NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: House Bill 73 (First Edition)

SHORT TITLE: Exempt Tobacco Compensation Payments

SPONSOR(S): Representative Baker, et al.

FISCAL IMPACT

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

($million)

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05
REVENUES					
General Fund					
Phase I		No estimate available			
Phase II	($9.7)	($7.2)	($10.4)	($13.1)	($13.1)
EXPENDITURES					

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

EFFECTIVE DATE: The act is effective for taxable years beginning on or after January 1, 1999.

BILL SUMMARY:
The bill exempts from corporate and individual income tax those payments made to tobacco farmers, tobacco workers, allotment holders and others as compensation for losses that have resulted from tobacco litigation, federal tobacco legislation, or reduced tobacco purchases by tobacco manufacturers. This bill specifically exempts payments from the Settlement Reserve Fund, a nonprofit corporation created pursuant to a consent decree in the State v. Phillip Morris settlement, and voluntary agreements with tobacco manufacturers.

ASSUMPTIONS AND METHODOLOGY:

PHASE II SETTLEMENT
The Phase II Settlement is an agreement between tobacco manufacturers and tobacco growers/ tobacco quota holders. The tobacco manufacturers will pay $5.15 billion over twelve years to 14 tobacco producing states to compensate growers and quota owners for the loss of income due to the reduction in the national marketing quota. North Carolina will receive 37.95% of these funds based on its share of the flue-cured and burley tobacco market. In 1999, the first year of the

program, North Carolina received $144,210,000. Future year distributions are shown in the chart below.

	Phase II Amount	N.C. Share 37.95%	Admin. Expense	Tax Year Disbursements	7% tax
1999	$380,000,000	$144,210,000	$5,000,000		
2000	$280,000,000	$106,260,000	$3,000,000	$139,210,000	$9,744,700
2001	$400,000,000	$151,800,000	$3,000,000	$103,260,000	$7,228,200
2002	$500,000,000	$189,750,000	$3,000,000	$148,800,000	$10,416,000
2003	$500,000,000	$189,750,000	$3,000,000	$186,750,000	$13,072,500
2004	$500,000,000	$189,750,000	$3,000,000	$186,750,000	$13,072,500
2005	$500,000,000	$189,750,000	$3,000,000	$186,750,000	$13,072,500
2006	$500,000,000	$189,750,000	$3,000,000	$186,750,000	$13,072,500
2007	$500,000,000	$189,750,000	$3,000,000	$186,750,000	$13,072,500
2008	$500,000,000	$189,750,000	$3,000,000	$186,750,000	$13,072,500
2009	$295,000,000	$111,952,500	$3,000,000	$186,750,000	$13,072,500
2010	$295,000,000	$111,952,500	$3,000,000	$108,952,500	$7,626,675
2011				$108,952,500	$7,626,675
Total	$5,150,000,000	$1,954,425,000	$38,000,000	$1,916,425,000	$134,149,750

Serving as depository and trustee for the Phase II funds is Chase Manhattan Bank. The Phase II funds are being administered by the Womble Carlyle Sandridge and Rice Settlement Administration Group in Winston-Salem. This firm is being paid $5 million in the first year and $12 million over the next four years to certify growers and quota owners for payments. The chart above assumes the $3 million a year administrative fee will continue for the duration of the program.

The first $81.1 million in checks were mailed on December 30, 1999 to tobacco growers and tobacco quota owners. By April 2000, total disbursements were $135.1 million. If the fund administrator continues to mail checks to farmers and quota holders as claims are certified, then the total distributions in the year 2000 will equal approximately $139.2 million (total receipts minus $5 million in administrative expenses). The payments are split evenly between growers and quota owners. Flue-cured growers and quota owners received 94.5% of the funds at a rate of $1.37 per pound of basic quota lost between 1998 and 1999. Burley growers and quota owners received 5.5% of the funds at a rate of $.68 per pound of basic quota lost between 1998 and 1999.

These cash payments are a source of income and are fully taxable at the state and federal level. According to an IRS opinion, the payments are taxable in the year received, not in the year the checks were mailed. Upon the request of the Fiscal Research Division of the General Assembly, the Department of Revenue is determining the tax liability of the Phase II grant recipients by matching a database of the Phase II grantees against 1998 income tax returns for these individuals and corporate entities (partnerships, LLCs, etc.). Since this data is not yet available, this note must assume that 100% of the Phase II payments are taxable (no offsetting losses) and the income is taxed at 7%, the midpoint of the individual income tax rates. Without the detailed tax data that is forthcoming from the Department of Revenue, this fiscal note assumes that Phase II recipients will report these grants on their annual tax returns in the spring of each year and not report the income in quarterly estimated payments. From the $139.2 million paid to growers and quota owners in the year 2000, the state will earn $9.7 million in income tax in FY 2000-01 when returns are filed in the spring of 2001. House Bill 1840, the 2000 Appropriations Act, includes $10 million in anticipated income tax earnings from Phase II and Federal grant payments in the FY 2000-01 budget availability. Exempting Phase II payments from income tax will reduce General Fund revenue each year until 2011.

PHASE I SETTLEMENT

North Carolina is sharing in the $206 billion Phase I Settlement between five major tobacco companies and the state attorneys general of 46 states, four territories, and the District of Columbia. North Carolina's share of the fund over the next twenty-five years equals approximately $4.5 billion. This figure is subject to annual adjustment based on changes in the volume of cigarette sales, inflation, and increases in federal taxes. To date, North Carolina has received $193.4 million and will receive an average of $164 million each year over the next five years.

The 1999 General Assembly approved Senate Bill 6 in order to divide up the state's share of the Phase I money. Fifty percent of the funds are allotted to a nonprofit corporation that has been named The Golden L.E.A.F., Inc. The articles of incorporation for this foundation state that its purpose is to provide economic impact assistance to economically affected or tobacco dependent regions of the state. The foundation can provide education assistance, job training and employment assistance, scientific research, economic hardship assistance, public works and industrial recruitment, health and human services, and community assistance to these regions. The Board of Directors for the foundation has not spent any of the $96.7 million it has received thus far from Phase I, nor has it issued a plan for expending the $81.9 million (average) it will receive each year for the next five years. There is no way to estimate the amount of cash assistance the foundation will award farmers, quota owners and others under the criteria of economic hardship assistance. Any cash payments will be taxable by the state and federal governments.

Senate Bill 6 directed the remaining 50% of the Phase I settlement funds be divided equally between a trust fund for the benefit of health and a trust fund for the benefit of tobacco producers, tobacco allotment holders, and persons engaged in tobacco related businesses. However, Senate Bill 6 failed to create the commissions to administer these funds. HB 1431 was introduced in 1999 to establish a Health Trust Fund Commission and a Tobacco Trust Fund Commission, but this bill remains in the Senate Rules Committee. HB 1823, introduced in the 2000 Session, creates the same Tobacco and Health Trust Fund Commissions, but this bill is still being debated in the House Select Committee on the Tobacco Settlement. At this time there is no way to estimate the amount of cash assistance these two commissions will give tobacco farmers and quota owners.

TECHNICAL CONSIDERATIONS:
The effective date should be changed to taxable years beginning on or after January 1, 2000 since tax year 1999 returns have been filed, except for extensions. While there were no known payments made in 1999 and thus no tax due in 1999, most tax exemptions and credits are prospective and not retroactive.

FISCAL RESEARCH DIVISION 733-4910

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