NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: House Bill 1559 (Senate Finance Committee Substitute)

SHORT TITLE: Conform with Federal Law

SPONSOR(S): Representative Luebke, et al.

FISCAL IMPACT

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

($ million)

	FY 2000-01	**FY 2001-02**	**FY 2002-03**	**FY 2003-04**	**FY 2004-05**
REVENUES					
General Fund					
Conform Tax Deadline			No fiscal impact		
Clarify Sales Factor			No fiscal impact		
IRC Update *	-2.03	-4.35	.65	.85	.60
Pension Tax Withholding			No estimate available (small gain possible)		
Treasury Offset Program			No estimate available (potential revenue gain)		

* Due to the timing of estimated payments of corporations and high-income individuals, the $1.37 million revenue gain anticipated in FY 1999-00 may carry forward to FY 2000-01.

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

EFFECTIVE DATE: Sections 2 and 3 (pension tax withholding) of the bill are effective January 1, 2001. The remainder of the act is effective when it becomes law.

BILL SUMMARY:
Section one of the bill updates the reference to the Internal Revenue Code used in state tax provisions from June 1, 1999, to January 1, 2000. Sections two and three conform state pension tax withholding provisions to federal law. Section four conforms state statutes with federal law regarding deadlines for payments of certain estimated income taxes. Section five clarifies in the corporate apportionment formula that receipts of a multistate corporation should only include the net gain realized from the sale or maturity of securities, not the rolled over capital or return of principal. Section 6 allows the Department of Revenue to collect delinquent tax debts with the assistance of the U.S. Department of the Treasury and allows the Department to charge a $15 collection assistance fee to the taxpayer owing the debt.

ASSUMPTIONS AND METHODOLOGY:

Pension Tax Withholding

The 1999 General Assembly approved HB 1466 (S.L. 1999-414) to provide that a pension payer required to withhold federal taxes on a pension payment to a North Carolina resident must withhold state taxes on a pension payment, annuity, or deferred compensation unless the recipient elects not to withhold. When analyzing HB 1466, the Fiscal Research Division of the General Assembly found that the Internal Revenue Service (IRS) did not track the number of taxpayers that had federal income tax withheld from their pension payment, annuity, or deferred compensation. When a company submits withheld income taxes, it does not separately account for current and former employees. Similarly, the North Carolina Department of Revenue has no data on the number of taxpayers that have chosen voluntary withholding of their pension payment, annuity, or deferred compensation.

While no data is available from the IRS or the Department of Revenue on withholding on eligible rollover distributions, the General Fund should not receive a windfall from this tax change in sections 2 and 3 of the bill. First, these IRA or 401(K) distributions normally occur when individuals change jobs. If the individuals roll their pension distributions into another IRA or 401(K) within 60 days, then their withholding is refunded. Second, those not intending to rollover the funds into a new IRA or 401(K) may have already included the tax into their quarterly estimated payments. <u>The state might gain a small amount of interest on funds that are withheld monthly instead of submitted quarterly in estimated payments. Unfortunately, the extent of this gain cannot be quantified.</u>

Conform Estimated Tax Deadline

There is no fiscal impact of section 4 because it codifies the administrative practice of the Department of Revenue. This section recognizes the federal forgiveness of penalties for late payment of estimated taxes by farmers and fishermen if the final return is filed, with taxes paid in full, by March 1 following the end of the taxable year. Even though the state law has been out of conformity with the federal law since 1985, state administrators and tax preparers have been following the federal law.

Clarify Sales Factor

There is no fiscal impact of section 5 because it codifies the administrative practice of the Department of Revenue. The Department believes that "gross receipts for the purpose of computing the sales factor should only include net gain, and not the rolled over capital or return of principal, realized from the sale or maturity of securities." A New York securities firm has filed a protest of this departmental interpretation. The North Carolina Attorney General ruled in favor of the Department on a similar issue in 1983, but has not issued an official opinion on this exact topic. While passage of this section has no fiscal impact, failure to approve this measure and clarify the sales factor in the statute, puts the state at risk of losing a minimum of $3 million a year. This estimate is based on a limited review of audit cases and protests by the Department of Revenue's Corporate, Excise and Insurance Tax Division.

Treasury Offset Program

Section six of the bill establishes a $15 collection assistance fee in the Department of Revenue for participation in the U.S. Treasury Offset Program. The IRS Restructuring and Reform Act of 1998 authorized the offsetting of federal tax refunds to collect past due legally enforceable state income tax obligations beginning January 1, 2000. The state debt must be for individual income accounts of North Carolina residents, must be less than 10 years delinquent , and is at least $25. The Department requested the collection fee because of the cost of participating in the federal program. The Department is required to send the taxpayer a certified letter 60 days before it submits the debt to the

U.S. Treasury. The current cost of a certified letter is $3.01. The Department must also pay the federal government a processing fee for each offset claim it submits. The current federal fee is $9.65 per claim. This total for the certified letter and the processing fee is $12.66. The balance of the $15 fee is for administrative cost of the program (preparing the letters, submitting claims, keeping a database, etc.) and for a dedicated phone line to electronically submit claims to the federal government (estimated to cost $1,000 a month).

The revenue received from the fee and from the offset of federal tax refunds depends on the number of claims submitted. The Department has received information from Delaware, Illinois, Iowa, Kentucky, Maryland, Missouri, and New Jersey for the period January 1 through May 3, 2000. Those seven states submitted 260,703 claims for refund offsets equaling $343.7 million. Thus far, these states have received approximately $14 million from 29,338 taxpayers. Statistically, 11.3% of the claims filed yielded an average return of $475. Based on the early experience of these states, for every 1,000 claims filed by the North Carolina Department of Revenue, there will be 113 federal tax refunds offset to pay state debt. At $475 per claim for 113 debt offsets, the state will earn $53,675 for every 1000 claims filed. The state will also earn $1,695 from the collection assistance fee paid by 113 taxpayers. The state will pay approximately $15,000 to file the 1,000 claims. The net revenue for 1,000 files claimed is $40,370.

The problem with this program in the short run is that the Department of Revenue does not have an appropriation to pay for program expenses and to get the program underway. Unless the Office of State Budget and Management (OSBM) authorizes the transfer of lapsed salaries or other funds for this effort in FY 2000-01, no claims will be filed next fiscal year. The other problem is that this provision does not authorize the Department to retain the $15 collection assistance fee to offset program expenses. The fee will go to the General Fund with the collected debt. It is uncertain when the program will begin and the number of claims that will be pursued.

IRC Update

Since North Carolina individual and corporate income tax tracks the federal income tax law, it is necessary each year to update state statutory references to the Internal Revenue Code (I.R.C.). President Clinton signed the Tax Relief Extension Act of 1999 into law on December 17, 1999. Department of Revenue officials and legislative staff have determined that some of the provisions in this act have an impact on the state's tax laws. The attached chart shows the fiscal impact of the bill based on estimates by the Congressional Joint Committee on Taxation. The North Carolina percentage of the national estimate is based on actual tax collections. The national estimates are further adjusted for the state fiscal year. Section 7 clarifies that any changes that increase North Carolina taxable income for 1999 taxable year become effective for taxable years beginning on or after January 1, 2000.

Tax Relief Extension Act of 1999- Impact on General Fund

Fiscal Year ($ Millions)							
	Effective Date	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Individual Income Tax							
Extend exclusion for employer-provided education assistance through 12/31/01	05/31/2000		-1.15	-2.30	-0.95		
Deny charitable contribution deduction for transfers associated with split-dollar insurance arrangements	02/08/1999	Negligible Revenue Effect					
Individual and Corporate Income Tax							
Extend the work opportunity and the welfare to work tax credits through 12/31/01	06/30/1999	-0.30	-0.43	-0.40	-0.21	-0.08	-0.03
Extend expensing of environmental remediation expenditures through 12/31/01	12/17/1999		-0.23	-0.32	-0.11	-0.01	-0.01
Provide that Federal Farm Production Payments are taxable in the year of receipt	12/17/1999	Negligible Revenue Effect					
Prohibit the use of the installment method by accrual method taxpayers	iso/a 12/17/1999	2.59	3.67	2.20	1.39	0.39	0.04
Clarify the tax treatment of income and losses on derivatives	12/17/1999	0.00	0.01	0.01	0.01	0.01	0.01
Limit conversion of character of income from constructive ownership transactions	teio/a 7/12/1999	0.08	0.24	0.25	0.27	0.28	0.29
Allow employers to transfer excess pension assets used for retiree health benefits through 12/31/05	tmi tyba 12/31/2000		0.10	0.21	0.21	0.22	0.23
Corporate Income Tax							
Reduce basis in assets for distributions by a partnership to a corporate partner of stock in another corporation	07/14/1999	0.01	0.02	0.04	0.05	0.05	0.05
Extend exceptions under subpart F for active financing income through 12/31/01	tyba 12/31/1999	-1.01	-4.26	-4.03			
Total General Fund Impact		1.37	-2.03	-4.35	0.65	0.85	0.60

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%)

iso/a = installment sales on or after

teio/a = transactions entered into on or after

tmi = transfers made in

tyba = taxable year beginning in

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