

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** SB 1112 (House Finance Committee Substitute) No Sales Tax Fee / Other Changes

**SHORT TITLE:** No Sales Tax Fee / Other Changes

**SPONSOR(S):** Senator John Kerr

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
<b>REVENUES</b>	<b><u>FY 1999-00</u></b>	<b><u>FY 2000-01</u></b>	<b><u>FY 2001-02</u></b>	<b><u>FY 2002-03</u></b>	<b><u>FY 2003-04</u></b>
<b>General Fund</b>					
Sales Tax Reg. Fee	(\$270,000)	(\$540,000)	(\$540,000)	(\$540,000)	(\$540,000)
Check Cashing	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000
Pawnbrokers	\$337,500	\$337,500	\$337,500	\$337,500	\$337,500
Prescription Drugs	(\$1,200,000)	(\$1,872,000)	(\$2,190,000)	(\$2,560,000)	(\$3,000,000)
Medical Equipment	(\$450,000)	(\$640,000)	(\$680,000)	(\$730,000)	(\$790,000)
Used Equipment	\$937,500	\$1,250,000	\$1,250,000	\$1,250,000	\$1,250,000
Local Airports	(\$4,040)	(\$4,040)	(\$4,040)	(\$18,040)	(\$18,040)
Shoppers' Guides	<u>\$1,875,000</u>	<u>\$2,500,000</u>	<u>\$2,500,000</u>	<u>\$2,500,000</u>	<u>\$2,500,000</u>
<b>Net General Fund</b>	\$1,975,960	\$1,781,460	\$1,423,460	\$989,460	\$489,460
<b>Local Govts.</b>					
Prescription Drugs	(\$600,000)	(\$936,000)	(\$1,095,000)	(\$1,280,000)	(\$1,500,000)
Medical Equipment	(\$230,000)	(\$320,000)	(\$340,000)	(\$370,000)	(\$390,000)
Used Equipment	NA	NA	NA	NA	NA
Local Airports	(\$2,020)	(\$2,020)	(\$2,020)	(\$9,020)	(\$9,020)
Shoppers' Guides	<u>\$937,500</u>	<u>\$1,250,000</u>	<u>\$1,250,000</u>	<u>\$1,250,000</u>	<u>\$1,250,000</u>
<b>Net Local Govt.</b>	\$105,480	(\$8,020)	(\$187,020)	(\$409,020)	(\$649,020)
<b>Highway Fund</b>					
Special Mobile Equipment	\$41,160	\$41,160	\$41,160	\$41,160	\$41,160
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> Department of Revenue, Department of Transportation – Division of Motor Vehicles					
<b>EFFECTIVE DATE:</b> Sections 1 (sales tax registration fee) and 27 (vehicle registration for special mobile equipment) of this act become effective January 1, 2000. Sections 2 (check cashers & pawnbrokers) and 14 (local airport authorities) become effective July 1, 1999. Section 5 (medical equipment), sections 6 and 7 (prescription drugs), section 8 (used equipment), sections 9 and 11 (nonprofit sales), section 10 (shoppers' guide), section 13 (tips), section 15 & 17 (bad checks), section 16 (income					

tax penalty), and section 22 (fuel in special mobile equipment) become effective October 1, 1999. Section 24 (fuel tax refunds to special mobile equipment) applies to taxes paid on or after January 1, 1999. The remainder of this act is effective when it becomes law.

**BILL SUMMARY:** This bill amends various tax laws and related statutes.

**ASSUMPTIONS AND METHODOLOGY:**

The following is a section by section analysis of SB 1112 PCS:

Section 1

This section repeals the \$15 sales tax certificate of registration fee charged to new businesses. The number of registrations in recent years is as follows:

FY 1995-96	34,559
FY 1996-97	38,193
FY 1997-98	36,609

In 1998 and 1999, sales tax registrations are averaging approximately 3,000 a month. Assuming the continuation of the current registration rate, this section will eliminate the \$15 fee for 36,000 businesses each year. The General Fund revenue loss will be \$540,000 per year. The FY 1999-00 revenue loss will be \$270,000 due to a January 1, 2000 effective date.

Section 2

This section imposes an annual \$750 privilege license tax on each location of a check cashing or pawnbroker business. As of May 28, 1999, there are 195 check cashing businesses in North Carolina with 975 locations. The number of check cashing businesses has grown tremendously since 1997 when the state approved SB 312 (1997 SL, chapter 391) regulating the industry and approving the delayed deposit of personal checks. The Consumer Finance Administrator at the Office of the Commissioner of Banks thinks the check cashing market has now reached a saturation point and receives only two or three applications per month for new locations. This fiscal note assumes the number of check cashing businesses will peak at 1,000 in FY 1999-00. The \$750,000 in revenue from the \$750 tax on 1,000 locations will be deposited in the General Fund. With the 1997 law scheduled to sunset on July 1, 2001, it is uncertain how many locations will exist in FY 2001-02 and beyond.

As for pawnbrokers, there is no exact data on the number of businesses in the state. Prior to 1997, pawnbrokers were subject to an annual privilege license tax of \$275 (formerly GS 105-50). The Department of Revenue reports that the number of pawnbrokers paying the privilege tax declined from 584 in FY 1993-94 to 356 in FY 1996-97. The past chair of the NC Pawn Brokers Association estimates there are 450 pawnbrokers in the state. The Consumer Finance Administrator at the Office of the Commissioner of Banks found 500 pawnbrokers in an internet phone directory search in 1997. This fiscal note will assume 450 pawnbroker locations and no future growth. The \$750 annual privilege tax will result in \$337,500 in revenue to the General Fund each year.

Section 3

Cost avoidance – if not removed, the color contrast requirement in the law could interfere with the processing of tax returns by optical character reader.

Section 4

No fiscal impact – clarifies definition of utility.

Section 5

This section exempts from state and local sales tax all durable medical equipment and medical sundries that are eligible for coverage under Medicare or Medicaid. This section is identical to SB 884, Medical Equipment Sales Tax, for which a fiscal note was filed on April 23, 1999. Only a brief explanation of the fiscal impact of this section will appear in this fiscal note.

Durable Medical Equipment (DME) includes a variety of medical items such as wheelchairs, IV bag holders, and cane stands. Medical sundries are easily and frequently disposed of items like latex gloves, gauze, medical tape, and syringes. The exemption only applies to items purchased on prescription or by a Certificate of Medical Need. According to the Department of Revenue, there are currently 49 DME items covered by Medicare that are taxable under North Carolina law. The Department determined that these items are taxable because they are not designed to “correct or alleviate a physical ailment” (G.S. 105 – 164.13 (12) exempts items that correct or alleviate a physical ailment from sales tax). Since the tax applies to all 49 DME and sundry items regardless of the form or type of payment, the tax should be applied to all private pay, Medicare, and Medicaid sales.

Based on information from the federal Health Care Finance Administration and from a survey of the 110 member North Carolina Association of Medical Equipment Suppliers (NCAMES), Fiscal Research Division staff determined that this sales tax exemption would produce a state and local revenue loss of \$900,000 in the FY 1999-00. According to the federal Health Care Financing Administration’s Office of the Actuary, national health spending is expected to grow at a rate of 6.5% annually through 2001 and 7.5% a year between 2001 and 2007. These growth rates are used in the chart below to calculate the revenue loss for this exemption in future years.

(\$million)

	<b>1999-00</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>
State	0.60	0.64	0.68	0.73	0.79
Local	0.30	0.32	0.34	0.37	0.39
Total	0.90	0.96	1.02	1.10	1.18

The actual amount shown for FY 1999-00 on page one reflects the adjustment for the October 1, 1999 effective date.

Section 6

Section 6 repeals the remaining state and local sales tax on prescription drugs. Most prescription drugs are either exempt from State and local sales and use taxes or are refundable. Drugs purchased with a prescription, prescription drugs distributed free of charge by the manufacturer of the drugs, and prescription drugs purchased for use in the commercial production of animals are already exempt from sales tax. Most hospitals receive refunds of State and local sales and use taxes paid on prescription drugs acquired by the hospital. The only entities that pay tax on prescription drugs are 1) physicians and other medical professionals who buy the drugs to administer to patients in the course of their practice and 2) state hospitals, (other than the UNC

hospitals), four state psychiatric hospitals, Alcohol and Drug Treatment Centers, and Mental Retardation Centers.

The Department of Revenue Sales and Use Tax Division estimates the state and local tax loss from this exemption to be \$2.4 million in FY 1999-00. This estimate is considerably less than an estimate made in 1997 for SB 41 due to recent Tax Review Board decisions which held that physicians can be retail sellers of prescription drugs and therefore sales are exempt. The estimate is based on information obtained from sales and use tax audits of medical and dental practices and from an AMA survey. The number of medical professionals was obtained from the Census of Service Industries for North Carolina. The Department did not estimate any growth in the volume of prescription sales or in prescription drug prices. Data from [State Employee Health Benefit Plan's self-insured indemnity program](#) show that prescription drug prices increase 15% to 19% a year. This fiscal note uses a 17% inflation rate, the midpoint of this range. The October 1, 1999 effective date will reduce the FY 1999-00 revenue loss by one fourth.

#### Section 7

No fiscal impact - incorporates the exemption of prescription drugs distributed free of charge by the drug manufacturer into the language in Section 6.

#### Section 8

This section removes a sales tax exemption for trade-in items. More exactly, the exemption is for “a used article taken in trade, or a series of trades, as a credit or part payment on the sale of a new article if tax is paid on the sales price of the new article”. When a similar law change was proposed in 1991, the Department of Revenue estimated that removing the exemption would result in a \$750,000 to \$1,000,000 annual revenue gain. The Department has not recalculated the amount since that time. Both the Sales Tax Division and the Tax Research Division of the Department of Revenue believe there has been limited growth in this area. Based on audit results they believe that many dealers are already charging the tax in the bill. Therefore, while the price of traded-in items has grown significantly, the actual potential loss has not grown, or grown moderately. As a result, the Department believes that \$1,000,000 to \$1,500,000 would be an accurate estimate for the current year. The fiscal note uses the mid-point of these two numbers, \$1,250,000, for the fiscal estimate of the General Fund loss. There is no information on the local sales tax loss. Most items in this category are taxed at the 1%, \$80 maximum state tax only.

#### Section 9

This section deletes the requirement that a nonprofit corporation must be chartered or incorporated in North Carolina for two years before its sales are tax exempt. The Director of the Sales Tax Division of the Department of Revenue believes the fiscal impact of this section is negligible, because few nonprofits are rejected for tax exemption status.

#### Section 10

This section repeals a sales tax exemption for free circulation publications such as shoppers' guides. The Department of Revenue Sales and Use Tax Division reports that the state tax loss for this exemption is \$2.5 million a year. Thus repeal of this exemption will provide a revenue gain of \$2.5 million to the General Fund each year. The corresponding local sales tax gain will be \$1.25 million each year. The October 1, 1999 effective date will reduce the FY 1999-00 revenue gain to \$1,875,000 for the General Fund and \$937,500 for local governments.

Section 11

This section allows a sales tax exemption for corporate contributions of inventory to governmental entities. There have been no taxpayer complaints about the existing law, but Department officials perceive this as a future problem. No fiscal estimate is available, but the Department of Revenue believes that the impact is insignificant.

Section 12

No fiscal impact – this existing language is being moved to the exemption section of the sales tax statutes.

Section 13

No fiscal impact – this increases the allowable service charge or tip on meals from 15% to 20%.

Section 14

This section allows all local airport authorities to receive a refund of state and local sales taxes. Of the 33 local airport authorities in North Carolina, 24 receive refunds of sales and use tax either directly or through their city or county government. Over the years, many airports were given refund authority through local bills such as HB 708 ratified in the 1999 Session for Sanford-Lee and Brunswick airports. The nine airports not receiving refunds were contacted by the General Assembly’s Fiscal Research Division to determine the amount of tax to be refunded by this provision. Five of the six airports responding to the phone survey reported annual expenditures of \$84,500, with a sixth airport projecting a major expansion beginning in 2002 that will expend \$350,000 a year for three years. For the three airports not reporting, it is assumed that each will expend \$5,500 a year (the midpoint of expenditures for airports not receiving refunds).

	<u>FY 99-00</u>	<u>FY 00-01</u>	<u>FY 01-02</u>	<u>FY 02-03</u>	<u>FY 03-04</u>
Tri-County AA	\$5,500	\$5,500	\$5,500	\$5,500	\$5,500
Asheboro AA	\$5,500	\$5,500	\$5,500	\$5,500	\$5,500
Northeast Regional AA	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000
Elizabeth City AA	\$5,000	\$5,000	\$5,000	\$5,000	\$5,000
Goldsboro AA	\$5,500	\$5,500	\$5,500	\$5,500	\$5,500
Morganton -Lenoir AA				\$350,000	\$350,000
Rockingham Co AA	\$20,000	\$20,000	\$20,000	\$20,000	\$20,000
Rutherford Co AA	\$5,500	\$5,500	\$5,500	\$5,500	\$5,500
Avery Co AA	\$4,000	\$4,000	\$4,000	\$4,000	\$4,000
	\$101,000	\$101,000	\$101,000	\$451,000	\$451,000
States Sales Tax (4%)	\$4,040	\$4,040	\$4,040	\$18,040	\$18,040
Local Sales Tax (2%)	\$2,020	\$2,020	\$2,020	\$9,020	\$9,020

Sections 15 & 17

No estimate available – the language allowing the Secretary of Revenue to waive penalties for bad checks is permissive. If the Secretary of Revenue chooses to waive a substantial number of penalties, there will be a small revenue loss.

### Section 16

No estimate available. The Department of Revenue assesses very few penalties for negligence. This section could produce a small revenue gain for the General Fund if penalties are easier to assess on corporate taxpayers.

### Section 18

No fiscal impact – technical change.

### Section 19

No estimate available. By extending the time a taxpayer can request a refund, this section might produce a small revenue loss. However, the Department of Revenue has received only a small number of complaints about the current refund policy.

### Sections 20 & 21

No fiscal impact – since there was no fee for this license, its repeal will not harm the Highway Fund.

### Sections 22 & 24

No estimate available. These sections will produce a small revenue loss to the Highway Fund and the Highway Trust Fund, but the Department of Revenue cannot provide the data needed to quantify the loss. Currently operators of special mobile equipment buy enough tax paid clear diesel fuel to cover their miles driven on the highway. For off highway use, the equipment operators use dyed, non-tax diesel fuel. If they request a refund for tax paid on clear fuel, their refunds are processed annually. By providing that dyed fuel may be used in special mobile equipment, this section codifies an administrative practice allowed by the Department of Revenue. However, the Highway Fund will lose the tax paid currently on diesel fuel for highway use. For those that apply for a refund, it will speed up the refund process and the state will lose interest on invested funds.

### Section 23

No fiscal impact – motor fuel suppliers pay by electronic funds transfer and have not paid late, but this section does clarify discount policy.

### Section 25

No fiscal impact – according to Revenue, the statute requiring bonded fuel importers to register is unnecessary due to the lack of importers in this category.

### Section 26

No fiscal impact - codifies the administrative practice used by the Division of Motor Vehicles to register vehicles leased out of state.

Section 27

The fee for special mobile equipment is doubled by section 27. As of January 1, 2000, the fee will increase from \$20 a year to \$40 on 2,058 pieces of special mobile equipment. This fee increase will produce a \$41,160 revenue gain for the Highway Fund each year. It is difficult to project future year growth in the volume of vehicles registered, because there has been no consistent pattern of registration in the last five years. Equipment numbers have increased and declined in recent years.

Section 28

No fiscal impact – equipment operators now can apply for overweight or oversize permits for larger width.

Section 29

No estimate available – this section may reduce DMV revenue from penalties, but no data are available to quantify the amount.

Section 30

No fiscal impact – broadens access to information.

**FISCAL RESEARCH DIVISION 733-4910**

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