



## INTRODUCTION

### House Appropriations Subcommittees Get to Work

This week was dominated by the work of House Appropriations subcommittees reviewing the Senate budget (in preparation for crafting a competing House budget plan), and by the unveiling of three tax reform proposals (summarized below). At least one House subcommittee revealed its “target,” the total dollars allocated by the Appropriations “big chairs” to each subcommittee to fund its area of state government – Justice and Public Safety, Health and Human Services, Education, Transportation, etc. The General Government subcommittee chairman announced that their target was \$401 million, roughly \$20 million less than allocated in the Senate budget. This means the House subcommittee will be required to make cuts totaling to a 5% reduction, on top of any reductions reflected in the Senate budget. While other subcommittees have yet to release their target, it’s rumored that most will be asked to find similar-sized cuts in their respective portions of the budget. How these extra dollars will be allocated, and how the competing tax packages factor into the total revenue needed to fund state services, is not yet clear. Once the House releases its budget (likely at the end of next week or early the following week) many of these questions will be answered, and the battle lines between the chambers more clearly drawn.

### Budget Schedule

A preliminary schedule released in one of the Appropriations subcommittees this week laid out the following schedule:

June 3-7: House Appropriations subcommittees complete work

June 10-14: House budget passes Appropriations, Finance Committees and the full House.

June 17-27: Joint Conference Committee works out compromise budget; House and Senate pass and send to Governor McCrory by Thursday, June 27.



## NORTH CAROLINA GROUND WATER ASSOCIATION



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While this is certainly not set in stone, this schedule would allow the budget to be in effect by the start of the new Fiscal Year, which begins on July 1. If an agreement cannot be reached by this date, a continuing resolution could be passed to fund state services for a certain period (30-90 days, typically); however, many of the same Republican leaders now controlling the legislature were outspoken in their opposition to continuing resolutions when past Democratically-controlled legislatures could not finalize a budget deal, and will likely do everything possible to avoid a similar predicament.

### **Holding Hostages**

As the budget process continues, policy committees continue to meet, debate and pass bills as normal. Since the crossover deadline has passed, most of the bills being considered originated in the opposite chamber, so House committee schedules are loaded with Senate bills, and vice versa. What is different, though typical of this point in the session, is that bills that have passed committee are not immediately reported out to the floor for a vote. This process of stalling action on bills which are likely important to sponsors from the other chamber is known at the legislature as holding hostages, essentially ammunition for the ongoing conflict over the budget and tax reform between the House and Senate (the thinking is, a member may lose patience with the brinkmanship being played out by his or her chamber's leaders if their signature bill for the session is in danger for too long, and push for compromise on the bigger issues). This process was most clearly illustrated this week when, asked about the status of a particular bill which had passed committee but not been reported out, one chairman replied that while there was no problem with the substance of the bill it just hadn't been reported out yet, and patted his coat pocket for effect.

The result of this mutual armament can be seen in the daily calendar, which is notable for the number of bills in committee but the relative lack of action on the floor. The House held two "skeleton" (no-vote) sessions this week, and the Senate sessions were equally sparse. Until the major conflicts are resolved, the number of hostages will grow, with substantive legislation or bills known to be important to the other chamber's leadership especially prized. The question on the minds of many lobbyists is: once the major issues are resolved and the hostages are "freed," how much time will be left for getting them passed and to the Governor before the members leave town, and how many bills will be left on the legislative 5-yard line until the short session next May?

### **Tax Reform Three Ways**

Thursday morning the House and Senate Finance Committees met back-to-back, with each chamber laying out its version of the expected tax reform package. Somewhat surprisingly the Senate had two versions to show, one which has been the subject of previous reports (the Senate leadership-approved version which is being promoted by Senate leader Berger at [www.nctaxcut.com](http://www.nctaxcut.com)) and another crafted by a bipartisan group led by Republican Sen. Fletcher Hartsell and Democratic Sen. Dan Clodfelter. The unofficial spokesman for the "official" Senate Republican plan is Sen. Bob Rucho.

Rep. David Lewis, who has spearheaded the tax reform effort in the House, presented his plan to the House Finance committee, and promoted it as a "responsible and measured" approach to tax reform (a thinly-veiled shot at the Senator Rucho's more controversial plan). Neither the House or the bipartisan Senate plan are as far-reaching – neither would tax groceries or prescription drugs, or expand the sales tax to cover personal services like haircuts or attorney's fees, for example – and both would raise more revenue, requiring fewer cuts to state services. That said,

neither would constitute the “largest tax cut in state history,” as Sen. Berger has billed his plan. Governor McCrory has weighed in, saying the House and bipartisan Senate plans are “closest to his position,” and that he opposes taxing groceries and prescription drugs.

Democrats and advocates jumped on all three plans as being regressive, punishing middle-class taxpayers while benefitting the wealthy and corporations. They say taxing things like groceries and basic services hits lower-income earners hardest, pointing out that the elimination or capping of the mortgage-interest deduction would put home ownership out of reach for many families, and expanding sales tax to prescription drugs and hospitals will raise the cost of health care, already a major expense for many families. As we have noted previously, the tax calculator on [www.nctaxcut.com](http://www.nctaxcut.com) demonstrates that middle-income earners who have fewer children would see a tax cut under Sen. Rucho’s plan, while those with more children would see a tax increase overall.

Proponents of the plan counter that the current tax system, adopted in the 1930s when North Carolina had a manufacturing and agriculture-based economy, is riddled with exemptions and loopholes that are too confusing and high tax rates that make the state unattractive to businesses. More business investment in the state will lead to more jobs, they say, which will lead to higher income and better economy for everyone. Supporters of the House and official Senate plans have said it is their intention to eventually lower the corporate and personal income tax to zero, but making that change abruptly would create too much upheaval and controversy to be possible in the short term.

The chart below lays out the basic differences between the three plans, which will need to be condensed into a single plan that both chambers can support if a significant reform of our tax code, so long discussed but never realized, is to become a reality.

<b>Tax</b>	<b>House</b>	<b>Senate/Bipartisan</b>	<b>Senate/Rucho</b>
Sales Tax (current base 4.75% plus 2% for local gov’ts, some municipalities have voted to raise past the 2%)	Base drops from 6.75% to 6.65% starting in 2014, local gov’ts lose the 0.1%	Base drops from 6.75% to 6.5% starting in Sept. 2014, state portion lowered to 4.5%	Base drops from 6.75% to 6.5% starting in 2015, state portion raised to 5%, local lowered to 1.5%
Subject to Sales Tax	Expanded to include installation/servicing of goods – auto repair, deliveries, etc. Movies/entertainment taxed (with some exceptions). Does not tax groceries or prescription drugs	Expanded to include installation/servicing of goods – auto repair, deliveries, etc. Movies/entertainment taxed. Does not tax groceries or prescription drugs	Expanded over four years to ~130 services not currently taxed. Movies/entertainment taxed. Also taxes groceries and prescription drugs
Individual Income Tax (currently 3-tiered system based on income level)	Flat 5.9% rate	Flat 5.9% rate	Step down from 5.5% to 4.5% over three years, starting in 2014
Exemptions	First \$12,000 of income or itemized deductions (including mortgage interest) up to \$25,000 (for married filing jointly)	New housing expense deduction, greater of \$5000 or mortgage interest up to \$10,000	First \$10,000 of income (increased to \$12,500 in 2015), sliding exemption for married couples between \$30K-\$80K. Mortgage interest deduction eliminated

<b>Tax</b>	<b>House</b>	<b>Senate/Bipartisan</b>	<b>Senate/Rucho</b>
Corporate Income Tax	Rate drops from 6.9% to 5.4% over 3 years	Rate drops from 6.9% to 5.95%, some credits repealed, changes tax structure for manufacturers	Rate drops from 6.9% to 6% over three years, some credits repealed, changes tax structure for manufacturers
Estate Tax	Repealed	N/A	Repealed
Cost (FYs 2013-2014 and 2014-2015)	\$222 million	\$770 million	Surplus of \$652 million, set aside to repay federal unemployment insurance debt
Misc.	Child tax credit raised from \$100 to \$250	Charitable contribution deduction capped	Exemption for nonprofits/charities eliminated

### **Tillis (officially) Running for U.S. Senate**

On Friday House Speaker Thom Tillis, long expected to enter the race for the U.S. Senate seat currently held by Sen. Kay Hagan, made his official campaign announcement. Tillis said he plans to file the requisite paperwork early next week in Washington, and will stay on as Speaker until the end of his term (which will expire at the end of 2014). Tillis is widely credited with helping usher in the Republican majorities in the House and Senate in 2010, setting the stage for Governor McCrory's election last year. He is a prolific fundraiser and has shown a willingness to travel the state to bring his message to the voters, which he quit his job to do during the 2010 campaign cycle. A Super-PAC founded by Tillis supporters was announced last week, and has already begun raising donations (which, unlike donations to Tillis' official campaign, can be unlimited) to promote his candidacy. Sen. Hagan is seen as one of the more vulnerable incumbents in the 2014 Senate campaign, serving her first term and representing a state that went for the Republican Presidential candidate. Given that the U.S. Senate campaign will headline the 2014 cycle, we will all see and hear plenty more about this race, and about Speaker Tillis' record in Raleigh.

What this announcement means for the fate of various legislative proposals is not completely clear, though observers expect Tillis' campaign for the Senate to influence his legislative priorities and decisions fairly significantly. His endorsement of a tax reform package that could be seen as a tax hike on the middle class while benefitting the wealthy, for example, would likely not play well in a statewide campaign. If he can be seen to broker a compromise plan, however, which is seen as more equitable and avoids some of the more controversial taxes included in the Senate plan (on groceries and prescription drugs, for example), that could be the stuff of effective campaign ads targeted at middle-class and elderly voters. Another practical consideration is that the sooner session can adjourn, the sooner Tillis can hit the campaign (and fundraising) trail, so this session's days are truly numbered.

Given that Tillis will have to win his party's nomination before he could face Hagan, his blocking of legislation supported by social conservatives, including bills not popular with a majority of voters, would exacerbate any challenge from the right he is likely to face during the primary. Who may present that challenge has yet to be seen, with some high profile Republicans already bowing out and others mulling their decision. If Senate President Pro Tem Phil Berger

enters the race as well, the effect on the ongoing legislative battles is likely to reach epic proportions.

## BILL UPDATES

HOUSE BILL 688, Amend Continuing Education Requirements/Certification Well Contractors. At the request of the **North Carolina Ground Water Association** this legislation was amended in the Senate Commerce Committee to require well contractors to satisfactorily complete the number of hours within a one-year period as required by the Commission, and would prohibit the Commission from requiring more than four hours within a one-year period. The original provision would have reduced the required hours to 2 per year. **The bill as amended was approved by the Senate Commerce Committee and will next be considered by the full Senate.**

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