

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: SB 1554 (House Finance Committee Substitute)

SHORT TITLE: Modify Controlled Substances Tax

SPONSOR(S):

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	(\$million)				
	<u>FY 1998-99</u>	<u>FY 1999-00</u>	<u>FY 2000-01</u>	<u>FY 2001-02</u>	<u>FY 2002-03</u>
REVENUES					
General Fund	.65	1.3	1.3	1.3	1.3
Law Enforcement Agencies	1.95	3.9	3.9	3.9	3.9
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue - Unauthorized Substance Tax Division					
EFFECTIVE DATE: The act is effective when it becomes law.					

BILL SUMMARY: This bill reinstates the excise tax on controlled substances, but reduces the tax rates.

BACKGROUND: The General Assembly enacted the excise tax on controlled substances in 1989 as a means of generating revenue for State and local law enforcement agencies and for the General Fund. Under the law, a person who acquires illegal drugs is required to pay tax on the drugs within 48 hours of acquiring possession if the tax has not already been paid as evidenced by a tax stamp. A person paying the tax is not required to disclose his or her identity and any information obtained in assessing the tax is confidential and cannot be used in a criminal prosecution other than a prosecution for failure to comply with the tax statute itself. Seventy-five percent of the revenue generated by assessments of the tax is distributed to the law enforcement agencies whose investigation led to the assessment. The remainder of the revenue is credited to the General Fund as a non-tax revenue.

In Lynn v. West, the United States Court of Appeals for the Fourth Circuit ruled that the controlled substance tax was, "in reality," a criminal penalty rather than a tax, and could not be enforced without all the criminal procedure safeguards guaranteed by the Fifth and Sixth Amendments of the United States Constitution. As a result of the Lynn case, the Department of Revenue was forced to stop collecting the tax on the date the opinion was issued, January 13, 1998. However, the Department of Revenue did not stop collecting the tax on illicit spirituous liquor.

The federal court in the Lynn case analyzed the tax under the United States Supreme Court's 1995 opinion holding Montana's illegal drug tax unconstitutional because it was a second punishment, not a true tax, and thus violated the double jeopardy clause of the Fifth Amendment. 970 grams of cocaine were seized from Lynn in 1993. The tax rate was \$200 a gram, with a penalty equal to 100% of the tax.¹ The court concluded that the tax is a criminal penalty because the rate of tax appeared to be eight times the street value of the cocaine and, when combined with the 100% tax penalty², yielded a total tax that was sixteen times the street value of the cocaine. The court also based its ruling on the tax exemption for those who possess drugs legally and the tax's lack of a relationship to lawful possession.

The North Carolina Court of Appeals upheld the constitutionality of the State's excise tax on controlled substances in 1996 and the North Carolina Supreme Court affirmed March 7, 1997. Because the constitutionality of the tax depends on an interpretation of the federal constitution, the federal court in Lynn was not bound by the opinion of the North Carolina courts. The Department of Revenue is asked the United States Supreme Court to review and overturn the Lynn decision. On October 5, 1998, the U.S. Supreme Court let stand the federal appeals court ruling in Lynn.

ASSUMPTIONS AND METHODOLOGY:

The Department of Revenue has collected between \$5 million and \$6.5 million from the controlled substance tax each year since FY 1992-93. (see chart below)

	<u>Assessments</u>	<u>Amount Collected</u>
FY 92-93	3,406	\$6,079,479
FY 93-94	4,230	\$5,651,844
FY 94-95	4,984	\$5,352,982
FY 95-96	5,026	\$5,852,463
FY 96-97	6,096	\$6,436,959
FY 97-98 (7 months)	3,036	\$3,976,904

Before the court ruling, the Department was on pace to collect \$8.3 million in FY 1997-98. The Department of Revenue's Director of the Unauthorized Substance Division had no explanation

¹ The tax on marijuana is \$3.50 a gram, except for separated stems and stalks, which are taxed at 40¢ a gram. The tax on "low-street-value" drugs is \$50.00 for ten dosage units and the tax on other drugs not sold by weight is \$400.00 for ten dosages units.

² The 100% penalty was reduced to 50% in 1995. The tobacco tax penalty is also 50%.

for the increase. If the program were renewed, the Director projected future year collections would average \$6 to \$7 million per year based on the previous tax rates. This fiscal note will assume the midpoint of this range or \$6.5 million.

The controlled substance tax program ended in January 1998 except for voluntary installment payments, garnishment payments, and collections from those waiving their *Lynn v. West* created rights. Based on the court ruling, future year budget and revenue projections assume no collections from the controlled substance tax. With SB 1554, the controlled substance taxes are reinstated and the resulting tax collections are considered new revenue from a tax estimating standpoint. The Department of Revenue estimates a decline in revenues of 15% to 20% based on the lower tax rates in SB 1554. This estimate is based on the fact that half of the tax collection is from marijuana, which is unchanged, and the remaining half is from cocaine and other drugs. Applying a 20% reduction to the previous law collection rate of \$6.5 million yields \$5.2 million in annual controlled substance tax revenue. Of this amount, \$3.9 million will go to law enforcement agencies (75%) and \$1.3 million will go to the General Fund (25%). Due to the delay in passage of SB 1554, it is anticipated that the Department of Revenue would be unable to restart drug tax collections until January 1, 1999 and thus FY 1998-99 revenues will be half the annual estimate.

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