NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: SB 841 (Fourth Edition)

SHORT TITLE: Modify Corporate Dividend Taxation

SPONSOR(S):

FISCAL IMPACT

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

($Million)

	FY 1997-98	FY 1998-99	FY 1999-00	FY 2000-01	FY 2001-02
REVENUES					
General Fund					
Subsidiary Dividends	($3.4)	($3.4)	($3.5)	($3.7)	($3.9)
School Sales Tax Refunds		($26.8)	($30.2)	($33.6)	($34.2)
Total G.F.	($3.4)	($30.2)	($33.7)	($37.3)	($38.1)
Local Govt.					
School Sales Tax Refunds		($13.4)	($15.1)	($16.8)	($17.1)

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

EFFECTIVE DATE: The changes to corporate subsidiary dividends are effective for taxable years beginning on or after January 1, 1997. School sales tax refunds are effective for taxes paid on or after July 1, 1997.

BILL SUMMARY: Sections 1 and 2 of the bill extend the subsidiary dividend deduction to out-of-state corporations and clarify that dividend income can be either business income or non-business income. Since 1969, only a corporation domiciled or based in North Carolina that holds more than 50% of the outstanding voting stock of a subsidiary may deduct the dividends it receives from that subsidiary. Recent U.S. Supreme Court cases have found that a state cannot discriminate in favor of local commerce against out-of-state commerce. Legislative and Attorney General attorneys believe the subsidiary dividend law discriminates against out-of-state companies and suggest the law be changed before it is challenged in court. Section 3 allows local school administrative units to receive an annual refund of state sales taxes paid. Cities, counties and specifically named local authorities and state institutions currently receive sales tax refunds.

ASSUMPTIONS AND METHODOLOGY:

Subsidiary Dividends

Using a database of 1994 taxable C corporations, the Tax Research Division of the Department of Revenue estimates the proposed changes in corporate dividend taxation in SB 841 will create a $3.35million loss in the General Fund for FY 1997-98. The state's revenue loss is a tax savings to both the non-NC domiciled corporations ($3.05 million) and the NC domiciled corporations ($.3 million). The Department of Revenue believes a 5% growth rate in dividends is appropriate for estimating the impact in future years. The tax loss is reduced by the decline of the corporate income tax rate over the next three years as follows:

FY 1997-98	7.25%
FY 1998-99	7.0%
FY 1999 & thereafter	6.9%

School Sales Tax Refunds

Historical data on capital outlays by local schools was provided by the Department of Public Instruction. Refunds are paid annually in the year after the taxable purchases are made. The analysis assumes 5.1% annual growth in current expense purchases and anticipates that the $450 million of expenditures from the March 1 issuance of state bonds each year are expended over a 30-month period beginning 6 months after the issuance of bonds (to allow for land acquisition and site work). For school building capital outlay it is assumed that 50% of the cost is for taxable materials and supplies. School capital outlay excluding the proceeds from the $1.8 billion bond issue are projected to grow 6.4% per year.

The analysis is reduced by the material and supplies portion (50% assumed) of school capital financed from installment purchase arrangements and certificates of participation. The reason is that counties already receive a sales tax refund on these purchases because the county is contracting for the construction or renovation. The dollar amount of the activity financed by these sources of financing are forecast to increase at an annual rate of 20%. However, the $1.8 billion of state school bonds will cause the refunds to grow over the next few years.

This estimate is conservative in light of the recent Attorney General's Opinion that made clear the conditions that must be met for counties and school boards to work together to receive a sales tax refund under current law. If an interlocal agreement is developed (county must own or lease school building during construction or county purchases current expense items and donates to school board), a sales tax refund can be granted under current law. This means that the revenue loss estimates are overstated to the extent that counties and school boards in some counties develop interlocal agreements and receive refunds.

FISCAL RESEARCH DIVISION **DATE**: August 26, 1997
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