NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: House Bill 1430 (Third Edition)

SHORT TITLE: IRC Update.

SPONSOR(S):

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

($Million)

	FY 2004-05	**FY 2005-06**	**FY 2006-07**	**FY 2007-08**	**FY 2008-09**
REVENUES					
General Fund					
IRC Update	(2.6)	(5.0)	(5.5)	(6.3)	(6.6)
Low-Income Housing				(18.6)	(37.5)
Sales Tax Clarification		No Fiscal Impact			
Electricity Sales Tax	0	9.65	9.68	9.71	9.74
Total General Fund	(2.6)	4.65	4.18	(15.2)	(34.4)
Utilities Special Fund	$12.6				
Insurance Reg. Fund	$24.1				
AOC – Family Court Fee		No Estimate Available			

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue; Utilities Commission; Department of Insurance; North Carolina Housing Finance Agency; Administrative Office of the Courts

EFFECTIVE DATE: Part 2 (Utilities Commission fee) and Part 5 (sales tax clarification) become effective July 1, 2004. Part 6 (electricity sales tax) becomes effective October 1, 2004 and applies to sales of electricity made on or after that date. All other parts of the bill are effective when the act becomes law.

BILL SUMMARY: This act updates the reference to the Internal Revenue Code used in defining and determining certain state tax provisions, sets the public utility and insurance regulatory fees, extends the sunset on the low-income housing tax credit, clarifies the sales tax incentives for major projects, maintains the current sales tax rates on electricity sold to manufacturers, sets temporary sales tax rate on electricity sold to aluminum smelters; and creates a fee for services received from a supervised visitation and exchange center through a family court program.

ASSUMPTIONS AND METHODOLOGY:

PART 1. IRC Update

Part 1 of the bill conforms the North Carolina tax code to changes made in the Internal Revenue Code in 2003 and 2004 by Congressional approval of P.L. 108-121, The Military Family Relief Act of 2003, P.L. 108-173, The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 and P.L. 108-218, The Pension Funding Equity Act of 2004.

I. The Military Family Relief Act

Of the ten major provisions in the Military Family Relief Act of 2003 (H.R. 3365), only two have a fiscal impact on North Carolina. The first major change is in the exclusion of gain from the sale of a principal residence. Current tax law allows an individual to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale of a principal residence. The taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of sale. The Military Family Relief Act of 2003 allows a member of the Armed Forces, Public Health Service, National Oceanic and Atmospheric Administration, or the Foreign Service to suspend for a maximum of ten years the five-year principal residence test. To qualify, these federal employees must be stationed more than 50 miles from their principal residence for duty in excess of 90 days. The provision is effective for sales made after May 6, 1997 and these employees have one year (November 11, 2003 to November 11, 2004) to apply for a refund.

The staff of the Congressional Joint Committee on Taxation (JCT) estimates that this exclusion will cost the federal treasury $68 million in the first year due to the refund provision. The federal loss in the following years is $14 million to $17 million a year. Both the Tax Research Division of the Department of Revenue and the Fiscal Research Division of the General Assembly base the North Carolina tax impact on the JCT estimate. The chart below shows the JCT estimate of federal tax loss divided by the capital gains tax rate of 25% to determine the loss in federal taxable income. Since the Department of Defense reports that 2.44% of active military personnel in the US claim North Carolina as their residence, then this percentage multiplied by the federal taxable income yields the loss of state taxable income. Multiplying the average personal income tax paid in 2001 (6.8%) times the North Carolina taxable income results in the estimated tax loss for this provision.

			($Million)		
Exclusion on Gain of Principal Residence	**FY 04-05**	**FY 05-06**	**FY 06-07**	**FY 07-08**	**FY 08-09**
JCT Estimate of Federal Tax Loss ($Millions)	($68.0)	($14.0)	($14.0)	($15.0)	($15.0)
Divide By Capital Gains Tax Rate on Sec 1250 gains	25%	25%	25%	25%	25%
Estimated Loss of Federal Taxable Income	($272.0)	($56.0)	($56.0)	($60.0)	($60.0)
Multiply By NC Residents as Percent of Total Military	2.44%	2.44%	2.44%	2.44%	2.44%
Estimated Loss of NC Taxable Income	($6.6)	($1.4)	($1.4)	($1.5)	($1.5)
Multiply By NC Average Tax Rate	6.8%	6.8%	6.8%	6.8%	6.8%
Estimated NC Tax Loss	**($0.5)**	**($0.1)**	**($0.1)**	**($0.1)**	**($0.1)**

The second provision of the Military Family Relief Act of 2003 that has a fiscal impact on North Carolina is an above the line deduction for the travel expenses of the National Guard and Reserves. Currently, National Guard and Reserve personnel may claim as itemized deductions their non-reimbursable expenses for transportation, meals, and lodging when they stay overnight for National Guard and Reserve meetings. However, these expenses must exceed 2% of a taxpayer's adjusted gross income (AGI) to be claimed. The provision in the Military Family Relief Act allows an above the line deduction on the transportation, meals, and lodging expenses of National Guard and Reserves who travel more than 100 miles and stay overnight at National Guard and Reserve meetings.

Again, the Joint Committee on Taxation estimate of the national revenue loss for this deduction is used. To obtain federal taxable income, the federal tax loss is divided by the average federal tax rate of 21.9%. To get state taxable income, the federal taxable income is multiplied by North Carolina's percentage of the U.S. Selected Reserve personnel (2.57%). Selected Reserve includes Air and Army National Guard; Army, Navy, Air Force, and Marine Corps Reserves, and when detached from the Department of Homeland Security to the Department of the Navy, the Coast Guard Reserve. The North Carolina taxable income is multiplied by the average income tax rate of 6.8% to obtain the North Carolina tax loss from conforming to this provision.

			($Million)		
Above the Line Deduction for Reserve and Guard	**FY 04-05**	**FY 05-06**	**FY 06-07**	**FY 07-08**	**FY 08-09**
JCT Estimate of Federal Tax Loss ($Millions)	($90.0)	($77.0)	($78.0)	($80.0)	($82.0)
Divide By Average Federal Tax Rate	21.9%	21.9%	21.9%	21.9%	21.9%
Estimated Loss of Federal Taxable Income	($411.5)	($352.1)	($356.7)	($365.8)	($374.9)
Multiply NC Selected Reserve as Percent of Total	2.6%	2.6%	2.6%	2.6%	2.6%
Estimated Loss of NC Taxable Income	($10.6)	($9.0)	($9.1)	($9.4)	($9.6)
Multiply By NC Average Tax Rate	6.8%	6.8%	6.8%	6.8%	6.8%
Estimated NC Tax Loss	**($0.7)**	**($0.6)**	**($0.6)**	**($0.6)**	**($0.7)**

II. Medicare Prescription Drug, Improvement, and Modernization Act

There is one provision in the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (HR1) that will impact North Carolina revenues. This bill creates Health Savings Accounts (HSAs) that provide tax-favored treatment of savings for medical expenses under a high deductible health plan. A person is eligible for a HSA if he or she has a health plan with a deductible that is at least $1,000 for self only coverage or $2,000 for family coverage and the plan has an out-of-pocket expense limit that is no more than $5,000 for an individual or $10,000 for a family. Out-of-pocket expenses include deductibles, co-payments, and other amounts (other than premiums) spent for covered benefits under the plan.

Individual contributions to a HSA are deductible from adjusted gross income and employer contributions to a HSA are excludable from gross income and wages for employment tax purposes. Distributions from a HSA for qualified medical expenses are excluded from gross income. HSA distributions not spent on qualified medical expenses are included in gross income and subject to an additional 10% tax.

The Department of Insurance reported to the Fiscal Research Division in May 2004 that the following companies have high deductible health plans that are HSA eligible:

John Alden
Fortis
United Wisconsin Life
Medical Security
American Republic has a product pending approval.

As in previous examples, the Joint Committee on Taxation is used to determine the North Carolina revenue loss. The federal tax loss is divided by the average federal tax rate of 21.9% to determine the federal taxable income. State taxable income is 2.9% of the federal taxable income based on 2003 US Census population data. Multiplying the state taxable income times the 6.8% average state income tax rate yields the state tax loss from this provision.

			$Million)		
Health Savings Account	**FY 04-05**	**FY 05-06**	**FY 06-07**	**FY 07-08**	**FY 08-09**
JCT Estimate of Federal Tax Loss	($160)	($474)	($533)	($597)	($650)
Divide By Average Federal Tax Rate	21.9%	21.9%	21.9%	21.9%	21.9%
Estimated Loss of Federal Taxable Income	($731.6)	($2,167.4)	($2,437.1)	($2,729.8)	($2,972.1)
Multiply By NC Population as a % of US	2.9%	2.9%	2.9%	2.9%	2.9%
Estimated Loss of NC Taxable Income	($21.2)	($62.7)	($70.5)	($78.9)	($85.9)
Multiply By NC Average Tax Rate	6.8%	6.8%	6.8%	6.8%	6.8%
Estimated NC Tax Loss	**($1.4)**	**($4.3)**	**($4.8)**	**($5.4)**	**($5.8)**

III. The Pension Funding Equity Act

The primary aim of the Pension Funding Equity Act of 2004 (H.R. 3108) is to reduce mandatory corporate contributions to defined benefit pension plans in 2004 and 2005. (In defined benefit plans, employers pay monthly pensions to retired workers usually based on their salary and years of service.) More specifically, the act changes the interest rate employers use to calculate their required pension contributions, provides temporary relief from additional contributions required of companies that have pension plans that are less than 90% funded, and allows multiemployer pension plans to defer for up to three years the amortization of part of the stock market losses that they incurred during the 2000 to 2002 period.

The Congressional Joint Committee on Taxation (JCT) estimates this legislation will produce a federal revenue gain for the first three fiscal years, then a loss in later years. Since a portion of employer contributions to qualified retirement plans is deductible from federal income tax, then a reduction in corporate payments into retirement funds will reduce the amount of corporate deductions and, thus, increase taxable income. Beginning in 2007, taxable income will fall as companies increase their retirement contributions and deduct these increasing contributions.

Normally the General Assembly and the Department of Revenue rely on the JCT estimates when computing the North Carolina share of tax loss or gain from federal legislation. When JCT was contacted for information on the Pension Funding Equity Act of 2004, the agency declined to share the methodology they used to estimate the change in revenue. The Congressional Budget

Office, a co-author of some of the bill analysis, was also contacted and referred all questions to JCT. Because of the complexity of this bill and the uncertainty of whether N.C. companies will take advantage of the bill's provisions, no estimate will be attempted on this federal act until the legislative and Revenue staff can verify the validity of the JCT estimate.

PART 2. Regulatory Fee for Utilities Commission

Part 2 of the bill sets the fees for regulation by the North Carolina Utilities Commission (Commission). Section 2.1 sets the public utility regulatory fee rate at 0.12% for FY 2004-05 (same rate as FY 2003-04). Revenue from this fee, which is assessed against regulated public utilities, is used to support the operations of both the Commission and the Public Staff. The Commission estimates the 0.12% regulatory fee will produce $12,600,000 in FY 2004-05. For the same period, the Commission estimates that the combined operations of the Commission and Public Staff will require total expenditures of not less than $12,616,620. The cash balance in the Commission's Accumulated Fee Margin Reserve Account and other special funds as of May 30, 2004 was $7.9 million. This represents approximately 7.5 months of operating reserve. At fiscal year end, the Commission estimates it will have a cash balance of approximately $6.95 million in the fund.

Section 2.2 sets the public utility regulatory fee to be paid by the North Carolina Electric Membership Corporation for the 2004-05 fiscal year at $200,000. This fee has remain unchanged since 1999 when discussions between the Utilities Commission and the industry determined $200,000 was the cost associated with regulating the electric membership cooperatives. In 2001, the Utilities Commission provided information to the General Assembly's Fiscal Research illustrating that these fees supported approximately 4000 hours of accounting, engineering, and legal time. This fee amount must be set by the General Assembly each year.

PART 3. Insurance Regulatory Charge

Part 3 of the bill sets the insurance regulatory charge at 5% for calendar year 2004. This fee is assessed against the 1.9% premiums tax paid by insurers and Article 65 companies (Blue Cross/Blue Shield) or against the presumed premiums tax that would be paid by HMOs if taxed at 1.9% (they are taxed at 1%). The revenue is used to reimburse the General Fund for appropriations to the Department of Insurance to pay expenses incurred in regulating the insurance industry and other industries and to other departments as specified in G.S. 58-6-25(d).

The total of the premiums tax collections for FY 2004-05 and the presumed premiums tax is estimated to be $388.8 million. Applying the 5% regulatory fee to the $388.8 million base would generate $24.10 million in regulatory fee revenue.

The Department estimates that the operating expenses will be $25.9 million for FY 2004-05 and that the reserve will have a balance of $13.85 million at the beginning of FY 2004-05. The total available from the reserve fund of $13.85 million and the estimated collections of $24.10 million will be $37.95 million. The total available less the estimated operating expenditures of $25.9 million will leave a year-end reserve balance of $12.05 million. By statute, the reserve balance shall not exceed one-third of the estimated operating expenses. The $12.05 estimated reserve is above one-third of the estimated operating expenditures.

Based on the above, the regulatory surcharge rate of 5%, assessed against companies that pay a premiums tax as well as the HMOs, is sufficient to defray the estimated cost of the operations of the Department and provide for a reserve fund.

PART 4. Extend Low-Income Housing Credit Sunset

Part 4 of the bill extends the Low-Income Housing Tax Credit program from 2006 to 2010. In the Tax Reform Act of 1986, Congress created the Low-Income Housing Tax Credit (LIHTC) program to fund housing for low and moderate-income households. The North Carolina Housing Finance Agency receives a per capita tax credit that can be used for new construction or rehabilitation of housing. Beginning in 2003, the per capita federal credit amount was indexed to the CPI. From 1987 to 1999, this federal credit helped finance the construction of 21,423 low-income housing units in the state.

In 1999, the General Assembly created a state low-income housing credit equal to a percentage of the federal LIHTC. North Carolina is now one of 14 states with a low-income housing tax credit program. The state low-income tax credit was revised in 2002. Instead of a percentage of the federal credit, the housing developer's tax credit is a percentage of the eligible basis of the housing project that qualifies for the federal LIHTC. The tax credit amount is based upon city/county income and the affordability of the constructed housing units as follows:

Type of Development	Percentage of Basis for which Credit is Allowed
• Units are in a "Low Income" county or city • 40% of the qualified residential units are affordable to households whose income is 50% or less of area median income	30%
• Units are in a Moderate Income county or city • 50% of the qualified residential units are affordable to households whose income is 50% or less of the area median income	20%
• Units are in a High Income county or city • 50% of the qualified residential units are affordable to households whose income is 40% or less of the area median income	10%
• Units are in a High Income county or city • 25% of the qualified residential units are affordable to households whose income is 30% or less of the area median income	10%

A developer may elect to receive the credit in the form of either a direct tax refund or a loan generated by transferring the credit to the Housing Finance Agency (HFA). The HFA will offer the developer a 0% interest 30-year balloon (no payments until maturity) loan equal to the credit amount. Neither a direct tax refund nor a loan received as a result of the transfer of the credit is considered taxable income by the State.

CURRENT CREDIT PROGRAM

The 2003 tax year is the first year under the revised state low-income housing tax credit. The Housing Finance Agency (HFA) awarded $33,659,990 in state tax credits to 50 housing projects. All 50 project developers chose the 30 year no interest loan option. The Secretary of Revenue will transfer half of the 2003 credit amount, $16,829,995, to the HFA in July 2004 and transfer the remaining half of the credit in July 2005. In the remaining two years of the tax credit program, the cost to the General Fund is estimated to be $34.9 million in Tax Year 2004 and $36.5 million in Tax Year 2005 as shown in the chart below.

Award Year	Population	Fed Tax Credit Per Capita Amount	Federal Tax Credit (FTC)	FTC % of Basis	Basis Amount	Average State Tax Credit	Utilization	$ Impact
2004	8,407,248	$1.80	$15.1 mil.	8.5%	$178.0 mil.	20%	98%	$34.9 mil.
2005	8,557,738	$1.85	$15.8 mil.	8.5%	$186.2 mil.	20%	98%	$36.5 mil.

The actual fiscal year revenue loss is different from the tax year credits awarded, because the payments are spread over two fiscal years as shown in the chart below.

Tax Year	FY 04-05	FY 05-06	FY 06-07	FY 07-08
2003	$16,829,995	$16,829,995		
2004		$17,447,512	$17,447,512	
2005			$17,759,823	$17,759,823
Total	**$16,829,995**	**$34,277,507**	**$35,207,335**	**$17,759,823**

CREDIT FORMULA

The following factors must be estimated in order to determine the state tax credit.

I. POPULATION

In Notice 2004-21, the Internal Revenue Service (IRS) directs North Carolina to use 8,407,248 as its population estimate for the federal low-income housing tax credit in 2004. This 2004 population estimate is actually from the July 2003 estimate for North Carolina done by the U.S. Census Bureau.

The State Demographics Unit in the North Carolina Office of State Budget and Management estimates the state population will grow 17.9% from 2000 to 2010. Dividing this decade growth

projection by 10 yields an annual population growth of 1.79% that is applied to the 2004 estimate. Future year state populations are shown below.

Award Year	Population
2004	8,407,248
2005	8,557,738
2006	8,710,921
2007	8,866,847
2008	9,025,563
2009	9,187,121
2010	9,351,570

II. FEDERAL PER CAPITA CREDIT AMOUNT

Notice 2004-21 also sets the federal per capita credit amount for 2004 at $1.80. Beginning in 2003, this per capita credit amount is adjusted annually by the Consumer Price Index (CPI) and is rounded down to the nearest .05. The chart below shows the CPI projected by the U.S. Bureau of Labor Statistics for the years 2004 through 2011. The base rate of $1.80 is adjusted by the CPI as shown in the Actual column. The results of rounding down the rates to the nearest .05 are shown in the Rounded column.

	CPI	Actual	Rounded
2004	1.9%	$1.80	
2005	1.3%	$1.83	$1.80
2006	1.9%	$1.86	$1.85
2007	2.4%	$1.89	$1.85
2008	2.3%	$1.94	$1.90
2009	2.3%	$1.98	$1.95
2010	2.3%	$2.03	$2.00
2011	2.2%	$2.07	$2.05

The Rounded per capita amount multiplied by the Population estimate yields the annual federal low-income housing tax credit for the state. The North Carolina Housing Finance Agency may award these tax credits to developers of low-income housing projects.

Award Year	Population	Fed Tax Credit Per Capita Amount	Federal Tax Credit (FTC)
2004	8,407,248	$1.80	$15,133,046
2005	8,557,738	$1.80	$15,403,928
2006	8,710,921	$1.85	$16,115,204
2007	8,866,847	$1.85	$16,403,666
2008	9,025,563	$1.90	$17,148,570
2009	9,187,121	$1.95	$17,914,886
2010	9,351,570	$2.00	$18,703,141

III. STATE TAX CREDIT

The state tax credit is applied against the basis of the housing projects funded by the federal tax credits. Basis for this credit is the total cost of constructing the buildings minus items not subject to depreciation such as land and reserves. The Housing Finance Agency estimates the federal tax credit is equal to 8.5% of the eligible basis in the funded properties . Dividing the federal tax credit amount by 8.5% gives the project basis amount.

Award Year	Federal Tax Credit (FTC)	FTC % of Basis	Basis Amount
2004	$15,133,046	8.5%	$178,035,840
2005	$15,403,928	8.5%	$181,222,682
2006	$16,115,204	8.5%	$189,590,639
2007	$16,403,666	8.5%	$192,984,311
2008	$17,148,570	8.5%	$201,747,885
2009	$17,914,886	8.5%	$210,763,361
2010	$18,703,141	8.5%	$220,036,949

The state low-income housing tax credit varies by county income at rates of 10% (high income), 20% (moderate income), and 30% (low income). The HFA staff estimates the state credit in future years will average 20%. The 20% credit average is consistent with the 19.1% actual credit average in 2003. Finally, the HFA assumes that developers will utilize 95% of all credits. In 2003, 50 of 51 projects accepted the state credit for a utilization rate of 98%. This analysis assumes the 98% rate due to the 30-year no interest loan option of the credit.

Award Year	Basis Amount	Average State Tax Credit	Utilization	$ Impact
2004	$178,035,840	20%	98%	$34,895,025
2005	$181,222,682	20%	98%	$35,519,646
2006	$189,590,639	20%	98%	$37,159,765
2007	$192,984,311	20%	98%	$37,824,925
2008	$201,747,885	20%	98%	$39,542,586
2009	$210,763,361	20%	98%	$41,309,619
2010	$220,036,949	20%	98%	$43,127,242

IV. FISCAL IMPACT OF CREDIT EXTENSION

This bill extends the state low-income housing tax credit four additional years – tax years 2006 through 2009. However, the tax year impacts shown above must be distributed by fiscal years. This analysis assumes that the project developers will continue to take the 30-year no interest loans. This means each tax year's credit amount will be transferred to the HFA in two annual installment payments. For example, the 2006 tax year credit amount will be paid in July 2007 (FY 2007-08) and July 2008 (FY 2008-09). The following chart shows the fiscal year impact of the tax credit program until its sunset date.

Tax Year	FY 07-08	FY 08-09	FY 09-10	FY 10-11	FY 11-12
2006	$18,579,883	$18,579,883			
2007		$18,912,463	$18,912,463		
2008			$19,771,293	$19,771,293	
2009				$20,654,809	$20,654,809
Total	**$18,579,883**	**$37,492,345**	**$38,683,755**	**$40,426,102**	**$20,654,809**

PART 5. Sales Tax Clarification

Section 5.1 clarifies that the sales tax refund on building materials, authorized in House Bill 2 of the 2003 Special Session, only applies to materials purchased for initial construction of projects valued at or over $100 million. Items purchased for repairs and renovations, and well as replacement equipment, would not qualify for a refund. Since this section codifies the Department of Revenue's current interpretation and practice, there is no fiscal impact.

PART 6. Maintain Current Sales Tax Rates on Electricity

Section 6.1 repeals the graduated sales tax rates on electricity purchased by manufacturers. These rates were enacted in Senate Bill 748 during the 2001 Session in reaction to an administrative ruling on the taxability of electricity in aluminum smelting operations. The Secretary of Revenue issued a Directive on February 14, 2000 that ruled electricity is not “an ingredient or component part of the materials being produced by a manufacturer in the operation of an arc furnace or an induction furnace”. The Secretary determined that electricity is a form of energy, not a form of matter or tangible property that the Legislature intended to exempt from tax. The Directive overruled previous private letter rulings from the Sales and Use Tax Division of the Department of Revenue that allowed a sales tax exemption for arc furnaces. Effective March 1, 2000, electricity used in arc furnaces once again became subject to the 2.83% sales tax. The Directive clarified that electricity used in induction furnaces is not tax exempt. The state’s only aluminum smelter, Alcoa Badin Works, began paying the 2.83% tax in March 2000.

Senate Bill 843 was introduced on April 4, 2001 to reverse the Revenue decision by exempting “sales to a manufacturer of electricity that is separately metered or measured and that is used in the electrolytic smelting process to manufacture aluminum." House Bill 959 went even further by exempting electricity sold to electrical charging processing, arc furnaces, and electrolytic process for manufacturing. While these bills failed to pass out of the Finance committees, the issue was revived on the House floor as an amendment to Senate Bill 748, Bill Lee Act Changes. The final version of SB 748 had a tax rate of .17% beginning January 1, 2002 for those manufacturers who use over 900,000 megawatt hours of power each year. The only firm eligible for this low rate is Alcoa Badin Works when at full production. SB 748 also included the following additional rates beginning in July 1, 2005:

2% = for manufacturers using between 250,000 and 900,000 megawatt hours each year
2.25% = for manufacturers using between 5,000 and 250,000 megawatt hours each year
2.83% = for manufacturers using less than 5,000 megawatt hours each year (current tax)

By repealing G. S. 105-164.4(a)(1g) and preventing the reduction of tax rates on electricity on July 1, 2005, the state will save approximately $9.6 million to $9.7 million each fiscal year. In February 2004, the major electric utilities in the state were asked to submit a list of their

manufacturing customers that consumed more than 5,000-megawatt hours of electricity each year. Each utility was asked to provide the amount of megawatt hours used and the amount paid by each manufacturer in fiscal year 2003. The current and proposed tax rates were applied to this data and the results are shown below.

Annual Megawatts	**Tax Rate**	**Duke Energy Customers**	**Progress Energy Customers**	**Dominion Customers**	**ElectriCities West Region**
Over 5,000 and up to 250,000	2.25%	531	595	26	5
Over 250,000 and up to 900,000	2%	2	12	1	0
Over 900,000	0.17%	0	0	0	0
General Fund Loss		**($3,131,175)**	**($6,026,335)**	**($400,766)**	**($35,203)**
Total General Fund Loss			**($9,593,479)**		

When the proposed tax rates are applied to customer bills in 2003, the General Fund loss of sales tax revenue equals approximately $9.6 million. To determine the future revenue loss from the new rates, the state's two major electric utilities were asked for their projection of electricity consumption by the manufacturing sector. Progress Energy replied that the projected growth in its industrial sector is .8% a year from 2004 to 2012. Duke Energy projects a .63% decline in consumption each year from 2004 to 2012. Applying these change rates to the manufacturer electricity consumption in 2003 yields the following revenue loss estimates for the 2% and 2.25% tax rates (Dominion and ElectriCities were held constant). Neither of the state's major utilities nor the Department of Revenue reported any facilities that qualified for the .17% tax rate.

	Duke Energy Customers	**Progress Energy Customers**	**Dominion Customers**	**ElectriCities West Customers**	**Total**
FY 2003-04	($3,131,175)	($6,026,335)	($400,766)	($35,203)	($9,593,479)
FY 2004-05	($3,111,449)	($6,074,546)	($400,766)	($35,203)	($9,621,963)
FY 2005-06	($3,091,846)	($6,123,142)	($400,766)	($35,203)	($9,650,958)
FY 2006-07	($3,072,368)	($6,172,127)	($400,766)	($35,203)	($9,680,464)
FY 2007-08	($3,053,012)	($6,221,504)	($400,766)	($35,203)	($9,710,485)
FY 2008-09	($3,033,778)	($6,271,276)	($400,766)	($35,203)	($9,741,023)
FY 2009-10	($3,014,665)	($6,321,446)	($400,766)	($35,203)	($9,772,081)

Section 6.3 reestablishes the .17% tax rate for aluminum smelting facilities for the period October 1, 2004 to October 1, 2007. As mentioned above, the debate on reduced rates began with Revenue ruling that electricity used in aluminum smelting was taxable at the Alcoa Badin plant. Unfortunately, Alcoa closed the Badin Works and laid off 300+ employees in

August 2002. (Alcoa permanently closed similar aging aluminum smelter facilities in Troutdale, Oregon and Rockdale, Texas.) The Badin plant continues to operate its anode and ingot casting facilities to supply material to Alcoa locations across the U.S. Analysts for the aluminum industry predict the aluminum smelters at Badin will not reopen until a strong economic recovery boosts demand and pushes prices up to make the plant competitive with newer facilities and low cost foreign producers. It is not known if the current upswing in the economy will make the Badin plant profitable enough to restart production. When the plant is in full production, the reduction in tax from 2.83% to .17% creates a General Fund revenue loss of $800,000 a year. Since it is unknown if and when the Badin plant will reopen, there is no revenue estimate for this section.

PART 7. Family Court Fees

Part 7 allows the Administrative Office of the Courts (AOC) to establish a fee of up to $30 for using a supervised custody/exchange center. These centers exist in several judicial districts and are funded by federal Violence Against Women Act (VAWA) funds. Use of these federal funds means that the centers can only serve a domestic violence victim population. By authorizing this fee, these centers can establish a separate funding source allowing them to serve any divorced couple with custody exchange issues. It is believed the fees will be deposited into a receipt fund within AOC with its use limited to supporting these centers. Section 7.1(b) authorizes AOC to set up a sliding scale of costs based on indigency. This is standard practice in the court system, and the language clearly waives the fee for Domestic Violence victims who are already getting services paid by VAWA. There is no estimate available on the revenue generated by this fee since it is unknown how many judicial districts will choose to impose it.

SOURCES OF DATA: Congressional Joint Committee on Taxation; Department of Revenue-Tax Research Division; Department of Defense "2002 Selected Manpower Statistics"; IRS "Statistics of Income Bulletin Fall 2003"; US Census Bureau "2003 US Statistics in Brief"; Department of Insurance; North Carolina Utilities Commission; NC Housing Finance Agency, Internal Revenue Service, State Demographics Unit in the North Carolina Office of State Budget and Management, Bureau of Labor Statistics; Progress Energy; Duke Energy; Dominion; ElectriCities of North Carolina; Alcoa

TECHNICAL CONSIDERATIONS: None

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DATE: June 17, 2004

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