

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 236 (Third Edition)

SHORT TITLE: Revenue Administrative Changes

SPONSOR(S): Senators Kerr, Clodfelter, Dalton, Hartsell, and Hoyle

FISCAL IMPACT

	Yes (X)	No ()	No Estimate Available ()		
	(\$million)				
	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>

REVENUES

General Fund

Parts 1,5 & 8

No Estimate Available

Parts 2 & 3

See Assumption & Methodology

Parts 4, 6, 7, 9, & 11

No Fiscal Impact

Local Governments

Sales Tax Distribution

No Estimate Available

Highway Fund

Temporary Permits

No Estimate Available

Leaking Petroleum

Underground Storage Tank

Cleanup Funds

- Dyed Diesel Fuel

1.2

1.2

1.2

1.2

1.2

- Aviation Fuel

.34

.34

.34

.34

.34

EXPENDITURES

General Fund

Dept. of Revenue - Sales Tax Distribution

No Fiscal Impact

PRINCIPAL DEPARTMENT(S) &

PROGRAM(S) AFFECTED: Department of Revenue; Department of Transportation – Division of Motor Vehicles; Department of Crime Control and Public Safety – Division of the State Highway Patrol; Department of Commerce; Department of Administration – Division of Surplus Property

EFFECTIVE DATE: Parts 1 (dividend deduction) and 8 (R&D credit) are effective for taxable years beginning on or after January 1, 2003. Part 5 (sales tax distribution) becomes effective July 1, 2003. Part 9 (consolidated returns) of this act is effective for taxable years beginning on or after January 1, 2003, and shall expire for taxable years beginning on or after January 1, 2005. Part 10 (motor fuel tax changes) becomes effective January 1, 2004. The remainder of this act is effective when it becomes law.

BILL SUMMARY: The bill makes the following administrative changes to the Revenue Laws:

- Modifies the dividend received deduction for regulated investment companies (RIC) and real estate investment trusts (REIT) to ensure that all dividends are treated uniformly.
- Amends the reporting requirements regarding sales of seized property by the Secretary of Revenue to avoid duplicate report filings.
- Extends until October 1, 2005, the Department of Revenue’s authority to use outside collection agencies for in-state tax debts.
- Revises the secrecy provision regarding the disclosure of tax information to reflect the transfer of the Division of Motor Vehicles to the State Highway Patrol.
- Ensures that the monthly distribution of local sales and use tax proceeds is based on taxpayer data from filed returns.
- Requires the Department of Revenue to make the projection of estimated tax proceeds for the local hold harmless distribution.
- Clarifies that the filing fee for an annual report is nonrefundable.
- Clarifies the eligibility rules for taxpayers taking the research and development tax credit.
- Requires corporate taxpayers filing a consolidated tax return for federal tax purposes to provide on the state return certain financial information from the federal return as well as identifying information about affiliated companies
- Makes various changes to the motor fuel tax laws.
- Codifies municipal practice for bad debt charge off.

ASSUMPTIONS AND METHODOLOGY:

Part 1: Modify dividend received deduction for RICS and REITS

These sections are a continuation of the state effort to tax all dividends uniformly. The Department of Revenue considers the change with respect to regulated investment companies (RICs) a technical change. RIC dividends are deducted under federal law, so, therefore, there is no adjustment needed under state law. On the other hand, real estate investment trusts (REITs) do not qualify for the federal dividend received deduction. Responding to a staff query, the National Association of REITs reported “that most REIT investors are individuals or mutual funds ultimately owned by individuals”. This would imply that this statutory change would have no fiscal impact on corporations. The Department of Revenue has no information on corporate investment in REITs that can be used to confirm this assumption of no fiscal impact.

Part 2: Avoid duplicative reporting requirements on seized property

The Department of Revenue may sell real or personal property of a taxpayer to collect a delinquent tax debt. The Department often uses the seizure of property for the payment of unauthorized substance taxes. The sale of the seized property is handled by the Department of Administration’s Division of Surplus Property. The Department of Administration files public

notices both online and in written format on all bids and sales of property. The Department of Revenue's filing of seized property sales with the superior court is considered redundant.

Due to a backlog of seized property, an auction of property was held weekly in 2002. The Department of Revenue expects 2003 to be a more normal year with only 20 to 24 auctions. Up until December 2002, the Division of Surplus Property filed an auction sales report with the clerk of Superior Court in Wake County on behalf of the Department of Revenue. Neither State Surplus Property (SSP) nor the Department of Revenue paid any filing fees for reporting auction sales prior to December 2002. When the Department of Revenue starting filing the reports with the court in December 2002, they were asked to pay a filing fee and to pay \$5,612 for previously filed reports between May and November 2002. Instead of paying the court fee for past reports, the Department retrieved the reports from the clerk's office and sent a one-page letter to the clerk explaining that details of all sales for the period November 7, 2000, through November 21, 2002, were available for inspection at the Division of Surplus Property Warehouse during normal business hours.

If approved, this change will have no fiscal impact because it conforms the statutes to the current practice of the Department. If not approved, the Department of Revenue could be forced to begin paying court filing fees.

Part 3: Continue using collection agencies for in-state debt

As part of its Project Collect Tax, the Department of Revenue has been using in-state and out-of-state collection agencies to reduce its backlog of delinquent debt. The Department's experience to date with collection agencies is shown below.

	Collection Agency Total Collections*	
<u>Year</u>	<u>In-State</u>	<u>Out-Of-State</u>
2001	\$ 446,388	\$ 706,411
2002	\$4,370,797	\$4,526,101
2003	\$ 415,878	\$ 227,764

* Includes 20% Collection Assistance Fee Collections.

While the Department is now dependent on collection agencies to help with debt collection, it is developing a collection call center to bring the collection effort back in house. By utilizing private collection agencies or the new call center, the Department projects it will collect \$4.3 million in in-state delinquent debt in each of the next two years. Prematurely ending the collection agency contracts before the collection call center is up and running, could hamper the in-state collection effort. Thus, failure to extend the authority to use in-state collection agents could result in a General Fund loss of up to \$3.2 million in FY 03-04 (9 months revenue since authority ends Oct 2003).

Part 4: Revise secrecy provision to reflect transfer of DMV Enforcement

This section has no fiscal impact. It changes the statutory reference for the Division of Motor Vehicles (DMV) Enforcement Section from the Department of Transportation to the Division of the State Highway Patrol of the Department of Crime Control and Public Safety to reflect a transfer of personnel and duties. Part 4 gives the same information and authority to the State Highway Patrol as was received by DMV.

Part 5: Base local sales tax distributions on taxpayer data

Under current law, retailers submit their sales tax returns and payments on a quarterly, monthly, or semi-monthly basis. In order to minimize the paperwork burden on taxpayers while maximizing funds available to the state, semi-monthly payment retailers – mostly very large retailers – are required to submit electronic payments twice a month, but only submit one refund form for the entire month. The law requires that payments to local governments be based on the “tax collected”. Therefore, the Department of Revenue has to make a series of assumptions about the distribution of the tax collected, distribute funds to local units on those assumptions, and then adjust the next local payment to reflect the appropriate distribution once the return is received from the taxpayer. With state sales tax payments to local units shifting from quarterly to monthly, effective July 1, 2003, even more estimating and reconciliation is required. The legislation allows the Department of Revenue to hold funds until the refund documentation is received.

The only potential fiscal impact of this change is related to the “float”. Conceivably the local units would experience a small loss of float (interest) because the state would be holding some of the funds up to two weeks longer, and thus gaining the interest. However, the amount of float shift would be extremely small since the new monthly payment schedule would significantly limit the amount of time between receipt of a taxpayer payment and a return of a portion of those funds to the appropriate local units. The change would also reduce the estimating workload of the Department, although this is not expected to translate into position reductions.

Part 6: Simplify the procedure for hold harmless calculation

Under current law, local governments are to receive a “hold harmless” payment from the state if their projected revenue from the new local half-cent sales tax does not exceed the reimbursement they would have received as payment for previous tax law changes (eliminating the intangibles tax, homestead exemption, food stamp sales tax exemption, eliminating the tax on inventories). Currently, the Office of State Budget and Management (OSBM) and the General Assembly’s Fiscal Research Division are both required to provide estimates of local sales tax and reimbursement revenues to the Department of Revenue. The Secretary of Revenue is then directed to calculate “hold harmless” distribution amounts, distribute the funds, and offer an explanation to the Joint Legislative Commission on Governmental Operations if the payments do not reflect the lowest estimates offered by OSBM and Fiscal Research.

The legislation shifts OSBM’s estimating responsibility to the Department of Revenue. While the hold harmless legislation was under consideration in the 2001 Session, all hold harmless estimates were developed jointly by the Department of Revenue’s Tax Research Division and the Fiscal Research Division. As a practical matter, the data needed to make projections is housed in Revenue’s Tax Research Division.

Part 7: Clarify annual report filing fee is nonrefundable

This section has no fiscal impact, because the Department of Revenue has never refunded an annual report fee. The section converts the departmental practice into statutory language.

Part 8: Clarify eligibility for Research and Development credit

The Bill Lee Act contains a tax credit for qualified research and development expenditures that applies to manufacturers and other specifically named industries. During the last few months, the Department of Revenue has been fine-tuning its interpretation of the Bill Lee Act eligibility.

One of the new rulings is that the qualifying expenditures for the research and development (R & D) credit must take place on the physical premises of the qualifying industry. For example, R & D spending at a manufacturing plant would be eligible because manufacturing is an eligible industrial classification for Bill Lee Act purposes. However, if these expenditures took place at a separate research facility, the costs would not be eligible.

Discussions with the Department of Revenue and Department of Commerce indicate that in the past, eligible taxpayers have been taking the credit based on qualified R & D spending at all facilities, regardless of whether the facility at which an activity took place fits within the listing of eligible industrial classifications. As a result of the new interpretations, the Department of Revenue has begun to audit companies claiming the R & D credit to determine eligibility. At this time, the Department is holding off on assessments, pending legislative activity on this issue.

The original fiscal note and subsequent updates have been based on the actual practice under the broad interpretation of legislative intent. Thus, these costs have been built into the official General Fund revenue estimate used for the purpose of preparing a state budget. If the language in the bill is not adopted, there may be cases in which additional General Fund revenue, relative to the currently budgeted estimates, is generated under the new administrative interpretation of the Department of Revenue.

Part 9: Require additional data from affiliated corporations

Part 9 is a means for the Department of Revenue to collect data that its Tax Research Division can use to estimate the impact of adopting a consolidated return for corporate income tax in North Carolina. This part of the bill will sunset in two years.

Part 10: Change motor fuel tax laws

Many sections of Part 10 have no fiscal impact. Sections 10.2 and 10.8 are technical changes. Sections 10.4 and 10.5 change reporting requirements. Section 10.6 changes departmental bonding requirements. Section 10.7 provides additional reasons why the Secretary of Revenue can deny an application for a motor fuel license. Section 10.9 removes the requirement that shipping documents issued by a terminal operator must be machine printed. Section 10.10 conforms language to changes made in the 2001-2002 session.

Section 10.1 reduces the number of days for a temporary permit for motor carriers from 20 to 3. This could increase Highway Fund revenues by increasing the number of permits issued or the number of permanent licenses issued. No estimate is available for the permit volume.

Sections 10.14 and 10.16 require kerosene terminal operators to be licensed and to file reports. Currently jet fuel and kerosene are delivered from the pipeline directly to the state's three major airports. Since this delivery method bypasses the motor fuel terminals, it also bypasses the Department of Revenue's reporting and accountability mechanism. From January 1, 1999, to December 31, 2001, the Department of Revenue found 407 million gallons of jet fuel delivered but not reported to the agency. Over this three-year period, the state lost approximately \$1 million in inspection tax revenue. Passage of these sections should help the state claim the ¼ cent inspection tax on all jet fuel sales in the future and gain roughly \$340,000 a year for the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund and the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund.

Section 10.15 imposes the ¼ cent inspection tax on dyed diesel fuel. This tax is collected at the terminal rack and the Department of Revenue estimates it will yield approximately \$1.2 million a year. The net proceeds, after deducting administrative costs, are deposited into the Commercial Leaking Petroleum Underground Storage Tank Cleanup Fund and the Noncommercial Leaking Petroleum Underground Storage Tank Cleanup Fund.

Part 11: Codify municipal bad debt charge off

There is no fiscal impact from this part of the bill because it only codifies an exemption for bad debt that the Department of Revenue has given municipalities in regards to the sales tax on electricity.

SOURCES OF DATA: National Association of REITs; Department of Revenue

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