



NORTH CAROLINA GENERAL ASSEMBLY

Session 2019

Legislative Fiscal Note

REVISED

Short Title: Revenue Laws Recommendations.
Bill Number: House Bill 1080 (Third Edition)
Sponsor(s): Representatives Howard, Ross, Setzer, and Szoka

SUMMARY TABLE

FISCAL IMPACT OF PCS to H1080, V3 (\$ in millions)

| | <u>FY 2020-21</u> | <u>FY 2021-22</u> | <u>FY 2022-23</u> | <u>FY 2023-24</u> | <u>FY 2024-25</u> |
|----------------------------|--|-------------------|-------------------|-------------------|-------------------|
| State Impact | | | | | |
| General Fund Revenue | (36.0) | - | - | - | - |
| Less Expenditures | <i>Likely increase to General Fund expenditures between \$349m and \$843m through FY 2030-31; see Fiscal Analysis section.</i> | | | | |
| General Fund Impact | | | | | |
| Special Fund Revenues | <i>Likely increase to Special Fund Revenue of \$4m through FY 2030-31; see Fiscal Analysis section.</i> | | | | |
| Special Fund Impact | | | | | |

| | |
|-------------------------|-------------------------------------|
| NET STATE IMPACT | See Fiscal Analysis Section. |
|-------------------------|-------------------------------------|

Revision Note: *This Fiscal Note has been revised to indicate the correct fiscal year for the projected \$36 million reduction to General Fund revenue.*

FISCAL IMPACT SUMMARY

The original fiscal note erroneously showed the fiscal impact on General Fund Revenue occurring in FY 2021-2022 due to a formatting error. The revised fiscal note corrects this error and shows the fiscal impact occurring in FY 2020-21.

Section 1 updates North Carolina’s reference to the Internal Revenue Code from January 1, 2019 to May 1, 2020. The fiscal impact results from conforming to a lower threshold amount for the medical expense deduction of 7.5% of income instead of 10% for the 2019 and 2020 tax years. The bill decouples from other federal tax provisions that would otherwise have had a negative impact on State revenue.

Section 7.4 extends the authority of the Economic Investment Committee to make new awards under the Job Development Investment Grant Program (JDIG) from 2021 to 2030. Awards made between 2021 and 2030 are estimated to increase special fund revenue by \$4 million between FY 2021-22 and FY 2030-31. Though ultimately the exact fiscal impact of extending the JDIG sunset on General Fund expenditures is unknown, a likely estimate indicates an increase of between \$329 million and \$843 million between FY 2021-22 and FY 2030-31.

FISCAL ANALYSIS

SECTION 1: IRC CONFORMITY

Reducing the threshold for the medical expense deduction to 7.5% is expected to increase the cost of the deduction by approximately \$18 million each tax year. Due to the timing of the legislation, adjustments are made for the difference between the tax year and the State's fiscal year.

The fiscal impact of reducing the medical expense deduction threshold was estimated using the Fiscal Research Microsimulation Tax Model. The Model uses prior year Federal and North Carolina tax return data that has been "aged" to approximate 2019 and 2020 tax year data.

SECTION 7.4: JDIG SUNSET EXTENSION

BACKGROUND

Current Program Description: The Job Development Investment Grant (JDIG) program provides a discretionary incentive offering sustained annual grants directly to new and expanding businesses statewide. The amount of the grant is calculated using a percentage (up to 75% in non-Tier 1 areas and up to 80% for Tier 1 areas) of the personal income tax withholdings generated by the new employees hired by the business. Grant payments to a business occur only after the Department of Revenue verifies that the company has created jobs and generated withholdings pursuant to the JDIG agreement so as to be entitled to a disbursement. A JDIG agreement may last up to 12 years and is a binding obligation of the State. The General Assembly annually appropriates funds necessary to pay existing JDIG obligations (i.e., awards already committed), an amount determined by the Department of Commerce's yearly April 1 funding study. This cash-flow method of appropriation creates a delay between a grant award and the appropriation for payment of that award: a grant award made in calendar year 2021 may receive its first disbursement in FY 2023-24, and the appropriation for that disbursement also would be made in FY 2023-24.

A portion of JDIG payments to projects located in Tier 2 and 3 counties (10% and 25%, respectively) are redirected and allocated to the Utility Account for economic infrastructure grants to local governments in Tier 1 and 2 counties that are reasonably anticipated to create jobs.

Liability Cap: Current General Statutes require that the total amount paid out in any single grant year to all companies awarded a grant in the same calendar year (CY) cannot exceed \$35 million (increased from \$20 million in 2018); this cap translates to a maximum potential liability of \$420

million over the maximum contract term of 12 years for a grant, for all businesses awarded a grant in the same calendar year. Each calendar year, the JDIG program's liability cap (its award-making capacity) resets on January 1st. In the event that Commerce does not fully commit a year's liability cap, it may not be awarded in a subsequent year. Similarly, if a company whose award was granted under a prior year's liability cap withdraws or is terminated from the program, Commerce may not re-award that forgone portion of the liability cap.

The \$35 million liability cap is subject to geographic limitations as of 2018. Of the \$35 million, no more than \$20 million may be used for projects located in counties with a total employment of 500,00 or more, and \$5 million is reserved for projects located in counties with economic distress rankings in the highest 50% (all Tier 1 counties and the 10 most economically distressed Tier 2 counties).

JDIG Fees: Application and Annual Reporting Fees: Companies applying for a JDIG must pay a fee of \$10,000 if the project is located in a Tier 3 county, \$5,000 if the project is located in a Tier 2 county, and \$1,000 if the project is located in a Tier 1 county. Award recipients also submit performance reports by March 1, along with a reporting fee of the greater of \$2,500 or 0.03% of an amount equal to the grant less the maximum amount to be transferred to the Utility Fund. These fees are ultimately deposited into a special fund, used to support expenditures for Commerce administration of the program.

REVENUES: GENERAL FUND & SPECIAL FUND

A. General Fund

Any projected increases in General Fund revenue due to future JDIG grants have not been included in this analysis because the exact revenue is unknown for two reasons:

1. The State provides a JDIG payment to a company based on the amount of personal income tax withholdings new employees will remit to the Department of Revenue. However, all or some part of withholdings may be refunded when these new employees file their tax returns.
2. Often the State expends additional money from the General Fund to attract a JDIG recipient to North Carolina (e.g., other State incentives, tax credits, and workforce grants). While Commerce models a cost-benefit analysis for each JDIG, to ensure that an awarded grant will provide a positive net effect on the State's General Fund *over the course of a grant's term*, the exact revenue impact on an annual fiscal year basis cannot be determined.

B. Special Fund

This analysis assumes a rate of applications consistent with the past five years for which data is available (2015-2019) and a rate of annual report filings consistent with the past five fiscal years (FY 2015-16 through FY 2019-20). Extending the JDIG expiration from 2021 to 2030 would increase special fund revenues by approximately \$4 million between FY 2020-21 and FY 2030-31 (see Attachment A).



1. *Application Fees:* Based on Annual Reports submitted for years 2015-2019, the Department of Commerce receives an average of approximately 23 applications per year. Of those 23 applications, an average of 14% (3) are for projects located in Tier 1 counties, 27% (6) are located in Tier 2 counties, and 59% (14) are located in Tier 3 counties. Assuming consistent application rates moving forward, extending the authority of the Economic Investment Committee to make new awards will yield increased revenues from application fees of *\$161,000 per year, or \$1.6 million from FY 2020-21 through FY 2030-31.*
2. *Annual Report Fees:* This analysis assumes that 23 applications will yield 21 grantees that file annual reports for 12 years, with the first annual report filed for the year following the award year. Companies may apply for JDIG grants and ultimately not accept the award or might withdraw from the program before filing an annual report. Projects that received awards in calendar year 2021 would file their first annual report for performance year 2022 by March of 2023, paying an annual report fee in FY 2022-23. Assuming the minimum annual report payment of \$2,500, extending the JDIG sunset until 2030 would increase revenues from annual report fees by *\$2.4 million between FY 2020-21 and FY 2030-31.*

EXPENDITURES

A. Total Maximum Liability

If the maximum allowable amount (\$35 million) is awarded in each year, if all companies remain active and achieve full disbursement, and if the first payment is made based on the calendar year performance in the year immediately after the award year, then extending the JDIG sunset yields a maximum potential liability of *\$1.575 billion through FY 2030-31* (see Attachment B). Total liability would extend beyond FY 2030-31 even if no new JDIG awards were made after calendar year 2030 given the 12-year maximum grant term.

B. Potential Liability Based on Program History

Based on JDIG program history, the State could anticipate paying within a range of \$329 million to \$843 million through FY 2030-31. This range is based on a low-end projection scenario and a high-end projection scenario under the following conditions:

1. *Low-end Scenario:* This is based on an award rate of 51% of the maximum liability cap (five-year average) and a 41% company performance rate (average of award years entirely or mostly closed). (See Attachment C)
2. *High-end Scenario:* This is based on an award rate of 85% of the maximum liability cap (the highest utilization rate in the past five years) and a 63% company performance rate (based on Commerce's most recent JDIG Annual Report). (See Attachment D)

Commerce Cap Utilization: Given the gradual "ramp up" of new jobs by each company, the fact that most companies do not receive a full 12-year grant term, and that in several years of a grant cohort the annual maximum cap is not reached, the actual State liability is typically less than the maximum. Over the past five years, the ratio of awards committed by Commerce to the authorized maximum liability has ranged from a low of 31% to a high of 85%, as depicted in the table below:

| Award Year | Annual Cap | Maximum Liability | Total Awards | % Utilized |
|-------------------|-------------------|--------------------------|---------------------|-------------------|
| CY 2015 | \$20 million | \$240 million | \$96 million | 40% |
| CY 2016 | \$20 million | \$240 million | \$75 million | 31% |
| CY 2017 | \$20 million | \$240 million | \$204 million | 85% |
| CY 2018 | \$35 million | \$420 million | \$216 million | 51% |
| CY 2019 | \$35 million | \$420 million | \$192 million | 46% |

*The annual cap increased from \$15 million to \$20 million in October 2015 and from \$20 million to \$35 million in June 2018.

Company Performance: In addition, companies are often not eligible for the full amount initially awarded to them due to failure to achieve 100% of the performance requirements. For example, companies forgo a year's grant payments for failure to achieve 80% compliance with the minimum requirements, based on a weighted average of performance factors, and may receive a pro-rated payment for compliance between 80% and 100%. At certain points of non-compliance, a company may lose its grant entirely. Of the 282 grants that have been awarded through calendar year 2018, 127 awards (45%) have been terminated or withdrawn.

The ratio of payment to liability has varied given how well particular companies have performed year over year and the impact of economic events such as the Great Recession. Since JDIG's inception in 2003, projects awarded in grant years 2003-2010 have either ended or are nearing the end of their grant terms. These projects either have no remaining potential liability or a small potential liability in future years (according to Commerce's most recent funding study), as shown below:

| Award Year | Total Awarded (Millions) | Total Disbursement (Millions) | Remaining Liability (Millions) | Maximum Performance Rate |
|-------------------|---------------------------------|--------------------------------------|---------------------------------------|---------------------------------|
| 2003 | \$39 | \$18 | \$0 | 46% |
| 2004 | \$109 | \$63 | \$0 | 58% |
| 2005 | \$55 | \$13 | \$0 | 24% |
| 2006 | \$188 | \$105 | \$3.7 | 58% |
| 2007 | \$114 | \$33 | \$1.3 | 30% |
| 2008 | \$125 | \$11 | \$0.08 | 9% |
| 2009 | \$120 | \$51 | \$18.8 | 58% |
| 2010 | \$104 | \$42 | \$4.8 | 45% |

The low-end performance estimate is based on the average performance rate across grant years 2003-2010 (41%), commensurate with performance over an economic event like the Great Recession.

A high-end performance estimate is based on Commerce's most recent JDIG Annual Report, which reports a 63% compliance rate across all active grants. This high-end performance estimate also assumes a dramatic decrease in the grant termination rate, commensurate with strong economic growth.

Ultimately, the exact fiscal impact of the JDIG extension is unknown due to the following variables:

1. The extent to which Commerce utilizes the maximum liability cap authority.
2. How well a company will perform in any particular year of an agreement.
3. The impact that the broader economic environment will have on the program.

RECURRING APPROPRIATIONS

General Fund appropriations pay for existing award commitments made under prior years' liability cap authority. To determine the amount needed to pay awards under contract in the following fiscal year's budget, the Department of Commerce submits an annual funding study by April 1 to the General Assembly and the Fiscal Research Division; this study also includes the maximum liability associated with active grants through their full terms. The current recurring appropriation to fund prior years' awards is \$71.7 million, and the General Assembly has adjusted this appropriation on a nonrecurring basis after receiving the annual funding study from Commerce. Historically, JDIG disbursements have been less than \$71.7 million per fiscal year. A five-year history of Commerce's estimated JDIG disbursements and actual disbursements is below:

| Year | Funding Study Estimate | Actual Disbursements |
|-------------|-------------------------------|-----------------------------|
| FY 2015-16 | \$67.3 million | \$54.8 million |
| FY 2016-17 | \$73.7 million | \$58.6 million |
| FY 2017-18 | \$74.5 million | \$65.5 million |
| FY 2018-19 | \$74.0 million | \$61.2 million |
| FY 2019-20 | \$71.6 million | \$57.1 million |

Under current General Statutes, annual requirements for JDIG disbursements would eventually decrease and fall to zero as prior years' awards are closed out and no additional awards are made. The General Assembly would then have the option of redirecting the annual \$71.7 million appropriation to other purposes. Extending the JDIG sunset and accepting new awards between 2021 and 2030 may require an increase to the recurring appropriation for JDIG, though that increase would likely not happen for several budget cycles.

TECHNICAL CONSIDERATIONS

N/A.

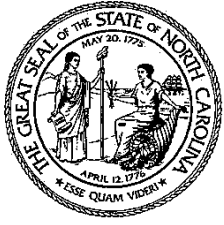
DATA SOURCES

North Carolina Department of Revenue, IRS Statistics of Income, Moody's Analytics Forecasts, North Carolina Department of Commerce

FISCAL ANALYSIS MEMORANDUM – PURPOSE AND LIMITATIONS

This document is a fiscal analysis of a bill, draft bill, amendment, committee substitute, or conference committee report that is confidential under Chapter 120 of the General Statutes. The

estimates in this analysis are based on the data, assumptions, and methodology described in the Fiscal Analysis section of this document. This document only addresses sections of the bill that have projected direct fiscal impacts on State or local governments and does not address sections that have no projected fiscal impacts. This document is not an official fiscal note. If a formal fiscal note is requested, please email your request to the Fiscal Research Division at FiscalNoteRequests@ncleg.net or call (919) 733-4910.



NORTH CAROLINA GENERAL ASSEMBLY

Session 2019

Legislative Fiscal Note

Attachment A: Fiscal Analysis of Special Fund Revenue Increase Due to JDIG Sunset Extension, FY 2021-22 through FY 2030-31

| Award Year | FY 2021-22 | FY 2022-23 | FY 2023-24 | FY 2024-25 | FY 2025-26 | FY 2026-27 | FY 2027-28 | FY 2028-29 | FY 2029-30 | FY 2030-31 |
|---------------------|-------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| 2021 | \$161,000 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 |
| 2022 | | \$161,000 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 |
| 2023 | | | \$161,000 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 |
| 2024 | | | | \$161,000 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 |
| 2025 | | | | | \$161,000 | \$52,500 | \$52,500 | \$52,500 | \$52,500 | \$52,500 |
| 2026 | | | | | | \$161,000 | \$52,500 | \$52,500 | \$52,500 | \$52,500 |
| 2027 | | | | | | | \$161,000 | \$52,500 | \$52,500 | \$52,500 |
| 2028 | | | | | | | | \$161,000 | \$52,500 | \$52,500 |
| 2029 | | | | | | | | | \$161,000 | \$52,500 |
| 2030 | | | | | | | | | | \$161,000 |
| Annual Total | \$161,000 | \$213,500 | \$266,000 | \$318,500 | \$371,000 | \$423,500 | \$476,000 | \$528,500 | \$581,000 | \$633,500 |
| Grand Total | \$3,972,500 | | | | | | | | | |

Note: Assumes application rate of 23 applications per year (commensurate with program history) and annual report filings by 21 grantees for the duration of the grant term.

Attachment B: Fiscal Analysis of Maximum Liability to State from New JDIG Awards, FY 2021-22 through FY 2030-31

| Award Year | FY 2021-22 | FY 2022-23 | FY 2023-24 | FY 2024-25 | FY 2025-26 | FY 2026-27 | FY 2027-28 | FY 2028-29 | FY 2029-30 | FY 2030-31 |
|---------------------|-----------------|--------------|--------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| 2021 | | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2022 | | | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2023 | | | | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2024 | | | | | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2025 | | | | | | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2026 | | | | | | | \$35,000,000 | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2027 | | | | | | | | \$35,000,000 | \$35,000,000 | \$35,000,000 |
| 2028 | | | | | | | | | \$35,000,000 | \$35,000,000 |
| 2029 | | | | | | | | | | \$35,000,000 |
| Annual Total | | \$35,000,000 | \$70,000,000 | \$105,000,000 | \$140,000,000 | \$175,000,000 | \$210,000,000 | \$245,000,000 | \$280,000,000 | \$315,000,000 |
| Grand Total | \$1,575,000,000 | | | | | | | | | |

Note: Assumes maximum liability awarded each year, full compliance, and no ramp-up period.

Attachment C: Fiscal Analysis of Low-End Projection of JDIG Payments, FY 2021-22 to FY 2030-31

| Award Year | FY 2021-22 | FY 2022-23 | FY 2023-24 | FY 2024-25 | FY 2025-26 | FY 2026-27 | FY 2027-28 | FY 2028-29 | FY 2029-30 | FY 2030-31 |
|---------------------|---------------|-------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| 2021 | | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2022 | | | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2023 | | | | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2024 | | | | | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2025 | | | | | | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2026 | | | | | | | \$7,318,500 | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2027 | | | | | | | | \$7,318,500 | \$7,318,500 | \$7,318,500 |
| 2028 | | | | | | | | | \$7,318,500 | \$7,318,500 |
| 2029 | | | | | | | | | | \$7,318,500 |
| Annual Total | | \$7,318,500 | \$14,637,000 | \$21,955,500 | \$29,274,000 | \$36,592,500 | \$43,911,000 | \$51,229,500 | \$58,548,000 | \$65,866,500 |
| Grand Total | \$329,332,500 | | | | | | | | | |

Note: Analysis includes unlikely front-loading of grant disbursements through equal disbursements in each year of the grant term. Projection based on 51% cap utilization (\$214 million total/\$17.85 million annually) and 41% company performance (\$7.3 million annually) in each award year.

Attachment D: Fiscal Analysis of High-End Projection of JDIG Payments, FY 2021-22 to FY 2030-31

| Award Year | FY 2021-22 | FY 2022-23 | FY 2023-24 | FY 2024-25 | FY 2025-26 | FY 2026-27 | FY 2027-28 | FY 2028-29 | FY 2029-30 | FY 2030-31 |
|---------------------|---------------|--------------|--------------|--------------|--------------|--------------|---------------|---------------|---------------|---------------|
| 2021 | | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2022 | | | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2023 | | | | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2024 | | | | | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2025 | | | | | | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2026 | | | | | | | \$18,742,500 | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2027 | | | | | | | | \$18,742,500 | \$18,742,500 | \$18,742,500 |
| 2028 | | | | | | | | | \$18,742,500 | \$18,742,500 |
| 2029 | | | | | | | | | | \$18,742,500 |
| Annual Total | | \$18,742,500 | \$37,485,000 | \$56,227,500 | \$74,970,000 | \$93,712,500 | \$112,455,000 | \$131,197,500 | \$149,940,000 | \$168,682,500 |
| Grand Total | \$843,412,500 | | | | | | | | | |

Note: Analysis includes unlikely front-loading of grant disbursements through equal disbursements in each year of the grant term. Projection based on 85% cap utilization (\$357 million total/\$29.75 million annually) and 63% company performance (\$18.7 million annually) in each award year.

LEGISLATIVE FISCAL NOTE – PURPOSE AND LIMITATIONS

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CONTACT INFORMATION

Questions on this analysis should be directed to the Fiscal Research Division at (919) 733-4910.

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June 18, 2020



Signed copy located in the NCGA Principal Clerk's Offices