NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: SB 316 HCS (HOUSE COMMITTEE FINANCE SUBSTITUTE)
SHORT TITLE: AMEND BILL LEE ACT/AB
SPONSOR(S): **House Committee Substitute for SB 316**

FISCAL IMPACT

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

	FY 1997-98	**FY 1998-99**	**FY 1999-00**	**FY 2000-01**	**FY 2001-02**
REVENUES ($Mill.)					
State General Fund:					
Leasing Changes*	-.2 to -.5	-.8 to -1.6	-1.5 to -3.0	-2.4 to -4.8	-3.3 to -6.6
Other Provisions		**	-.2	-.4	-.7
Central Admin. Offices			-1.0	-1.8	-4.5
"Planned Expansion" Provisions			-.7	-2.2	-4.3
Enterprise Zone Provisions			-1.8	-4.9	-9.7
Total Cost	-.2 to -.5	-.8 to -1.6	-5.2 to -6.7	-11.7 to -14.1	-22.5 to -25.8

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

EFFECTIVE DATE: See "Bill Summary".

*See "Technical Considerations"
**Less than $100,000

BILL SUMMARY: Amends business tax incentives package adopted by the 1996 General Assembly as follows:

(1) Modifies the wage test that applies to taxpayers seeking to use the various tax credits. The 1996 bill required such taxpayers to pay at least 110% of the average weekly wage in the county in which the jobs or investment will be located; and, it **provided** that positions **paying** $100,000 or more, **annually,** be excluded from the calculation. SB 316 requires the 110% test to apply to the lesser of average county private insured wages, average state private insured wages, or the average county private insured wages multiplied by the "county income/wage adjustment" factor.

The "county income/wage adjustment" determines a single county's ratio per capita income, to its annualized private sector wages , **and compares this ratio** *to the same measure* for the state as a whole.

In addition, jobs paying $100,000 or more **(excluded** from calculation **in the 1996 bill)** would be included. This would become effective for tax years beginning on or after January 1, 1997)

(2) Extends the investment tax credit to leased machinery and equipment that is depreciated for federal tax purposes (effective for tax years beginning on or after January 1, 1997).

(3) Removes the requirement that corporate taxpayers elect whether to apply the credit against the franchise tax**,** or the income tax **,**at the time of applying for the credit with the Department of Commerce (effective beginning with 1996 tax year)**.**

(4) Modifies the formula for determining which tier of economic conditions a county is in by using a 3-year average of the per capita income and unemployment rate factors instead ,of the most recent year for which data is available (effective beginning with 1998 designations).

(5) Allows a **"Tier 1"** county [the most-distressed] to keep this status for a minimum of two years (effective with designations for 1997 and future calendar years) and eliminates wage test (effective beginning with 1997 tax year)

(6) Expands **"Tier 1"** designation to "enterprise zones", which are defined as census tracts in a city that meet the following requirements:

(a) The zone must be located in a city with a population of at least 10,000
(b) The census tract must have a population of at least 3,000
(c) The 1990 census poverty rate must be at least 20%.

The zone can be either a single county that meets the requirements or tow or more contiguous
that together meet the requirements.

(7) The 1996 incentive package contained a provision that allows a taxpayer to take the jobs tax credit that applied to the enterprise tier for the year that a taxpayer signs a letter of commitment with the Department of Commerce to create at least 20 new full-time jobs in a specific areas within two years. This bill extends the "planned expansion" language to the investment in machinery and equipment subject to the targeted investment tax credit. This change is effective for tax years beginning on or after January 1, 1998.

(8) Expands the list of eligible industries for which the 1996 incentives package applies to air courier services, effective for tax years beginning on or after January 1, 1997.

(9) Expands the list of eligible industries for which the 1996 incentives package applies to a central administrative office that employs at least 40 people.

ASSUMPTIONS AND METHODOLOGY:

Investment Tax Credit Changes: An extensive library and internet search for investment data yielded two pieces of information useful for estimating the impact of extending the targeted investment tax credit. This first data was 1992 rental payments for machinery and equipment as reported by manufacturers in North Carolina on the 1992 Census of Manufacturers (Census Bureau). This data was used to simulate the investment base for 1997 (using 8% annual growth in acquisitions of machinery and equipment) by assuming various lease terms. The results of these simulations were then compared to the total capital investment in machinery/equipment by North Carolina manufacturers reported in the same Census report. This led to a ratio of dollars for capital leases versus total acquisitions of 10%.

Next, the Equipment Leasing Association of America was contacted. A recent survey of the members of the association indicated that about 15% of new investment was funded through leases. The data did not break out capital leases that can be depreciated versus operating leases. The bill applies only to capital leases. For the purpose of this analysis it was assumed that two-thirds of the dollar volume of leases was for capital leases. This means that 10% of capital acquisitions are made through capital leases. This ratio was applied to the 1996 session estimates of the investment tax credit.

Finally, the Department of Revenue indicates that some taxpayers may be taking the credit on leased equipment due to the fact that capital leases are depreciated for federal tax purposes. For this analysis an estimating range was used. The bottom of the range is based on the assumption that the cost is only 50% of the estimated amount because taxpayers are already using the credit on leased equipment. The top of the range assumes that no taxpayers are used the credit on leased equipment.

Enterprise Zone Addition: The estimate for the impact of the enterprise designation on the jobs credit and investment tax credit are based on relating the population in each eligible zone to the population of areas receiving the credits under the original 1996 legislation. The estimate was then multiplied by a 50% factor due to the feeling of both the Governor's Economic Policy Advisor and Fiscal Research that the investment and job creation intensity would be lower in the zones than in other areas due to cost factors, housing displacement, regulations, etc. There is no historical data on job creation and investment within census tracts.

"Planned Expansion Change": The Governor's Economic Policy Advisor examined the number of counties that would have been affected by the planned expansion changes, using 1996 and 1997 listings under the distressed county formula. One county moved from tier 1 to tier 2, and two counties moved from each of tiers two through four to the next higher tier. Next, it was assumed that all of the projected investment would have applied for locking in the lower tier under the proposed change. The projected investment tax credit costs were then adjusted to account for the lower threshold achieved by locking in the lower tier. The projected number of companies investing or expanding in the affected counties (used for the1996 bill analysis) were

multiplied by the amount of the lower threshold, and the standard investment tax credit estimating formula was applied to estimate fiscal year costs

Central Administrative Offices: The Governor's Economic Policy Advisor examined the change in central administrative office establishments over a 4-year period, using Employment Security Commission data. The number of establishments was adjusted for those with 40 or fewer employees. This provided an estimate of 6-12 qualifying establishments per year. Using existing data it was estimated that qualifying establishments would employee 100-200 individuals. Next, a square footage requirement was developed and this was costed out using data for the Charlotte office space market. Unlike the 1996 estimates, this analysis assumed 100% immediate usage of the tax credits. To be conservative, this Fiscal Research Division estimate uses a number close to the high end of the estimated assumptions used by the Governor's Economic Policy Advisor.

Other Changes: The Governor's Economic Policy Advisor analyzed the Tier 1 grandfathering by reviewing actual economic data for the Tier 1 counties. This analysis indicated that 4 counties would fit this category. For these counties the impact on the jobs tax credit resulting from maintaining the $12,500 credit in lieu of $4,000 was calculated by applying the difference to the actual number of jobs created in the relevant counties. Next, a high and **then a** low estimate was calculated**,** using different assumptions about how many of the companies, **each year,** would claim the credit. These assumptions were the same as those used in developing the consensus executive/legislative estimates used for the William S. Lee Act in 1996. The impact of the addition of "air courier services" is minimal due to the limited scope of activity in North Carolina according to Employment Security Commission data.

TECHNICAL CONSIDERATIONS:

It should be noted that the cost of the leased equipment and machinery extension was embedded in the total cost of the investment tax credit adopted in the 1996 bill. The reason had to do with the lack of data available at the time on the breakdown between purchased and leased equipment. If this portion of the bill is not enacted, the cushion built into the 1996 revenue estimate would add show up as excess revenues that would become part of the year-end General Fund credit balance.

FISCAL RESEARCH DIVISION (733-4910)
PREPARED BY: Dave Crotts
APPROVED BY: Tom Covington **TomC**
DATE: May 6, 1997

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