

**NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE**

BILL NUMBER: SB 1227 (First Edition)
SHORT TITLE: Update IRC Reference/Conform Gift Tax
SPONSOR(S): Senators Kerr, Hoyle, Cochrane, Dalton, Hartsell, and Webster

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$ Millions)				
	<u>FY 1998-99</u>	<u>FY 1999-00</u>	<u>FY 2000-01</u>	<u>FY 2001-02</u>	<u>FY 2002-03</u>
REVENUES					
GENERAL FUND	(\$13.13)	(\$12.03)	(\$14.85)	(\$20.73)	(\$34.77)
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue					
EFFECTIVE DATE: Section 4 (Qualified Tuition Programs) becomes effective for taxable years beginning on or after January 1, 1998. The remainder of the act is effective when it becomes law.					

BILL SUMMARY: The act updates the reference to the Internal Revenue Code used in defining and determining certain state tax provisions (from January 1, 1997 to June 1, 1998) and conforms to federal gift tax treatment of contributions to qualified tuition programs.

BACKGROUND: Each year the General Assembly changes the reference date in the definition of the Internal Revenue Code used in the state individual and corporate income tax statutes. Congress made hundreds of changes in the Code with the passage of the Taxpayer Relief Act of 1997. These changes were reviewed by the Revenue Laws Study Committee and were recommended to the 1998 General Assembly with a few exceptions. Those tax law changes that affect the 1997 tax year cannot be adopted by North Carolina until 1998, because the state constitution prohibits enacting a retroactive tax increase.

ASSUMPTIONS AND METHODOLOGY: North Carolina estimates on updating the Internal Revenue Code reference are based on a percentage of the federal estimate calculated by the Congressional Joint Committee on Taxation. The percentage used is North Carolina's actual tax collections divided by national tax collections. (Individual = .723% and corporate = .542%.) The charts on the following pages show the fiscal impact of the major federal tax changes on the state's General Fund.

As for the gift tax change on qualified tuition programs, there should be little or no revenue loss to the state. The newly created College Vision Fund, administered by the State Education

Assistance Authority, is designed for middle income taxpayers who save an average of \$125 a month for their children's college education. While gifts exceeding \$10,000 may be accepted by the fund, such contributions are not the norm. Those with the means to give more than \$10,000 per year will probably invest in college trust funds bearing interest greater than the interest paid by the State Treasurer on the investments in the College Vision Fund.

INTERNAL REVENUE CODE UPDATE

STATE IMPACT

	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Affects Individual Income Tax Only						
Exclude capital gain from sale of residence	5/6/97	-3.62	-3.62	-3.62	-4.34	-4.34
Expand deduction for self-employed individuals' health insurance	2000	-	-0.28	-0.87	-1.62	-4.37
Establish Roth IRAs/Expand existing IRAs	1/1/98	-2.49	0.62	-2.50	-6.22	-13.23
Establish education IRAs	1/1/98	-4.66	-6.59	-7.66	-8.14	-10.47
Add room and board as qualifying expenses for Prepaid Tuition Programs	8/21/96	No impact - NC already exempts these expenses				
Reenact employer-provided educational assistance	1/1/97	-2.67	-1.81	-	-	-
Allow deduction of interest paid on qualified higher education loans	1/1/98	-0.50	-0.88	-1.47	-2.00	-2.23
Restrict penalty for underpayment of estimated income tax	12/31/97	-0.12	-0.13	-0.14	-0.14	-0.15
Increase standard deduction for individuals claimed as dependent by another	1/1/98	-0.27	-0.25	-0.25	-0.25	-0.25
Change net operating loss carryback and forward periods	1/1/98	0.22	0.26	0.19	0.13	0.10
Increase charitable mileage rate from 12 cents to 14 cents	1/1/98	-0.40	-0.42	-0.44	-0.46	-0.49
Extend deduction for FMV of stock contributed to private foundation	6/1/97	-0.07	-0.03	-	-	-
Expand rules on home office as principal place of business	1/1/99	-0.86	-1.76	-1.83	-1.90	-1.98
Exclude capital gain from sale of qualified small business stock	8/1/97	-0.36	-0.36	-0.36	-0.36	-0.36
Increase maximum amount of self-employed 401(k) contributions	1/1/98	No estimate available				
Modify tax treatment of Employee Stock Ownership Plans (ESOP) in S corporations	12/31/97	-0.17	-0.25	-0.30	-0.32	-0.33
Change tax treatment of rural mail carriers' reimbursed mileage	1/1/98	-0.01	-0.01	-0.01	-0.01	-0.01
Defer gain from sale of livestock due to drought, flood or other weather related event	1/1/97	-0.01	-0.01	-0.01	-0.01	-0.01
Expand business meals/entertainment deduction for air transportation employees, truck drivers, railroad employees, and merchant marines	1/1/98	-0.12	-0.20	-0.27	-0.35	-0.45

Internal Revenue Code Update (Continued)	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Affects Individual Income Tax Only						
Clarify exclusion of the value of employer-provided parking	1/1/98	0.06	0.08	0.09	0.09	0.09
Increase exclusion of income earned by US citizens residing in foreign countries		-0.22	-0.36	-0.48	-0.59	-0.70
Exclude from income the disability payments to former police officers and fire fighters retroactive to 1989, 1990, and 1991		-	-	-	-	-
Exclude from income government survivor annuities to slain public safety officers	1/1/97	-0.01	-0.01	-0.01	-0.01	-0.01
Deny nonrecognition of gain of involuntarily converted property	6/8/97	0.03	0.04	0.06	0.08	0.09
Provide an above the line deduction for state and local officials' expenses	1/1/87	-0.03	-0.03	-0.03	-0.04	-0.04
Change basis recovery method for pension plan payments modified	12/31/97	0.02	0.04	0.07	0.08	0.11
Simplify treatment of personal transactions in foreign currency	12/31/97	-0.01	-0.01	-0.01	-0.01	-0.01
Increase full funding limit with 20 year amortization for pensions	12/31/98	-0.03	-0.09	-0.10	-0.13	-0.14
Affects Partnerships (Individual Income Tax)						
Classify sale or exchange of inventory in partnership as ordinary income	8/5/97	No impact - NC already taxes as ordinary income				
Change formula for allocation of basis among distributed assets of partnership	8/5/97	0.38	0.40	0.41	0.43	0.44
Extend period from 5 to 7 years for recognition of precontribution gains	6/8/97	-	-	-	0.01	0.07
Affects both Individual and Corporate Income Tax						
Extend R&D tax credit retroactive to 6/1/97	6/1/97	Costs included in the Bill Lee act				
Restrict income forecast method of depreciation	8/6/97	0.30	0.45	0.56	0.27	0.20
Eliminate short against the box transaction for stock	6/8/97	0.87	0.49	0.53	0.57	0.61
Require immediate accrual of interest on pool of debt instruments	8/5/97	1.99	2.59	2.31	2.05	0.72
Allow expensing of certain environmental remediation costs for brownfields	8/5/97	-0.95	-1.19	-0.46	0.00	0.01
Allow inventory adjustment for estimated shrinkage	8/5/97	-0.15	-0.17	-0.18	-0.20	-0.21
Change gain recognition rules under sections 1233 and 1234A of the Internal Revenue Code	8/5/97	0.20	0.18	0.18	0.18	0.18

Internal Revenue Code Update (Continued)	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Affects Both Individual and Corporate License Tax						
Include income from notional principal contracts and stock lending transactions in gross income of U.S. shareholders	8/5/97	0.14	0.15	0.15	0.15	0.15
Restrict like-kind exchanges involving foreign personal property	6/8/97	0.06	0.08	0.09	0.11	0.12
Limit treaty benefits for payments to hybrid entities	8/5/97	0.01	0.01	0.01	0.01	0.01
Exempt certain securities positions from U.S. property definition under subpart F	12/31/97	-0.01	-0.01	-0.01	-0.01	-0.01
Exempt active financing income from subpart F	1998	-0.49	-0.02	0.00	0.00	0.00
Modify look-back method for long term contracts	8/5/97	-0.01	-0.02	-0.03	-0.03	-0.03
Affects Corporate Income Tax Only						
Recognize gain from exchange of property for preferred stock treated as boot	6/8/97	0.20	0.21	0.22	0.23	0.05
Expand charitable deduction for corporate contributions of computer software and equipment	1/1/98	-0.26	-0.42	-0.27	-0.03	-0.01
Repeal income deferral when farms change from cash method to accrual method	7/1/96	0.18	0.19	0.20	0.20	0.21
Allow Subchapter S subsidiaries to be treated as separate corporations	1/1/97	No estimate available				
Clarify that software qualifies as export property	1/1/98	-0.23	-0.79	-0.94	-0.98	-1.04
Restrict corporate deductions relating to life insurance	8/6/98	0.29	0.50	0.76	1.05	1.34
Require recognition of gain from extraordinary dividend and other changes	9/13/95	-0.50	-0.29	-0.05	0.24	0.42
Repeal law allowing manufacturers to use installment method to report sales to their dealers	8/6/98	0.24	0.53	0.57	0.57	0.35
Require gain recognition on certain distributions of controlled corporation stock and change tax treatment of redemptions involving related corporations	6/8/97	1.37	1.20	1.04	0.88	0.73
Deny interest deduction on convertible debt	6/8/97	0.09	0.16	0.23	0.30	0.34
Defer gain allowed on sales of stock of certain corporations engaged in refining or processing agricultural products to farmer cooperatives engaged in marketing agricultural products	12/31/97	-0.37	-0.03	-0.03	-0.02	-0.02
Modify control test and include attribution rules to determine unrelated business income tax consequences of certain payments from subsidiaries of tax-exempt organizations	12/31/98	0.00	0.00	0.02	0.03	0.03
Repeal 30% gross income limitation for regulated investment companies	8/5/97	-0.12	-0.15	-0.18	-0.21	-0.24

Internal Revenue Code Update (Continued)	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Affect Other NC Taxes						
Extend generation-skipping transfer tax exemption to grandnieces and grand nephews	1/1/98	-0.03	-0.03	-0.03	-0.03	-0.03
Total - IRC Update		-13.13	-12.03	-14.85	-20.73	-34.77
Gift Tax						
Treat contributions in excess of \$10,000 to state pre-paid tuition plans as being made ratably over a five year period	1/1/98	Negligible revenue effect				
Technical/Minor Impact						
Clarify that self-employed individual is eligible to deduct long term care insurance even if employer provides health insurance		No estimate available				
Recapture all depreciation on section 1250 property		No estimate available				
Clarify that medical savings account withdrawals are for individual who was eligible in the month the expenses were incurred		No estimate available				
Treat estate and its beneficiaries as related parties for purpose of disallowing loss deduction for sales of assets	8/5/97	Negligible revenue effect				
Relax luxury auto depreciation limits for clean burning fuel vehicles and electric vehicles	8/5/97	-0.01	0.00	0.00	0.00	0.00
Allow employer deduction for contributions to SIMPLE 401(k) with no 15% cap	1/1/97					
Allow securities traders and commodity traders and dealers to elect mark to market accounting rules	8/5/97	No estimate available				
Exclude from unrelated business tax income certain corporate sponsorship payments	12/31/97	Negligible revenue effect				
Change treatment of travel expenses of certain federal employees engaged in criminal investigations	8/6/97	No revenue impact				
Close partnership taxable year with respect to deceased partner	12/31/97	No revenue impact				
Deduct contributions made by ministers to retirement plans	12/31/97	Negligible revenue effect				
Clarify tax-free employer-provided employee meals	1/1/97	No revenue impact				
Authorize MedicarePlus Choice Medical Savings Accounts pilot program	1/1/99	No estimate available				

Internal Revenue Code Update (Continued)	Effective Date	(\$Millions)				
		98-99	99-00	00-01	01-02	02-03
Reduce carryback period for general business credits, but increase carry forward	1/1/98		Negligible revenue effect			
Repeal 30% gross income requirement for real estate investment trusts	8/5/97		Negligible revenue effect			

NOTES:

1) North Carolina estimates are based on a percentage of the federal estimate calculated by the Congressional Joint Committee on Taxation. The percentage used is N.C. actual tax collections divided by national tax collections. (Individual = .723% Corporate = .542%)

2) The North Carolina constitution prohibits enacting a retroactive tax increase, so this bill cannot adopt federal revenue increasing items for the 1997 tax year. This chart assumes that half of the revenue gained from tax increases in 1997 will be received by the Department in Tax Year 1998.

FISCAL RESEARCH DIVISION
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