	0.11	0.12
Limit treaty benefits for payments to hybrid entities	8/5/97	0.01	0.01	0.01	0.01	0.01
Exempt certain securities positions from U.S. property definition under subpart F	12/31/97	-0.01	-0.01	-0.01	-0.01	-0.01
Exempt active financing income from subpart F	1998	-0.49	-0.02	0.00	0.00	0.00
Modify look-back method for long term contracts	8/5/97	-0.01	-0.02	-0.03	-0.03	-0.03
Affects Corporate Income Tax Only						
Recognize gain from exchange of property for preferred stock treated as boot	6/8/97	0.20	0.21	0.22	0.23	0.05
Expand charitable deduction for corporate contributions of computer software and equipment	1/1/98	-0.26	-0.42	-0.27	-0.03	-0.01
Repeal income deferral when farms change from cash method to accrual method	7/1/96	0.18	0.19	0.20	0.20	0.21
Allow Subchapter S subsidiaries to be treated as separate corporations	1/1/97	No estimate available				

Taxpayer Relief Act of 1997 (Continued)	Effective	(\$Millions)				
	Date	98-99	99-00	00-01	01-02	02-03
Affects Corporate Income Tax Only						
Clarify that software qualifies as export property	1/1/98	-0.23	-0.79	-0.94	-0.98	-1.04
Restrict corporate deductions relating to life insurance	8/6/98	0.29	0.50	0.76	1.05	1.34
Require recognition of gain from extraordinary dividend and other changes	9/13/95	-0.50	-0.29	-0.05	0.24	0.42
Repeal law allowing manufacturers to use installment method to report sales to their dealers	8/6/98	0.24	0.53	0.57	0.57	0.35
Require gain recognition on certain distributions of controlled corporation stock and change tax treatment of redemptions involving related corporations	6/8/97	1.37	1.20	1.04	0.88	0.73
Deny interest deduction on convertible debt	6/8/97	0.09	0.16	0.23	0.30	0.34
Defer gain allowed on sales of stock of certain corporations engaged in refining or processing agricultural products to farmer cooperatives engaged in marketing agricultural products	12/31/97	-0.37	-0.03	-0.03	-0.02	-0.02
Modify control test and include attribution rules to determine unrelated business income						
tax consequences of certain payments from subsidiaries of tax-exempt organizations	12/31/98	0.00	0.00	0.02	0.03	0.03
Repeal 30% gross income limitation for regulated investment companies	8/5/97	-0.12	-0.15	-0.18	-0.21	-0.24
Affect Other NC Taxes						
Extend generation-skipping transfer tax exemption to grandnieces and grand nephews	1/1/98	-0.03	-0.03	-0.03	-0.03	-0.03
TOTAL - IRC UPDATE		-6.97	-4.01	-10.7	-18.53	-33.64

Taxpayer Relief Act of 1997 - Other Provisions	Effective Date	98-99	(\$Millions)			
			99-00	00-01	01-02	02-03
Gift Tax						
Treat contributions in excess of \$10,000 to state pre-paid tuition plans as being made ratably over a five year period	1/1/98		Negligible revenue effect			
Technical/Minor Impact						
Clarify that self-employed individual is eligible to deduct long term care insurance even if employer provides health insurance			No estimate available			
Recapture all depreciation on section 1250 property			No estimate available			
Clarify that medical savings account withdrawals are for individual who was eligible in the month the expenses were incurred			No estimate available			
Treat estate and its beneficiaries as related parties for purpose of disallowing loss deduction for sales of assets	8/5/97		Negligible revenue effect			
Relax luxury auto depreciation limits for clean burning fuel vehicles and electric vehicles	8/5/97	-0.01	0.00	0.00	0.00	0.00
Allow employer deduction for contributions to SIMPLE 401(k) with no 15% cap	1/1/97		No estimate available			
Allow securities traders and commodity traders and dealers to elect mark to market accounting rules	8/5/97		No estimate available			
Exclude from unrelated business tax income certain corporate sponsorship payments	12/31/97		Negligible revenue effect			
Change treatment of travel expenses of certain federal employees engaged in criminal investigations	8/6/97		No revenue impact			
Close partnership taxable year with respect to deceased partner	12/31/97		No revenue impact			
Deduct contributions made by ministers to retirement plans	12/31/97		Negligible revenue effect			
Clarify tax-free employer-provided employee meals	1/1/97		No revenue impact			
Authorize MedicarePlus Choice Medical Savings Accounts pilot program	1/1/99		No estimate available			

Taxpayer Relief Act of 1997 (Continued)

	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Reduce carryback period for general business credits, but increase carry forward	1/1/98		Negligible revenue effect			
Repeal 30% gross income requirement for real estate investment trusts	8/5/97		Negligible revenue effect			

NOTES:

- 1) North Carolina estimates are based on a percentage of the federal estimate calculated by the Congressional Joint Committee on Taxation. The percentage used is N.C. actual tax collections divided by national tax collections. (Individual = .723% Corporate = .542%)
- 2) The North Carolina constitution prohibits enacting a retroactive tax increase, so this bill cannot adopt federal revenue increasing items for the 1997 tax year. This chart assumes that half of the revenue gained from tax increases in 1997 will be received by the Department in Tax Year 1998.

FISCAL RESEARCH DIVISION

733-4910

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DATE: August 8, 1998



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