

NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: House Bill 1744 (First Edition)

SHORT TITLE: Exempt Unemployment Benefits.

SPONSOR(S): Representatives Adams and Wainwright

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$ Million)				
	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>
REVENUES					
General Fund	(50.1)	(36.4)	(31.2)		
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue; Employment Security Commission					
EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2004 and repealed effective for taxable years beginning on or after January 1, 2007.					

BILL SUMMARY:

The act exempts unemployment payments from the individual income tax.

ASSUMPTIONS AND METHODOLOGY:

To determine the General Fund revenue loss resulting from this act, the Employment Security Commission (ESC) was requested to project the unemployment benefits it would pay from 2004 to 2009. ESC estimates the insured unemployment rate will fall from 2.19% to 1.49% a year. The insured unemployment rate is typically 40% of the actual unemployment rate. This unemployment projection is consistent with estimates made by Economy.com. ESC factored in increases in average weekly benefit amounts and changes in the percentage of workers covered by unemployment insurance.

Projected UI Benefit Payments 2004-2009

Assumptions used in forecast

	Annual Benefits	Average annual insured unemployment rate	Percentage change in UI Benefits from previous year	Percentage change in Average Weekly Benefit Amount	Percentage Change in Covered Employment
2004	\$903,000,000	2.19%			
2005	\$711,000,000	1.63%	-21.30%	5%	3%
2006	\$673,000,000	1.51%	-5.30%	5%	3%
2007	\$704,000,000	1.49%	4.60%	4%	2%
2008	\$740,000,000	1.49%	5.10%	3%	2%
2009	\$777,000,000	1.49%	5.00%	3%	2%

These assumptions are consistent with Bureau of Economic Analysis (BEA) projections for total wage growth and total unemployment rates through 2010.

The Insured Unemployment Rates are consistent with a soft recovery during this period. The Insured Unemployment Rates are slightly higher than the average experienced in the late 1990s.

Based on the projected unemployment benefits shown above, what is the revenue loss from exempting these payments?

- **Taxable Income.** First, not all unemployment compensation is taxable. Internal Revenue Service (IRS) and ESC data indicate that unemployment compensation reported on NC resident returns is equal to approximately 83% of the compensation paid out by ESC. In the table below, the Projected Unemployment Compensation in the second column is multiplied by .83 to produce Taxable Unemployment Compensation in the third column.
- **Tax Rate.** In 2001, the average individual income tax rate for all taxpayers was 6.8%. Analysts with the Department of Revenue and the General Assembly believe this rate to be too high given the maximum weekly unemployment benefit is \$416 and the most that can be earned in the maximum 26 weeks of payments is \$10,816. The Department of Revenue’s Tax Research Division suggests a 6.2% average tax rate.
- **Tax Loss.** The 6.2% tax rate multiplied by the taxable compensation equals the tax year revenue loss in the fourth column. Since this tax exemption sunsets on January 1, 2007, this calculation is made only for tax years 2004, 2005, and 2006. This tax year loss must be converted into a fiscal year estimate. Because the average unemployment benefit is well below a worker’s normal wages, it is assumed that only 10% of unemployment payments

are voluntarily withheld for income tax. In the last column below, the FY 2004-05 revenue loss is equal to all income that would have been paid on unemployment payments reported on tax returns for the 2004 tax year and the loss of 10% withholding payments for the 2005 tax year. The FY 2005-06 revenue loss is equal to the remaining 90% of the 2005 tax year plus 10% withholding of the 2006 tax year. The FY 2006-07 revenue loss is the remaining 90% of the 2006 tax loss.

	<u>Projected Unemployment Compensation</u>	<u>Taxable Unemployment Compensation</u>	<u>Tax At 6.2%</u>		<u>General Fund Loss</u>
2004	\$903,000,000	\$749,490,000	\$46,468,380	04-05	\$50,127,186
2005	\$711,000,000	\$590,130,000	\$36,588,060	05-06	\$36,392,512
2006	\$673,000,000	\$558,590,000	\$34,632,580	06-07	\$31,169,322

SOURCES OF DATA: Employment Security Commission; Tax Research Division – Department of Revenue

TECHNICAL CONSIDERATIONS: None

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