NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 1231

SHORT TITLE: Amend Apportionment Formula

SPONSOR(S): Rep. Bob Hensley

FISCAL IMPACT

Yes (x) **No ( )** **No Estimate Available ( )**

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES: General Fund					
Recurring	**+$56.1**	**+$59.8**	**+$62.3**	**+$63.5**	**+$66.1**
Nonrecurring*	**+10.0**	**-**	**-**	**-**	**-**
Total	**+66.1**	**+59.8**	**+62.3**	**+63.5**	**+66.1**

PRINCIPAL DEPARTMENT AFFECTED: The corporate income tax is collected by the Department of Revenue. The enactment of the bill is not expected to affect the Department's budget requirements.

EFFECTIVE DATE: Tax years beginning on or after January 1, 2001.

*See "TECHNICAL CONSIDERATIONS"

ISSUE BACKGROUND: Because corporations do not account for their profits by geographic area, states have been forced to develop a means to allocate net income reported on a corporation's federal return to the states in which they operate. In the 1930's most states began using a formula that equally weighted three factors: (1) payroll in a state, relative to total U.S. payroll (2) property in a state relative to total U.S. property (3) sales of the corporation in a state relative to total sales in the U.S. In 1988, the North Carolina General Assembly approved legislation that "double-weighted" the sales factor. Under this plan the apportionment factors would be weighted as follows:

Factor	Pre-1988 Weight	1988 Weight
Payroll	33 1/3%	25%
Property	33 1/3%	25%
Sales	33 1/3%	50%

The practical effect of this change was to shift the tax burden from manufacturers with a concentration of plant and property in North Carolina to other taxpayers.

BILL SUMMARY: Restores the corporate income tax apportionment factor to the pre-1988 weights (see table above).

ASSUMPTIONS AND METHODOLOGY: The Department of Revenue has calculated the impact of the double-weighted apportionment formula using actual corporate income tax returns. The most recent tabulation, based on the 1994 tax year, indicated a revenue loss of $33.6 million (at 7% tax rate). This was equivalent to **4.96%** of the corporate income tax collection base for that year. The only other tabulation was for the 1990 tax year. This calculation indicated an impact equivalent to **7.82%** of the tax base.

The fact that we have only two observations of the actual impact, coupled with the tendency of corporate profits to fluctuate widely from year-to-year, suggests the need for a conservative estimate of the bill's impact for future years. The methodology actually used assumed that the effect of the double-weighted apportionment factor is equal to **5.00%** of the projected tax base. The tax base estimate for the 2001 tax year ($1.122 billion) is the same as that used in the General Fund Financial Model of the Fiscal Research Division. If we apply this number to the 5.00% assumption, we find that the revenue gain is $56.1 million for 2001.

The projected impact for later tax years is based on the growth in corporate tax revenues contained in the Financial Model. The source of the year-to-year growth was the March 2001 estimate of U.S. pre-tax profits developed by Data Resources, Inc. This is the primary economic variable used by most states to project corporate income tax receipts.

TECHNICAL CONSIDERATIONS: The annual corporate tax liability is paid through a combination of quarterly estimated tax payments during the tax year and a final payment made 2 ½ months after the end of the year. For calendar year corporations, the first two estimated payments are due April 15 and June 15. This means that for fiscal year 2001-02, **in theory** there would be a revenue gain equal to be the annual amount for the 2001 tax year plus the first two estimated payments for the 2002 tax year. This is equivalent to almost 18 months of impact in a 12-month period. The resulting one-time windfall **potential** is $26.9 million, or about 45% of the estimated 2002 tax year impact. The 45% assumption results from the fact that during the tax year corporations must pay at least 90% of the actual liability for the year to avoid a penalty for underestimating.

However, corporations may also meet their estimated tax payment requirement by remitting an amount equal to 100% of the prior year's actual tax liability. In a period of economic uncertainty and a potential for declining profits, this alternative test may mean some companies may not be required to adjust their first two estimated tax payments for the 2002 tax year for the enactment of the bill. To deal with this uncertainty, **only $10.0 million of the potential one-time windfall is included in the 2001-02 impact.**

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