This Bill Analysis reflects the contents of the bill as it was presented in committee.

# SENATE BILL 338: Economic Development/Tax Modifications

*2015-2016 General Assembly*

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| **Committee:** | Senate Re-ref to Commerce. If fav, re-ref to Finance. If fav, re-ref to Appropriations/Base Budget | **Date:** | April 22, 2015 |
| **Introduced by:** | Sens. Berger, Brown, Tillman | **Prepared by:** | Cindy Avrette<br>Dan Ettefagh<br>Committee Counsel |
| **Analysis of:** | First Edition | | |

***SUMMARY: Senate Bill 338 would adopt a single sales factor apportionment formula and reduce the corporate income tax rate to 3%. It would also modify the Job Development Investment Grant program (JDIG) to address concerns over the geographic distribution of the awards and provide special incentives for "high yield projects".***

## PART I. ELIMINATE CORPORATE TAXATION ON NORTH CAROLINA EMPLOYMENT AND CAPITAL INVESTMENT

Part I of the bill would move from a double-weighted sales factor apportionment formula to a single sales factor apportionment formula, effective for taxable years beginning on or after January 1, 2016.

A corporation that does business in more than one state must pay income tax to each of the states in which it has nexus. The U.S. Supreme Court cases have upheld the right of states to tax the income of multistate corporations so long as the income is fairly sourced to the taxing state. The conventional method used by states to source income has been the apportionment formula, which is used to derive an apportionment percentage. Generally speaking, a taxpayer multiplies its taxable income by its apportionment percentage to determine the amount of its income sourced to a state. The state's corporate income tax rate is applied to the corporation's income apportionable to that state.

In the 1960s, most states began to adopt an apportionment formula based on or substantially similar to the Uniform Division of Income for Tax Purposes Act (UDITPA).[1] The UDITPA formula is a composite of three factors: a property factor, a payroll factor, and a sales factor. Under UDITPA, the sum of the three factors is divided by three, resulting in a taxpayer's apportionment percentage. The purpose of the three factors are to give a reasonable approximation of the share of a company's profit that arises from doing business in a state, based on both the demand for company output in the state (sales factor) and the production activity in which it engages in the state (property and payroll factors).

In recent years, states have moved away from the three-factor formula towards a formula weighted more heavily by sales. The more weight given to the sales factor the more the formula tends to favor home-state industries that have a concentration of their total facilities in a state but sell their products all over the country. North Carolina shifted to a double-weighted sales factor apportionment formula in 1988 at the request of RJR Nabisco.[2] In 2009, North Carolina provided single sales factor apportionment

[1] UDITPA dates back to 1957.

[2] RJR Nabisco had plans for a large automated bakery in the Garner area. After the change was adopted, RJR Nabisco was bought out and forced to cut back on capital expenditures. The company never built the plant.



*This bill analysis was prepared by the nonpartisan legislative staff for the use of legislators in their deliberations and does not constitute an official statement of legislative intent.*

formula for capital intensive corporations at the request of Apple.[3] North Carolina also allows single sales factor apportionment for public utility companies and for excluded corporations.[4]

In a chart published by the Federation of Tax Administrators, only nine states are using a three-factor formula for the 2015 taxable year. Twelve states use a double weighted formula similar to North Carolina and more than 21 states have moved to a single sales factor formula.5

A single sales factor arguably makes a state a more attractive place for businesses to expand their property and payroll because if those factors are ignored in calculating a state's corporate tax, then a business can hire employees or build a plant without incurring additional tax on its corporate profits. All companies will not benefit from a single sales factor apportionment formula. The majority of North Carolina businesses are not multi-state corporations that apportion income and any change in the formula will not benefit them.

**PART II. CORPORATE INCOME TAX MODIFICATIONS**

Part II reduces the corporate income tax rate over two years from 5% to 4% for the 2016 taxable year and from 4% to 3% for the 2017 taxable year and thereafter.

In 2013, the General Assembly reduced the corporate income tax from 6.9% to 6% for the 2014 taxable year and 5% for the 2015 taxable year. In addition to these rate reductions, the law provided for a potential 1% rate reduction for taxable year 2016 if net General Fund tax collections for fiscal year 2014-15 meet the statutory target amount of $20,200,000,000 and a potential 1% rate reduction for taxable year 2017 if net General Fund tax collections for fiscal year 2015-16 meet the statutory target amount of $20,975,000,000. It is not anticipated that the rate triggers will be met for fiscal 2014-15 or for fiscal year 2015-16. This bill would repeal the statute that contains the trigger because the statute is obsolete and no longer necessary.

**PART III. JDIG MODIFICATIONS**

JDIG is a discretionary program of the State that provides funds to incentivize new or expanding business to create jobs in the State. The amount of the JDIG incentive to a company is equal to a percentage between 10% to 75% of the personal income tax withholdings generated by the eligible created positions.[6] If the business is in a tier 2 or 3 area, the incentive paid to the business is automatically reduced by 15% or 25%, respectively, and that portion is diverted into the Utility Account. The JDIG agreement can be for a term of up to 12 years. The amount that can be committed in JDIG grants has generally been capped at $15M per calendar year; however, the current cap is based on the 2013-15 biennium and is $22.5M, and the cap for 7/1/15 through 12/31/15 is $7.5M. Presuming a use of $1M of the allowed cap for a period and a term of 12 years, a $1M commitment would be paid each year of the 12-year term if the company met all required metrics, for a total commitment of $12M. The authority to enter new JDIG agreements is currently set to expire 1/1/16.

Part III of the bill makes modifications to the JDIG program, as follows:

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[3] Apple built its East Coast data center in Maiden, NC. To receive the single sales factor apportionment formula, it had to invest at least $1 billion in the infrastructure hub and employs at least 50 full-time employees.

[4] An excluded corporation is corporation engaged in business as a building or construction contractor, a securities dealer, or a loan company or a corporation that receives more than fifty percent (50%) of its ordinary gross income from intangible property.

[5] Surrounding states: TN has a double-weighted sales apportionment formula. SC and GA have a single sales factor apportionment formula. VA has a double weighted/sales formula. (Federation of Tax Administrators, February 2015)

[6] The amount of the incentive paid to a company is automatically decreased by 25% or 15% for tier 3 and tier 2 projects, respectively, with that percentage going to the Utility Account for infrastructure projects that are reasonably expected to create jobs in economically distressed counties (i.e. tier 1 and 2 counties).

1. It identifies a special category of projects as "high-yield projects" if the company will invest at least $1B in private funds and will create at least 2,500 jobs. In a year when a high-yield project is acquired, the traditional JDIG calendar year cap of $15M is, for that year, increased to $30M. If the company meets the minimum requirements for investment and job creation and if the company then meets all metrics of the performance agreement for three consecutive years, the JDIG award is augmented for subsequent years in the following ways:
    a. The calculation of the award can be increased from 75% of the withholdings associated with the created, eligible positions to 100% of those withholdings.
    b. The limitation on the term of the agreement is increased from 12 years to 20 years.
    c. The requirement that diverts a portion of the grant from the business to the Utility Account is eliminated.

    If the high-yield project fails to meet performance metrics after receiving the augmented award in any year, the augmented benefits expire and the company cannot, thereafter, regain the augmented benefits.

2. It addresses concerns about temporal distributions of JDIG awards during a single calendar year by making the $15M annual cap available in calendar quarter installments of $3.75M. Amounts within a single calendar year not utilized in a quarter roll over to the next quarter. This limitation does not apply to an award made to a high-yield project.

3. It addresses concerns about geographic distributions of JDIG awards in the following ways:
    a. It categorizes as major market communities the 3 counties with the highest average weekly wage for insured private employers.[7]
    b. It limits the amount of JDIG awards to major market communities to no more than twice the percentage of the community's population as compared to the State population. This limitation does not apply to an award made to a high-yield project.
    c. It converts the flat maximum percentage of withholdings that can be used to calculate the JDIG award from 75% to a tiered maximum percentage equal to 80% for tier 1, 70% for tier 2, 60% for tier 3, and 50% for major market communities.
    d. It modifies the minimum job creation requirements for JDIG projects from 10 jobs for tier 1 and 20 jobs for tiers 2 and 3 to 25 jobs for tier 1, 50 for tier 2, 200 for tier 3, and 250 for major market communities.
    e. It adds a wage standard requirement not currently in place for JDIG that requires the created jobs to pay an average weekly wage equal to or greater than a percentage of the average wage for all insured private employers in the county. The applicable percentage is 100% for tier 1, 110% for tier 2, 115% for tier 3, and 125% for major market communities.

4. The bill extends the authority to enter new JDIG agreements from 1/1/16 to 1/1/18.

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[7] Currently, the counties that are major market communities are the counties of Wake, Mecklenburg, and Durham.