

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
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FISCAL IMPACT STATEMENT

LS 7573

BILL NUMBER: HB 1728

NOTE PREPARED: Feb 25, 2003

BILL AMENDED: Feb 18, 2003

SUBJECT: Internal Revenue Code Update.

FIRST AUTHOR: Rep. Crawford

FIRST SPONSOR: Sen. Borst

BILL STATUS: As Passed - House

FUNDS AFFECTED: X

X

**GENERAL
DEDICATED
FEDERAL**

IMPACT: State & Local

Summary of Legislation: (Amended) The bill indicates that the term "Internal Revenue Code" refers to the federal Internal Revenue Code as it existed on January 1, 2003. The bill requires bonus depreciation to be added back to federal adjusted gross income for purposes of determining taxable state adjusted gross income for purposes of the Adjusted Gross Income Tax and the Financial Institutions Tax.

Effective Date: January 1, 2003 (retroactive).

Explanation of State Expenditures:

Explanation of State Revenues: This bill updates the reference to the Internal Revenue Code (IRC) to incorporate all the federal changes made up to January 1, 2003. These changes will only impact tax years beginning January 1, 2003, even though some of the federal provisions are retroactive. This includes changes resulting from the Job Creation and Worker Assistance Act of 2002 (P. L. 107-147). However, the bill requires that taxpayers add back the bonus first-year depreciation allowance provided under P.L. 107-147 in determining taxable Indiana adjusted gross income (AGI). Several provisions contained in P.L. 107-147 could potentially affect revenue from the Indiana AGI Tax. These provisions are as follows.

Net Operating Loss Carryback: P.L. 107-147 temporarily extends the general net operating loss (NOL) carryback period from two years to five years for NOLs arising in taxable years ending in 2001 and 2002. The extension also applies to NOLs arising in the same years that qualify for a three-year carryback period.

Discharge of Certain S-Corporation Indebtedness: P.L. 107-147 provides that income from the discharge of indebtedness of an S-Corporation that is excluded from the S-Corporation's income is not taken into account as an item of income by shareholders. Thus, certain corporate losses are not allowed to pass through to a shareholder under this provision.

Non-Accrual Accounting Limitation: P.L. 107-147 restricts the non-accrual experience method of accounting to amounts received for the performance of certain professional services and for services provided by certain small businesses.

Foster Care Payment Exclusion: P.L. 107-147 expands the existing exclusion from income for qualified foster care payments. The definition of qualified foster care payments was expanded to include payments by any placement agency that is licensed or certified by a state or local government, or an entity designated by a state or local government to make payments to foster care providers. The definition of a qualified foster care individual is expanded to include all individuals placed by a qualified foster care placement agency, regardless of age at the time of placement.

Educator Expense Deduction: P.L. 107-147 establishes an above-the-line deduction for up to \$250 per year of expenses paid or incurred by an eligible educator for books, supplies, computer equipment (including related software and services), and other equipment and materials used in the classroom. The expenses must be otherwise deductible under the itemized deduction for an un-reimbursed employee trade or business expense. An eligible educator is a K-12 teacher, instructor, aide, counselor, or principal in a school for at least 900 hours during the school year. The provision is effective in tax year 2003 only.

Clean-Fuel Vehicle Deduction: P.L. 107-147 delays the phaseout of the above-the-line deduction for clean-fuel vehicles until 2004. The phaseout (equal to one-quarter of the deduction per year) was scheduled to begin in 2002. The deduction will be reduced by 25% for property placed in service in 2004, 50% for property placed in service in 2005, and 75% for property placed in service in 2006. The deduction is eliminated beginning in 2007.

A summary of the estimated revenue impact of the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147) is outlined in the table below. This assumes that Indiana updates the Internal Revenue Code reference in IC 6-3-1-11 to January 1, 2003, to incorporate all the Internal Revenue Code changes made to date including those referenced above in P.L. 107-147; but excluding the special depreciation allowance.

| Provision (Revenue Impact in \$M) | FY 2003 | FY 2004 | FY 2005 |
|--------------------------------------|----------------|-------------|--------------|
| NOL Carrybacks | (26.00) | 7.81 | 16.74 |
| Discharge S-Corp. Indebtedness | .19 | .28 | .29 |
| Non-Accrual Accting. Limit | .14 | .16 | .11 |
| Foster Care Exclusion | (.07) | (.11) | (.17) |
| Educator Expense Deduction | (.51) | (.30) | (.04) |
| Clean-Fuel Vehicle Deduction | (.22) | (.31) | (.28) |
| Total Impact on State Revenue | (26.47) | 7.53 | 16.65 |

Explanation of Local Expenditures:

Explanation of Local Revenues: The IRC update could potentially affect taxable income of individual taxpayers, however, the impact on counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) is likely to be minimal.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: Tom Conley, Department of State Revenue, (317) 232-2107. Joint Committee on Taxation, *Summary of P.L. 107-147, The "Job Creation and Worker Assistance Act of 2002"*, March 22, 2002. Joint Committee on Taxation, *Technical Explanation of the "Job Creation and Worker Assistance Act of 2002"*, March 6, 2002. Joint Committee on Taxation, *Estimated Revenue Effects of the "Job Creation and Worker Assistance Act of 2002"*, March 6, 2002. William Sutton & Christopher Overend, Joint Committee on Taxation, (202) 226-7575; *2003 U. S. Master Tax Guide*, Commerce Clearinghouse.

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