GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2009

Legislative Fiscal Note

BILL NUMBER: House Bill 1829 (Second Edition)

SHORT TITLE: Econ. Development and Tax Collection Changes

SPONSOR(S): Representative Luebke

FISCAL IMPACT ($millions)

Yes (X) **No ( )** **No Estimate Available ( )**

	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-15
REVENUES:					
Section 1	**$0.0**	**-$1.5**	**-$3.0**	**-$4.0**	**-$5.0**
Section 2	**Insignificant impact based on information gathered from NCSEA and the Department of Revenue**				
Section 3	**No Impact – see assumptions and methodology**				
Section 4	**-$7.0**	**-$12.0**			
Section 5	**-$0.4**	**-$0.4**	**-$0.4**	**-$0.4**	**-$0.4**
Section 6	**$-1.5**				
Section 7	***Approximately $3 million annually in additional collections - see assumptions and methodology***				

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue; NC Dept of Secretary of State

EFFECTIVE DATE: See Bill Summary

BILL SUMMARY:

Section 1
Section 1 would extend the sunset on the Mill Rehabilitation Tax Credit until January 1, 2014. Under current law, it is set to sunset on January 1, 2011.

Section 2

Section 2 makes three changes to the credit for investing in renewable energy property. First, it changes the definition of "cost" to more closely parallel the federal definition under the Internal

Revenue Code. In doing so, it would make the credit more generous in situations where the taxpayer is leasing the property.

North Carolina's renewable energy tax credit allows a developer that leases renewable energy property to claim a tax credit equal to 35% of the cost of the property. As currently defined, the cost of leased property is determined by multiplying the annual rent by eight. This is the same definition that is used under the Bill Lee Act and Article 3J.

In some instances, a developer will structure a project in such a way as to elect for federal purposes to pass through the federal tax credit to an affiliated entity that is leasing the equipment. In these instances, the actual cost of the renewable energy property and installation can be greater than the amount derived by multiplying the annual rent by eight. This change to the definition would allow the person that elects to pass through the federal credit to use the actual cost of the property when calculating the tax credit.

Second, it creates a definition for the term "installation" that is consistent with how the Department of Revenue is currently interpreting the term through private letter rulings. The tax credit is limited to $2.5 million per installation. However, the term "installation" is not defined, and investors routinely seek rulings from the Department of Revenue for clarification of this term and its application to their particular projects. The Department has defined installation as "renewable energy property that standing alone or in combination with other machinery, equipment, or real property is able to produce usable renewable energy on its own." This section of the bill would codify this definition and it would also direct the Department to issue further guidance with reference to the different renewable energy technologies.

Third, it provides for a special allocation of the tax credit among the owners of the taxable entity. Generally speaking, a partner's distributive share of a tax credit is determined in accordance with federal provisions. The federal provisions provide that credits are allocated according to the partnership agreement. However, the allocation is determined in accordance with the partner's actual interest in the partnership if the allocation does not have a "substantial economic effect." This standard is designed to limit the formation of partnerships whose only purpose is to improve the tax situation of the partners. This bill would create a special allocation formula, which is identical to the formula used in North Carolina's historic rehabilitation and mill rehabilitation tax credits. Under this formula, the allocation of the credit would not be subject to the federal allocation provisions, but rather the credit may be allocated among any of the entity's owners, in its discretion, as long as the owner's adjusted basis in the entity is at least 40% of the amount of the credit allocated to that owner. The NCSEA believes that by allowing for this special allocation, it will attract investors and projects to the State because they can take full advantage of the credit by offsetting their State tax liability.

***Source*:** Committee Counsel Bill Summary

Section 3

Section 3 creates a new tax credit for construction of a facility in North Carolina for the manufacture of renewable energy property. The credit is equal to 25% of the installation and equipment costs of construction paid during the taxable year. The section becomes effective for taxable years beginning on or after January 1, 2011.

Renewable energy property includes all of the following:

- Biomass equipment that uses renewable biomass resources for biofuel production of ethanol, methanol, and biodiesel; anaerobic biogas production of methane utilizing agricultural and animal waste or garbage; or commercial thermal or electrical generation from renewable energy crops or wood waste materials.
- Hydroelectric generators.
- Solar energy equipment.
- Wind equipment.
- Geothermal heat pumps and equipment.

The credit may be taken against the franchise tax or the income tax. The entire credit must be taken in seven equal installments, beginning with the taxable year the facility is placed in service. If the facility is disposed of, or taken out of service, the taxpayer may not take any remaining installments. The credit is subject to the following limitations:

- The credit may not exceed 50% of the tax against which it is claimed for the taxable year. Any unused portion of the credit may be carried forward for the succeeding five years.
- Any unused portion of the credit may be carried forward for five years.
- A taxpayer that claims any other credit with respect to the construction of a facility to manufacture renewable energy property may not take this credit with respect to the same facility.

The credit would sunset for facilities placed in service on or after January 1, 2014.

Source**:** Committee Counsel Bill Summary

Section 4

Section 4 would decrease the number of retailers required to submit a pre-payment of 65% of the amount of sales tax revenue to be remitted for the following month by changing the threshold for this payment schedule from $10,000 to $15,000, effective October 1, 2010, and from $15,000 to $20,000, effective July 1, 2011. This change in the law does not change the amount of sales tax revenue submitted to the State, but it does change by one month the timing of the payment for the year of the transition to the lower threshold.

Retailers must remit sales tax payments to the State on one of three filing schedules:

- A retailer who is consistently liable for less than $100 a month in sales and use taxes must file a return and pay the taxes due on a quarterly basis.
- A retailer who is consistently liable for at least $100 but less than $10,000 a month must file a return and pay the taxes due on a monthly basis.
- A retailer who is consistently liable for at least $10,000 a month must make a monthly prepayment of the next month's tax liability. Prior to 2006, retailers in this category had to pay tax twice a month. At the request of several large retailers in the Streamlined Sales Tax Project, North Carolina adopted the once a month payment schedule.

The threshold limit of $10,000 was enacted in 2001 as a means to accelerate the payment of sales and use tax dollars into the General Fund for fiscal year 2001-02.[1] Prior to this change, the threshold amount for making bimonthly payments was $20,000. Since 2001, the State and local tax rate has increased from 6.5% to 7.75%.[2] The lowering of the threshold amount as well as the increase in the tax rate has subjected more retailers to the most extensive sales tax remittance requirements. Some of the small retailers in this category, especially those whose sales are not consistent from month to month, have expressed a cash flow hardship with the pre-payment requirement.

This provision would restore the sales tax filing thresholds to their pre-2001 level of $20,000 over a two-year period. By increasing the threshold from $10,000 to $15,000, the bill would relieve 2,133 retailers from the pre-payment requirement. These retailers would continue to file a monthly return and pay the sales tax due on a monthly basis. The increase of the threshold from $15,000 to $20,000 would relieve an additional 1,000 plus retailers from the pre-payment requirement.

Source: Committee Counsel Bill Summary

Section 5
Section 5 would stipulate that the first annual report of a LLC is due April 15 following its year of organization. The Revenue Laws Study Committee recommended this provision as part of its Revenue Laws Technical, Clarifying, and Administrative Changes proposal.

Section 6
Under G.S. 105-122, an annual franchise or privilege tax is imposed on foreign and domestic corporations doing business in North Carolina. Session Law 09-422 allowed companies that are required to use the percentage of completion method of accounting for construction contracts to treat billings in excess of costs as a definite and accrued liability that is deductible for franchise tax purposes. Section 6 would make this deduction retroactive to taxable years beginning on or after January 1, 2007.

Section 7
The proposal is a Revenue Laws recommendation and a recommendation of the Department of Revenue and was developed in collaboration with the Office of State Controller and the North Carolina Bankers Association. It would improve the Department's tax and debt collection process by:

- Expanding the use of the Setoff Debt Collection Act as follows: allow debts owed by a business to be set off against a tax refund due the business, allow a setoff against any type of tax refund, and allow a community college to submit for setoff debts owed the college.

- Authorizing the use of electronic process for sending notice of garnishment.

- Providing for a data match between the Department of Revenue and financial institutions holding accounts of delinquent taxpayers.

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[1] The acceleration of sales tax payments in 2001 created a nonrecurring revenue gain of more than $40 million in FY01-02.
[2] In some counties, the combined State and local sales tax rate is 8%.

- Expanding the Statewide Accounts Receivable Program to allow for collection of the following accounts receivable by setoff against payments the State owes to individuals and businesses: accounts receivable that are submitted to the Department of Revenue under the Setoff Debt Collection Act and overdue tax debts.

ASSUMPTIONS AND METHODOLOGY:

Section 1
The Mill Rehabilitation Tax Credit is scheduled to sunset under current law on January 1, 2011. Section 1 would extend the sunset to January 1, 2014. For a property to be eligible for the credit, the taxpayer must apply for eligibility certification prior to the sunset, but the property may be rehabilitated and the credit may be received in future years. The credit is not granted until the rehabilitation is completed and the property goes into service. The credit is 40% for rehabilitations in Tiers 1 and 2 counties and 30% in Tier 3 counties.

According to the State Historic Preservation Office, all of the projects that will be completed in the upcoming fiscal year have already been certified and thus would qualify for the credit under current law. Therefore, there is no fiscal impact in FY 2010-11. New projects that are currently not certified would potentially be completed in FY 2011-12 and subsequent fiscal years. Because several projects have been on hold during the Recession and a number of potential projects have recently applied for certification due to the impending sunset, it is anticipated that the fiscal impact will be less than normal, approximately $1.5 million in FY 2011-12 increasing to $5 million in FY 2014-15.

Since this bill will only affect properties that apply for eligibility certification after December 31, 2010, we have limited our analysis to those properties. With regard to these properties, we expect the following value of renovations to be completed:

Value of Completed Renovations for Properties that Apply for Certification After December 31, 2010 ($ millions)					
	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-2015
Tier 3	$0	$4.2	$9.3	$13.6	$18.2
Tiers 1 and 2	$0	$1.1	$2.3	$3.4	$4.6

Each property that receives the Mill Rehabilitation Tax Credit under Article 3H will have to forego the Historic Rehabilitation Tax Credit provided in Article 3D since a taxpayer is prohibited from receiving both credits. The credit provided by the Historic Rehabilitation Tax Credit is smaller and must be taken over four years. We expect the following fiscal impact related to the extension of the Mill Rehabilitation Tax Credit net of the reduction in the Historic Rehabilitations Tax Credit:

Fiscal Impact of Projects That Applied for Certification After December 31, 2010 ($ millions)					
	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14	FY 2014-2015
3H Tax Credit - Tier 3	$ -	$ 1.26	$ 2.79	$ 4.05	$ 5.47
less 3D Tax Credit	$ -	$ 0.17	$ 0.54	$ 1.08	$ 1.81
Fiscal Impact - Tier 3	$ -	$ 1.09	$ 2.25	$ 2.97	$ 3.66
3H Tax Credit - Tiers 1 and 2	$ -	$ 0.42	$ 0.93	$ 1.36	$ 1.82
less 3D Tax Credit	$ -	$ 0.04	$ 0.14	$ 0.27	$ 0.45
Fiscal Impact - Tiers 1 and 2	$ -	$ 0.38	$ 0.80	$ 1.08	$ 1.37
Total Fiscal Impact	**$ -**	**$ 1.47**	**$ 3.04**	**$ 4.04**	**$ 5.03**

Section 2

The change to the definition of cost will make the credit more generous for taxpayers that lease renewable energy property in the majority of cases, but it is estimated to have an insignificant fiscal impact because lessees of renewable energy property have already been following the federal rules under the Internal Revenue Code for determining the cost of leased property used to calculate the tax credit according to the NCSEA. This practice is consistent with the determination of cost as applied under the change made by House Bill 1829.

Adding a statutory definition of installation will not have an impact because House Bill 1829 codifies the definition as currently interpreted by the Department of Revenue in letter rulings.

The special allocation provision does not increase the amount of credits generated. It is intended to increase investment in renewable energy projects in North Carolina by allowing a pass-through entity to allocate the credit to investors that have sufficient tax liability to take advantage of the tax credits. Since the credit can only offset 50% of a taxpayer's tax liability per tax year, the tax credit might otherwise have to be carried forward and used in subsequent years or may not be fully utilized. According to the NCSEA, the special allocation provision has not been necessary previously for the tax credits to be fully utilized because taxpayers have been able to secure a single institutional investor like a bank or insurance company that could fully utilize the credits. Since the proposal is intended to enable the credits to continue to be fully utilized in spite of the current economic environment and does not increase the amount of tax credits generated, it is not estimated to have a significant fiscal impact.

Section 3

The bill creates a tax credit for the construction of a facility used to manufacture renewable energy property. Since there are no known projects that would qualify for the credit, there is no fiscal impact estimated.

Section 4

Section 4 reduces the number of retailers who must remit a prepayment of sales and use taxes to the Department of Revenue by changing the liability threshold from $10,000 to $20,000. Under

current law, a taxpayer who is consistently liable for at least $10,000 or more a month in State and local sales and use tax liability must file a monthly return and make a prepayment of a portion of the next month's tax liability. Under Section 4, retailers must be consistently liable for $20,000 or more monthly to meet the prepayment standards.

The threshold increase occurs in two stages. The first step increases the prepayment threshold requirement to $15,000 and becomes effective during FY 2010-11. This change results in a one-time reduction to General Fund availability of $7.0 million in FY 2010-11. The second step, increasing the threshold to $20,000, reduces General Fund availability by $12.0 million in 2011-12.

Section 5

The bill would require an annual report filing by April 15th for an LLC incorporating the previous year. As a result, any LLC incorporating in the first quarter of the calendar year would not file an annual report until April 15th of the following year. A revenue loss will result from those LLCs that organize in the first quarter and would have otherwise paid the $200 annual report filing fee on April 15th. Based on discussions with the Dept. of Secretary of State, the revenue loss is expected to be $400,000 annually.

Section 6

The bill applies the provision enacted last session that excludes from a corporation's franchise tax base all billings in excess of costs retroactively to taxable years beginning on or after January 1, 2007. The Department of Revenue completed a compliance project (Resolution Initiative) last year that was focused in part on collecting franchise taxes associated with billings in excess of costs for the 2007 through 2009 tax years. The bill allows taxpayers to file refund requests for amounts paid as a result of not getting the benefit of a franchise tax deduction for billings in excess of costs for these years. Consequently, the estimate starts with the Department of Revenue’s tax collections under last year’s Resolution Initiative associated with the billings in excess of costs issue. The estimate is then increased to recognize that some taxpayers complied with the Department’s interpretation of the law without regard to the Resolution Initiative.

Section 7

The proposal would enable the Department of Revenue to increase debt and tax collections by allowing for businesses debts to be setoff against tax refunds, and by allowing for debt setoffs against any type of tax refund. The proposal also creates a number of efficiencies to streamline the attachment and garnishment process, including identifying bank accounts of delinquent taxpayers through data matching between the Department and financial institutions. In addition, the proposal would allow for collection of delinquent taxes and debts by setoff against payments the State owes to these debtors.

The Department of Revenue anticipates that the proposal would result in additional collections of approximately $750,000 per quarter, or $3 million annually. Because of the January 1st effective date, the first year of collections would be half of the full-year amount, or $1.5 million.

SOURCES OF DATA:
Preservation NC, State Historic Preservation Society, North Carolina Department of Revenue, North Carolina Sustainable Energy Association, Department of Secretary of State

TECHNICAL CONSIDERATIONS: None

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