# GENERAL ASSEMBLY OF NORTH CAROLINA

## Session 2009

## Legislative Fiscal Note

**BILL NUMBER**: House Bill 1721 (Second Edition)

**SHORT TITLE**: H.E.L.P. Small Business Act.

**SPONSOR(S)**: Representatives Holliman, Braxton, Stewart, and Underhill

**FISCAL IMPACT**

Yes ( ) No ( ) No Estimate Available ( )

| | FY 2010-11 | FY 2011-12 | FY 2012-13 | FY 2013-14 | FY 2014-15 |
|---|---|---|---|---|---|
| **REVENUES ($ millions):** | | | | | |
| **Section 1.1** | | | | | |
| **Extended NOL carryback** | (21.4) | 3.8 | 3.4 | 2.5 | 1.7 |
| **Department of Defense homeowner program** | Insignificant Impact based on information obtained from US Joint Committee on Taxation | | | | |
| **Donations to Haiti relief** | Insignificant Impact based on information obtained from US Joint Committee on Taxation | | | | |
| **Increase medical expense threshold from 7.5% to 10%** | 0 | 0 | 0 | $8.5 | $8.8 |
| **FSA, HSA changes** | Insignificant Impact based on information obtained from US Joint Committee on Taxation | | | | |
| **Exec. Compensation** | Insignificant Impact based on information obtained from US Joint Committee on Taxation | | | | |
| **Enhanced Expensing** | (1.2) | (.8) | .6 | .4 | .3 |
| **Sections 1.2 & 1.3** | (3.6) | (8.0) | (8.0) | - | - |
| **Section 1.4** | (7.2) | (5.0) | (5.0) | (5.0) | - |
| **Section 1.5** | (7.2) | (15.5) | (16.5) | - | - |
| **TOTAL** | (40.6) | (25.5) | (25.5) | 6.4 | 10.8 |
| **EXPENDITURES:** | | | | | |
| **Section 1.5** | $59,242 | $60,709 | $65,341 | $69,359 | $72,418 |
| **Section 2.1 One NC Small Business** | $1,500,000 | - | - | - | - |
| **Section 2.2** | $402,861 | $402,861 | $402,861 | $402,861 | $402,861 |

| | | | | | |
|---|---|---|---|---|---|
| **Section 2.3 Rural Center – Small Business Asst. Fund** | **1,000,000** | **-** | **-** | **-** | |
| **Section 2.4 BLNC** | | | **Indeterminate Costs** | | |
| **POSITIONS (cumulative):** | **1.0** | **1.0** | **1.0** | **1.0** | **1.0** |

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

**EFFECTIVE DATE:** January 1, 2010

**BILL SUMMARY**: House Bill 1721, the H.E.L.P. Small Businesses Act, was recommended by the House Select Committee on Small Businesses, which met during the 2009-10 interim. The bill provides tax benefits to small businesses, including additional expensing of purchases, an increase of the overall cap on the Qualified Business Investments tax credit, a tax credit for providing health insurance, and a jobs creation tax credit. The bill also provides appropriations to organizations that provide programming and access to additional capital for small businesses, including the Department of Commerce, the Community College System, and the NC Rural Economic Development Center. The bill also directs the Department of Commerce to increase its advertising for the BLNC program, which provides an information portal to small business owners.

**ASSUMPTIONS AND METHODOLOGY**:

**PART 1: TAX BENEFITS FOR SMALL BUSINESSES**

**SECTION1.1 INTERNAL REVENUE CODE UPDATE:**
**Extended NOL Carryback**
The methodology used begins with the US Joint Committee on Taxation estimates of the nationwide federal impact by federal fiscal year (federal fiscal years run from October through September). The national numbers were prorated and an approximate state effective tax rate was applied to arrive at the estimated impact based on the federal fiscal year. Fiscal Research adjusted these numbers to an approximate fiscal impact based on the State's fiscal year. The numbers were also adjusted to take into consideration that the provision would only affect individual filers, since NC does not follow the federal net operating loss for corporate income tax purposes.

**Department of Defense Homeowner Assistance Program**
The fiscal impact was estimated to be insignificant based on prorating the US Joint Committee on Taxation estimates of the nationwide federal impact and applying an approximate state effective tax rate.

**Donations to Haiti Relief**
The fiscal impact was estimated to be insignificant based on prorating the US Joint Committee on Taxation estimates of the nationwide federal impact and applying an approximate state effective tax rate.

**Increase the Medical Expense Threshold From 7.5% to 10%**
Effective on January 1, 2013, the threshold for unreimbursed medical expenses is increased from 7.5% to 10% of adjusted gross income. To estimate the impact of increasing the threshold for the federal deduction would have on North Carolina individual income tax collections, the scenario was entered into the North Carolina Individual Income Tax Model. Increasing the threshold would result in a full fiscal year revenue increase of approximately $21 million in revenues. However, this change is waived for taxpayers 65 years and over for tax years 2013 through 2016. Using IRS SOI data, approximately 60% of the medical expense deduction comes from this age group. Therefore, until the new 10% threshold is assumed for all taxpayers in 2017, the revenue increase would be approximately $8.5 million for FY 13-14. This amount was then grown using Moody's Economy.com's Medical Care forecast.

**FSA/HSA and Executive Compensation Changes**
The fiscal impact was estimated to be insignificant based on prorating the US Joint Committee on Taxation estimates of the nationwide federal impact and applying an approximate state effective tax rate.

**Executive Compensation**
The fiscal impact was estimated to be insignificant based on prorating the US Joint Committee on Taxation estimates of the nationwide federal impact and applying an approximate state effective tax rate.

**Enhanced Expensing**
The methodology used begins with the US Joint Committee on Taxation estimates of the nationwide federal impact by federal fiscal year (federal fiscal years run from October through September). The national numbers were prorated and an approximate state effective tax rate was applied to arrive at the estimated impact based on the federal fiscal year. Fiscal Research adjusted these numbers to an approximate fiscal impact based on the State's fiscal year.

**SECTION 1.2 & 1.3 TAX BENEFITS FOR INVESTMENT IN QUALIFIED BUSINESSES:** These sections extend the qualified business tax credit and raise the cap to $8 million. The fiscal impact was estimated by assuming the cap is reached each year. The fiscal impact for FY 2010-11 reflects adjustments to taxpayers estimated payments for the 2011 tax year.

**SECTION 1.4 SMALL BUSINESSES THAT PROVIDE HEALTH INSURANCE:** Based on the Tax Expenditure Report from the Department of Revenue the full year cost of the credit is $5 million. The fiscal impact for FY 2010-11 reflects the credit taken against 2010 tax year liability plus adjustments to taxpayers estimated payments for the 2011 tax year.

**SECTION 1.5 TAX CREDIT FOR SMALL BUSINESSES:** To determine the fiscal impact of this section it was necessary to estimate the net number of new jobs generated by employers with 25 or fewer employees. Two key assumptions were needed to develop the estimate. The first assumption was to estimate net new jobs generated during 2010 to 2012 based on the employment growth experienced during 2003-2005. These years are expected to be a good representation of job growth for the current economic recovery. The second assumption relates to how much job creation would occur because of the credit. It was assumed that an employer's sensitivity to lower employee costs would be unitary. Thus, for each one percent decrease in costs there would be a corresponding one percent increase in employment. This assumption is based on the idea that some employers are at the margin of making a hiring decision and the $1,000 credit would be a sufficient benefit to spur the decision to hire a new full-time employee.

**To Estimate the Number of Net New Hires**

To estimate the number of net new hires for the time period of 2010 through 2012, data from the Bureau of Labor Statistics (BLS) was collected. The data was from the Employment Dynamics series, which provides the net employment gains by firm size. Net gain in employment is calculated by taking the total number of employment gains minus the employment losses. Because there was not a specific designation for firms with 25 employees or less, it was necessary to adjust the number of net hires. In the firm size category "20-49 employees", the net gain was reduced by assuming 20 percent of the net gain was from firms with 20 to 25 employees. Based on that data, and using the time-period from 2003-2005 as an indication of the growth trend for 2010-2012, the expected net gain in small business employment for the respective years was estimated. It was assumed that the annual full-time employment increases were retained as full-time employees for the requisite three years. The estimated gains in small businesses employment are listed in the second column of Table 1.

**TABLE 1: NET ANNUAL CHANGE IN FULL-TIME EMPLOYMENT FOR SMALL BUSINESSES**

| Year | Small Business Employment Increase | Increase from Tax Credit | Total Employment Gain | Revenue Impact |
|---|---|---|---|---|
| 2010 | 6,800 | 210 | 7,010 | $7,010,000 |
| 2011 | 14,900 | 450 | 15,350 | $15,350,000 |
| 2012 | 15,800 | 480 | 16,280 | $16,280,000 |

**Increase in Employment from Tax Credit**

The next step in determining the fiscal impact was to determine the increase in the net number of new jobs generated by the $1,000 tax credit. To make the estimate we had to determine the percentage decrease in employment costs as a result of the tax credit. Wage data from BLS for North Carolina indicated that the average annual wages in 2008 were $38,230. For new hires we assumed the average starting wages would meet the wage standard and be approximately 75% of the statewide average, or $28,675. In addition to wages, the cost of employment includes employer paid benefits, which were estimated at $4,200 annually. Thus, the net annual cost of hiring a new employee is estimated to be $32,875 ($28,675+$4,200). The decrease in the first year employee costs from the $1,000 tax credit would equal approximately three percent. Based on the assumption that firms will increase hiring proportional to the decrease in cost, the tax credit will generate a three percent increase in small business employment. The yearly increases in employment induced by the tax credit are listed in column three of Table 1. The final assumption needed to estimate the fiscal impact was that all newly generated hires were retained as full-time employees for the requisite three years.

**Fiscal Impact on State Revenue**

The revenue impact is estimated by multiplying the $1,000 credit by the annual net gain in employment, both from the expected job growth and the induced growth. The last column in Table 1 shows the fiscal impact of the credit. To calculate the fiscal year impact, it was assumed that all small businesses eligible for the credit were able to take the full amount of the credit for the tax year in which the credit was generated. It was also assumed that all new employment would meet the requirements for credit eligibility as set forth in Section 1.5 (d) of the bill.

**Administrative Costs for the Department of Revenue**

The Department of Revenue (DOR) indicates that its current staff will not be able to absorb the additional workload required in order to administer HB 1721. DOR anticipates that it will need one additional Tax Auditor position to fulfill the requirements of this legislation. In total, DOR estimates that it will need $59,242 for the Tax Auditor in FY 2010-11 (a breakdown of these expenses is provided in the chart below). Fiscal Research concurs with these estimates.

**TABLE 2: DEPARTMENT OF REVENUE ESTIMATED COSTS FOR ADMINISTERING HB 1721**

| Description | | Associated Cost FY 2010-11 |
|---|---|---|
| Tax Auditor | | |
| | Salary | $42,833 |
| | Social Security | $3,277 |
| | Retirement | $4,502 |
| | Medical Insurance | $4,929 |
| IT Services | | |
| | Telephone Service | $300 |
| | Maintenance Agreement - PC | $239 |
| | Maintenance Agreement – PC Software | $115 NR |
| | PC Purchases | $1,000 NR |
| | PC Software Purchases | $600 |
| Administrative Services | | |
| | Supplies | $500 |
| | Furniture Office | $1,000 NR |
| | Equipment (Calculator) | $100 NR |
| **TOTAL** | | **$59,242** |

DOR also indicates that although the implantation of a new tax credit will require the creation of a new corporate tax form, no new costs are anticipated for its design and associated training. DOR states that two temporary Data Entry Operators will be required to enter information from the new corporate tax form at a total cost of $49,485 ($11.05 per hour * 2,080 hrs/yr + $3,517 for social security). However, Fiscal Research estimates that current staffing levels exist to accommodate this additional task and that no additional resources are needed.

The total operational impact of this legislation on the Department of Revenue for FY 2010-11 totals $59,242 and 1.0 FTEs.

**PART 2: INCREASE FUNDING FOR SMALL BUSINESS SUPPORT PROGRAMS**

**SECTION 2.1 LEVERAGE FEDERAL FUNDS TO CREATE RESEARCH JOBS:** Section 2.1 appropriates $1,500,000 for the One North Carolina Small Business Fund for FY 2010-2011. One North Carolina Small Business is a program administered by the Department of Commerce. It reimburses qualifying North Carolina businesses for costs associated with applying for grants from the federal Small Business Innovation Research (SBIR) and Small Businesses Technology Transfer (STTR) programs and awards matching grants for those businesses that have been awarded an SBIR or STTR grant.

**SECTION 2.2 INCREASE FUNDING FOR SUPPORT SERVICES FOR SMALL BUSINESSES:** Section 2.2 increases the appropriation for the small business centers program in the NC Community College System by $402,861. This is the amount reduced from the program in the 2009 budget, and if distributed evenly among the State's 58 small business centers would result in an increase of approximately $6,945.88 for each center.

**SECTION 2.3 INCREASE ACCESS TO CAPITAL FOR SMALL BUSINESSES:** Section 2.3 appropriates $1,000,000 to the North Carolina Rural Economic Development Center (Rural Center) for FY 2010-2011 to be used to support existing small businesses by expanding access to capital.

**SECTION 2.4 MORE MARKETING FOR BUSINESS LINK NORTH CAROLINA PROGRAM:** Section 2.4 directs the Department of Commerce to increase marketing expenditures on the Business Link North Carolina (BLNC) program so as to reach the North Carolinians who can best benefit from BLNC’s services. Costs are indeterminate for this provision because the bill does not specify how or by how much the Department of Commerce should increase expenditures on BLNC.

**SOURCES OF DATA:** US Joint Committee on Taxation; Moody’s Economy.com; IRS; Tax Expenditure Report, 2009 by the Department of Revenue; Bureau of Labor Statistics; Department of Revenue.

**TECHNICAL CONSIDERATIONS**:

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