NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 2 (First Edition)

SHORT TITLE: Computer Manufacturing Tax Incentives.

SPONSOR(S): Senator Hoyle

FISCAL IMPACT ($Mil.)

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

	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10
REVENUES					
Computer Man. Credit (1)	**(10.0)**	**(10.0)**	**(20.0)**	**(20.0)**	**(20.0)**
Bill Lee Act Changes					
Jobs Credit (2)				**(.6)**	**(1.0)**
Mach./equip. Credit (2)			**(.3)**	**(.5)**	**(.9)**
Worker train. Credit (2)			**(.5)**	**(.4)**	**(.6)**
Real property Credit (2)		**(1.3)**	**(1.3)**	**(2.6)**	**(2.6)**
Bill Lee Act Subtotal		**(1.3)**	**(2.1)**	**(4.1)**	**(5.1)**
Sales Tax	*** See Assumptions and Methodology ***				
Grand Total		**(11.3)**	**(22.1)**	**(24.1)**	**(25.1)**

(1) The amount of the credit expected to be taken between 2005 and 2020 is $450 million.
(2) The amount of the Bill Lee Act credits expected to be taken between 2005 and 2020 is $42.8 million.

PRINCIPAL DEPARTMENTS AFFECTED: Department of Revenue and Department of Commerce. The enactment of the bill should not affect the budget requirements of either agency.

EFFECTIVE DATE: Sales tax provisions become effective January 1, 2005 and apply to sales made on or after that date. The remainder of the act is effective for business activities occurring on or after November 1, 2004 and for taxable years beginning on or after January 1, 2005.

BILL SUMMARY: The legislation makes several changes to the corporate, franchise, and sales taxes, particularly as they relate to computer manufacturing.

Large Computer Manufacturer Credit

The bill creates a new credit for large computer manufacturers that can be taken against the corporate income or franchise tax. In order to be eligible for this credit, the Secretary of Commerce must determine that the taxpayer will increase its employment level by at least 1,200 new, full-time jobs within five years of when the property is first used as a computer manufacturing and distribution facility. The Secretary must also determine that the taxpayer, directly or indirectly through "strategic partners" and related entities, has or will invest at least $100 million in private funds to construct a computer manufacturing and distribution facility in North Carolina over a five year period. In order to qualify for the credit, the taxpayer, as well as its strategic partners and related entities, must pay at least 50% of the health insurance premiums for its full-time employees, must have no outstanding OSHA citations at the new facility, and must have no overdue tax debts.

Having met these eligibility standards and those additional standards listed below for particular tax years, the taxpayer will qualify for the following maximum amount of tax credit:

Tax Year	Maximum Credit Per Year
2005-2009	$10,000,000
2010-2014	$15,000,000
2015-2019	$20,000,000

The legislation includes some additional requirements linked to particular tax years. In 2005, the taxpayer must invest at least $25 million in constructing the new facility by the end of the taxable year to claim the credit. This investment can be through the primary company, or its related entities and strategic partners as defined in the bill. In taxable years 2006-2010, the actual amount of the credit is determined by the increased employment level of the taxpayer and the number of consumer-ready computers and peripherals produced by the facility. (Note: The amount each computer and peripheral contributes toward the allowed credit amount is higher in 2006 than the remaining years). The credit calculation in 2010-2014 is similar to that used in 2006-2010 with two exceptions. If the taxpayer has ever attained an employment level of at least 1,500 at the facility for which the credit is claimed, the credit can be determined exclusively by output (assuming the employment level has not been reduced by more than 40% over the previous year), thus potentially reducing the employment requirement to claim the maximum credit. If the employer has never reached employment of 1,500, the maximum credit amount is reduced by $5 million (to $10 million).

For taxable years 2015-2019, the calculation becomes more complicated. During these years, the company may draw the maximum credit amount ($20,000,000) if the taxpayer has in any year attained an employment level of 2,500 at the facility for which the credit is claimed. The credit amount continues to vary depending upon the employment level ever attained and the current employment level. Additionally, if the taxpayer has ever attained an employment level of 2,500 and the taxpayer's employment level for the current year is at least 1,500, then the credit amount is determined by production output or is $20,000,000, whichever is less. However, if the taxpayer has ever attained an employment level of 2,500 **BUT** the taxpayer's employment level for the current year is less than 1,500, then the credit amount is the unit output of the facility multiplied by $6.25 or $15,000,000, whichever is less. The credit amount would be reduced if the taxpayer's employment level decreased by more than 40% from that of the previous year **AND** the employment level of the previous year was 1,500 or less, or the employment level for the current year is 900 or less. Moreover, if the taxpayer has ever attained an employment level of 1,500, then the credit amount is the unit output of the facility multiplied by $6.25 or $15,000,000, whichever is less. The credit amount would be reduced if the taxpayer's employment level decreased by more than 40% from that of the previous year and the employment level of the previous year was 1,500 or less, or the employment level for the current year is 900 or less. Finally, if the taxpayer has never attained an employment level of at least 1,500, then the maximum credit amount remains at $10,000,000 and the amount of the credit is reduced for any year the taxpayer does not reach an employment level of 1,500.

It should be noted that amounts listed above are the maximum credit amounts, creating a total maximum credit amount per eligible company of $225 million. Because there are specific employment and output level requirements, the computed tax credit may be lower. All tax credits can be carried forward for 25 years. If the company fails to create at least 1,200 new, permanent, full-time jobs through itself and its strategic partners and related entities, within five years of the beginning of construction, no further credits may be taken. However, failure to create the required jobs by the end of the five years does not result in the forfeiture of previously taken credits. There is no wage standard associated with the job creation targets. However, the employer must pay at least 50% of the employees' health insurance premium costs for all full-time employees.

<u>Bill Lee Act Changes</u>

The Bill Lee Act is the package of state tax incentives that was first adopted in 1996 and has been modified on numerous occasions. The incentives are primarily in the form of tax credits for investment in machinery and equipment, job creation, worker training, and research/development. The credits apply to activities undertaken by specifically named industrial classifications. For many of the credits, the counties of the State are divided into five economic distress tiers based on the unemployment rate, population growth, and per capita income. The lower the tier of a county, the more favorable the incentive.

The bill determines a taxpayer otherwise eligible for Bill Lee Act credits and who is eligible for the Large Computer Manufacturer Credit may take advantage of the following Bill Lee Act enhancements, regardless of the taxpayer’s location:

- No wage standard.
- Jobs credit is increased by $4,000 per eligible job.
- Investment threshold for the machinery and equipment credit of zero in lieu of $2 million for the highest tier.
- Maximum worker training credit of $1,000 maximum per worker instead of $500 in most counties.
- Real property investment tax credit (30%) versus no credit for many higher tier counties.

Sales Tax Refund Changes

The legislation also modifies the existing sales tax refund provision. During the 2003 Special Session (HB 2), the General Assembly authorized refunds of sales taxes paid by owners of a new, major industrial facility in relation to the construction of the facility. At that time, the refund was open only to bioprocessing and pharmaceutical/medicine manufacturers. In 2004, the refund provision was opened to several new classes of manufacturers, including computer manufacturers. This legislation alters the definition of computer manufacturer for purposes of a sales tax refund on construction to include such a company's related entities and strategic partners. It also adds printers to the items that can be manufactured at a facility to qualify as a computer manufacturer and be eligible for the refund.

ASSUMPTIONS AND METHODOLOGY:

Large Computer Manufacturer Credit

As noted above, the credit is capped in each year it is available, with a 25-year carry forward. The fiscal note assumes the maximum amount will be taken by two companies, one beginning in 2005 and a second one in 2007. The cap is assumed for the following reasons: 1) cap maximization has been assumed in prior fiscal notes when quantifying the cost of targeted incentive packages; 2) it is a cautious approach in a situation of uncertain impacts; 3) what is known about the company most likely to take advantage of the credit suggests it will take the maximum credit; and 4) the ability under the legislation to accumulate excess output for purposes of the credit and to carry the output forward to apply to years in which production does not justify the a maximum payout, makes it more likely the cap will be reached each year. Therefore, the **maximum assumed cost to the State of this portion of the bill is $450 million**. Because of the length of the credit, the loss would occur between 2005 and 2020, with potential carry forwards into 2044. Anticipated losses as a result of this credit for the first five years are included in the fiscal impact box.

Bill Lee Act

The legislation allows an eligible computer manufacturer to benefit from five of the Bill Lee benefit enhancements previously available only in Tier 1 counties or development zones. Based on materials furnished by the Department of Commerce, the analysis begins with the assumption of the location of a major computer manufacturer in a Tier 5 county in the Triad region. In addition, the discussions produced the following activity data that is relevant to the Bill Lee Act credits:

	2004	2005	2006	2007	2008	2009	2010
Jobs Created	0	0	500	400	100	300	0
M & E Investment ($Mil.)	$0	$30.0	$15.0	$10.0	$10.0	$5.0	$5.0
Workers Trained	0	0	500	400	100	300	0
Real Property Investment ($Mil.)	$0	$30.0	$0	$0	$0	$0	$0

Another key piece of data is that the expected average salary for the manufacturer is $27,000-$28,000. This is important to the credit impact calculation because the wage standard for the county in which the company is expected to locate is higher than this projected wage level. This means that the taxpayer would not have met the wage test under current law and thus would not be eligible for Bill Lee Act credits. This means that of the legislation, the impact is equal to the full amount of the potential Bill Lee Act credits, not just the incremental changes in this bill.

The jobs credit would be equal to $4,500 per job taken over four years. The credit for the investment in machinery and equipment is 7% of eligible expenditures, taken in equal installments over seven years. The worker training tax credit is equal to $1,000 per worker trained. The real property tax credit is 30% of the investment and is taken over seven years.

All of the credits affected by these changes, except for the worker training credit, are first taken in the year after the activity takes place. The worker training credit may be taken in the year in which the expenditure is incurred.

For the purpose of this analysis, it is assumed that the full amount of the credit for a tax year is taken during the fiscal year in which the tax year ends. Thus, the 2007 credit would be taken during the 2007-2008 fiscal year.

As in the analysis of the Large Computer Manufacturer Credit, it is assumed that another project that would be eligible for the Bill Lee Act changes would begin two years after the original location decision.

Finally, this analysis uses the assumption contained in the Department of Commerce spreadsheet that the taxpayer will be able to use all of the tax credit for the year in which the credit applies.

<u>Sales Tax Refund</u>

During the 2004 session, the total cost of expanding the group of manufacturers eligible for the refund, including computer manufacturing, was estimated at $2.4 million in FY 2004-2005 and $4.6 million in FY 2005-2006. As such, this cost has already been taken into account in our budgeting process. It is not anticipated that the inclusion of related entities in the definition will expand the scope of the refund provision. Therefore, no additional cost to the State is expected as a result of this provision. The inclusion of the term “printer” in the items considered computers for purposes of the refund could potentially expand the refund if a printer manufacturer develops a new major facility. However, given the nature of the industry, it is unlikely a $100 million or more investment is forthcoming in this area. Therefore, no fiscal impact is expected as a result of this change.

NOTE: For all calculations in the fiscal analysis, we have assumed two (2) such locations will occur in the five years covered by the memo. This assumption is based a consideration of the following information: 1) historical treatment of incentive package calculations by both Fiscal Research and the NC Department of Commerce; 2) the expected growth in the printer and server markets, the later driven a great deal by anticipated use of voice over Internet protocol (which utilizes servers) for communication; 3) the expected growth of the personal computer market as outlined by industry analysts and the SEC filings of major computer manufacturers; and 4) the continuing trend toward overseas production as a result of global financial and employment conditions. This is to be considered a simulation. Moreover, additional activity is possible, particularly in the out years is possible, but the likelihood is unknown.

SOURCES OF DATA: NC Department of Commerce

FISCAL RESEARCH DIVISION: (919) 733-4910
PREPARED BY: David Crotts; Linda Millsaps

APPROVED BY: James D. Johnson, Director
Fiscal Research Division

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