NORTH CAROLINA GENERAL ASSEMBLY
LEGISLATIVE FISCAL NOTE

BILL NUMBER: House Bill 231 (Fifth Edition) **REVISED**

SHORT TITLE: Education Revenue Act

SPONSOR(S):

FISCAL IMPACT

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

($million)

	FY 2001-02	**FY 2002-03**	**FY 2003-04**	**FY 2004-05**	**FY 2005-06**
REVENUES					
General Fund					
State Half Cent Sales Tax	246.3	398.7			
Sales Tax/Hold Harmless			(23.3)	(19.1)	(15.6)
Repeal Reimbursements			333.4	333.4	333.4
Sales Tax Holiday	0	(8.4)	(7.8)	(8.1)	(8.4)
5% tax on Satellite TV	9.8	21.7	22.9	24.1	25.3
8.25% Income Tax Rate	125.5	102.9	61.6		
Increase Standard Deduction	(9.7)	(32.0)	(45.0)	(45.8)	(46.5)
Increase Child Credit		(19.8)	(54.8)	(55.0)	(55.3)
Repeal CHIP Credit	18.9	18.9	18.9	18.9	18.9
Tax HMOs/Blue Cross		33.8	30.6	33.2	35.9
Liquor Sales Tax	11.9	24.7	25.6	26.6	27.6
Reduce Liquor Excise Tax	(3.5)	(10.9)	(11.4)	(12.0)	(12.6)
No Tax Break/Luxury Cars	1.7	2.4	2.6	2.7	2.9
6% Telecommunications Tax *	34.4	87.9	87.9	87.9	87.9
Total General Fund	**435.3**	**619.9**	**441.2**	**386.8**	**393.5**
Local Government					
Sales Tax Holiday	0	(3.7)	(4.9)	(5.1)	(5.3)
Local Half Cent Sales Tax**			419.8	441.2	462.8
Repeal Reimbursements			(333.4)	(333.4)	(333.4)
Sales Tax/Hold Harmless	-	-	23.3	19.1	15.6
Total Local Govt.	**0**	**(3.7)**	**104.8**	**121.8**	**139.7**

* Depends on passage of HB 571
** Assumes all counties approve the tax

EXPENDITURES

General Fund					
Income tax withholding tables	.14				
Sales Tax changes	.46	0	1.9	.4	.4
POSITIONS					
Dept. of Revenue			6	6	6

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue; Alcoholic Beverage Control Commission; Division of Motor Vehicles

EFFECTIVE DATE: Part 6 (8.25% tax rate) is effective for taxable years beginning on or after January 1, 2001, but expires for taxable years beginning on or after January 1, 2004. Part 9 (Children's Health Insurance Credit) is effective for taxable years beginning on or after January 1, 2001. Part 12c (transfer luxury car tax to General Fund) is effective July 1, 2001. Part 12 (repeal tax cap on luxury cars) is effective October 1, 2001. Part 1 (state half cent sales tax) is effective October 16, 2001 and expires by July 1, 2003. Part 11 (sales tax on liquor), except section 11d, is effective on December 1, 2001. Parts 7a ($5,500 standard deduction), 8a ($75 child credit), and 10 (insurance premium tax) are effective for taxable years beginning on or after January 1, 2002. Part 4 (sales tax holiday), Part 5 (satellite TV) and Part 13 (telecom) are effective January 1, 2002 and apply to sales made on or after that date. Section 11d (liquor excise tax) is effective on February 1, 2002. Parts 7b ($6,000 standard deduction) and 8b ($100 child credit) are effective for taxable years beginning on or after January 1, 2003. Part 2 (local half cent sales tax) and Part 3 (repeal reimbursements) are effective on July 1, 2003.

BILL SUMMARY:

House Bill 231 Senate Committee Substitute does the following:

Part 1) Increases the state sales and use tax by one-half cent from October 16, 2001 till July 1, 2003,

Part 2) Authorizes a half cent local option sales tax on July 1, 2003 and allows a 100% hold harmless guarantee on revenue previously received by local governments in state tax reimbursements,

Part 3) Repeals local government reimbursements for intangibles tax, inventory tax, reduced property valuation, and sales tax exemption for food purchased with food stamps,

Part 4) Creates a sales tax holiday on the first weekend in August each year for clothing, footwear, and school supplies valued at $100 or less per item and computer software and hardware valued at $3,500 or less per item.

Part 5) Imposes a 5% gross receipts tax on satellite TV services,

Part 6) Adds a new 8.25% individual income tax bracket for three tax years,

Part 7) Increases the standard deduction for married filing jointly filers from $5,000 to $6,000,

Part 8) Increases the tax credit for children from $60 to $100,

Part 9) Repeal the Children's Health Insurance Credit,

Part 10) Imposes a 1% gross premiums tax on HMOs and increases the gross premiums tax on medical service companies from .5% to 1%,

Part 11) Imposes a 6% state sales tax on liquor and reduces the liquor excise tax from 28% to 25%,

Part 12) Repeals the $1,500 highway use tax cap on motor vehicles and exempts fire and rescue vehicles from the highway use tax, and
Part 13) Taxes all telecommunications at 6%.

ASSUMPTIONS AND METHODOLOGY:

<u>Increase State Sales Tax By One-Half Cent Until July 1, 2003</u>

Part 1 of the bill increases the state sales tax by ½ cent, until July 1, 2003. This tax would not apply to food.

The General Assembly's Fiscal Research Division and the Office of State Budget, Planning and Management have agreed to the following sales tax revenue projections for FY 2001-02 and FY 2002-03:

(Millions)

Fiscal Year	Revenue from 1 Cent	Revenue from 1/2 Cent
2001-02	$765.2	$382.6
2002-03	$797.3	$398.7

These estimates assume a full year of tax.

Fiscal Research and the State Budget Office have also agreed to sales tax growth rate estimates for the next several fiscal years. The growth rates, as well as the corresponding 1 cent and ½ cent revenue estimates (in millions), are listed below.

Fiscal Year	Growth from Previous Year	Revenue from 1 Cent	Revenue from 1/2 Cent
2003-04	5.3%	$839.6	$419.8
2004-05	5.1%	$882.4	$441.2
2005-06	4.9%	$925.6	$462.8

Adjusting for the October 16, 2001 effective date and the July 1, 2003 sunset suggests the following potential revenue stream:

(Millions)

Fiscal Year	State Sales Tax
2001-02	$246.30
2002-03	$398.70

Local Option Sales Tax/Hold Harmless

Part 2 of the bill authorizes counties to levy an additional ½ cent local sales tax, effective July 1, 2003. This local option tax can be enacted through a special election or a vote of the county commission. This change potentially brings the local sales tax rate to 2-½%. However, the additional ½ cent will not apply to food.

As was noted above, the General Assembly's Fiscal Research Division and the Office of State Budget, Planning and Management have agreed to the following sales tax revenue projections for FY 2001-02 and FY 2002-03:

(Millions)

Fiscal Year	**Revenue from 1 Cent**	**Revenue from 1/2 Cent**
2001-02	$765.2	$382.6
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Fiscal Year	**Growth from Previous Year**	**Revenue from 1 Cent**	**Revenue from 1/2 Cent**
2003-04	5.3%	$839.6	$419.8
2004-05	5.1%	$882.4	$441.2
2005-06	4.9%	$925.6	$462.8

Adjusting for the effective date of this part of the bill suggests the following potential revenue stream from the new local option sales tax:

(Millions)

Fiscal Year	**Local Sales Tax**
2003-04	$419.80
2004-05	$441.20
2005-06	$462.80

These estimates represent the total, statewide potential revenue stream to local governments. Since the language is permissive, no exact fiscal estimate is possible on the bill.

Part 3 of the bill repeals the existing reimbursements to local governments for previous law changes. These reimbursements total $333.4 million annually (see section below on local government reimbursements). However, Part 2 of the bill instructs the Secretary of Revenue to make an annual hold harmless payment to those local governments whose gain from the sales tax is less than 100% of their loss from the repealed reimbursements. The sales tax distribution formula mirrors the existing formula, with ½ of the revenues distributed on an adjusted per capita basis and ½ distributed on a point of sale basis.

In order to calculate a statewide hold harmless cost, FY 1999-00 annual sales tax reports were used to determine what proportion of all annual sales tax distributions were forwarded to each community. These percentages of the total were then applied to the estimated revenue streams noted above to create local sales tax revenue estimates. The individual revenue estimates were compared with the annual reimbursement data for each county and municipality. If a particular community's sales tax revenue did not compare favorably with 100% of the reimbursement amount, a hold harmless estimate was generated for that community. These individual hold harmless amounts were then totaled to determine the combined state liability for the 100% hold harmless provision. This calculation was made for FY 2003-04 through FY 2005-06.

(Millions)

Fiscal Year	Hold Harmless
2003-04	($23.30)
2004-05	($19.10)
2005-06	($15.60)

Note: No fiscal impact is included for FY 2001-02 and FY 2002-03 as this portion of the bill does not become effective until FY 2003-04.

Repeal Local Government Reimbursements

Since 1979 the General Assembly has made several changes to tax law that impact local governments. The state's cities and counties have received reimbursements from the state for some of these losses, particularly as they relate to the sales and property tax bases. The state reimburses local governments for property tax losses related to the repeal of taxes on inventories and intangibles, as well as some of the losses associated with the homestead exemption. Locals also receive a reimbursement for sales taxes that are no longer paid on items purchased with food stamps.

The legislature began exempting certain categories of intangible property in 1979. At that time, deposit accounts of less than $1,000 were exempted. In 1985 that exemption was expanded to include money on deposit, money on hand, and certain accounts receivable. In 1995 most of the remaining forms of intangible property were exempted. Through legislation in 1980, 1985, and 1987 the property tax on inventories was also removed. In 1985 the General Assembly exempted food stamps from local sales taxes. Most major changes in the homestead exemption have also included reimbursement, at least in part, by state government. Many of these reimbursement amounts are based on actual tax losses related to the first year of the repeal. These reimbursement amounts are fixed. The remainder was frozen in 1991.

According to the Department of Revenue's Tax Research Division, annual reimbursements are as follows:

	(Millions)
Reimbursement	**Amount**
Food Stamps	$6.4
Intangibles	$128.7
Homestead	$8.2
Retail & Wholesale Inventory	$82.0
Manufacturers Inventory	$108.1
TOTAL	$333.4

Part 3 of the bill repeals all of these reimbursements. Because all reimbursement amounts are either fixed or frozen, no growth is included in the estimate.

Begin Sales Tax Holiday

Part 4 of the bill creates a temporary, three-day sales tax exemption for clothing, clothing accessories, school supplies, computers, printers, and educational software. The exemption does not apply to clothing and footwear items that exceed $100. This is generally referred to as a sales tax holiday. The temporary exemption or "holiday" occurs each year over the first weekend in August. Some version of a sales tax holiday exists in seven other states and the District of Columbia.

Arthur Andersen Consulting, under contract with the National Retail Federation, developed a model to be used by states to determine the sales tax impact of a variety of sales tax holidays. This model incorporates data from the U.S. Census Bureau of Economic Analysis, U.S. Catalog Market Report, Forrester Research, Eggert's Blue Chip Estimates, the Florida Retail Association, the Texas Controller's Office, and various state governments.

Assuming a three-day exemption that applies to clothing, accessories, and footwear with a $100 per item cap, the model indicates a FY 2002-03 state revenue loss of $6.53 million. The expected local tax loss from this portion of the holiday is $2.91 million.

The sales tax holiday also includes computers, printers, printer supplies, and educational software ($3,500 cap). A similar sales tax holiday for computers exists in Pennsylvania. Using results of that computer sales tax holiday as a proxy for North Carolina, making adjustments for population, income, and the length of the holiday suggests this portion of the holiday will cost the state an additional $1.87 million in the first year and local governments $830,000.

Combining these loss figures and using a 4% growth rate creates the following five-year cost estimate.

($Million)

	2001-02	2002-03	2003-04	2004-05	2005-06
State	0	8.40	7.77	8.08	8.40
Local	0	3.74	4.86	5.05	5.25

These numbers include the temporary .5 cent state sales tax and assume the local governments will enact the local option .5 cent sales tax in July 2003.

Note: Interpretation of this bill section by the Department of Revenue could alter the fiscal impact of the legislation.

Equalize Taxation of Satellite TV and Cable TV

Part 5 of the bill imposes a 5% state tax on satellite television. Under current federal law, local governments can tax cable television by rates up to 5%. Local governments cannot levy a tax on satellite television.

According to an April 1, 2001 industry report from SkyTrends, there are approximately 836,000 Direct to Home or "DTH" subscribers in North Carolina. These numbers include customers of all the major DTH service providers: DirecTV, ECHOSTAR, and C-Band (Primestar is no longer in operation). Assuming an average monthly bill of $45 suggests that these subscribers pay approximately $540.00 annually for this service. Multiplying the number of subscribers times the average annual bill creates a gross sales estimate of $451.44 million. Applying a 5% tax to that amount generates a potential revenue stream of $22.57 million. Because this would be a new tax on an industry that does not now currently pay tax, the estimate is reduced by 10% to account for potential compliance issues.

An 8% growth rate is applied each year, resulting in the fiscal estimates listed below.

FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
9.8	21.7	22.9	24.1	25.3

The first fiscal year is reduced to account for the January 1, 2002 effective date.

Create New Tax Bracket for Taxable Income Over $200,000

Individual income tax rates are now 6%, 7%, and 7.75% as shown below.

Filing status		Taxable income is more than	But not over
	6%	$0	$12,750
Single	7%	$12,750	$60,000
	7.75%	$60,000	
	6%	$0	$17,000
Head of Household	7%	$17,000	$80,000
	7.75%	$80,000	
	6%	$0	$21,250
Married Filing Jointly	7%	$21,250	$100,000
or Qualifying Widow(er)	7.75%	$100,000	
	6%	$0	$10,625
Married Filing	7%	$10,625	$50,000
Separately	7.75%	$50,000	

Part 6 of the bill adds a new tax bracket for taxable incomes that are twice the current top rate as shown in the chart below.

8.25% for taxable incomes over:

$200,000	Married filing jointly
$160,000	Head of household
$120,000	Single
$100,000	Married filing separately

In tax year 2001, this tax increase will impact 9,848 single filers, 52,463 married couples, and 1,148 heads of households. The new 8.25% tax bracket sunsets after tax year 2003. The revenue estimates below were calculated using the North Carolina Individual Income Tax Model.

FY 2001-02	$125.5 mil.
FY 2002-03	$102.9 mil.
FY 2003-04	$61.6 mil.

First year revenues equal all of Tax Year 2001 for returns filed in spring 2002 and 45% of Tax Year 2002 because of withholding and two quarterly estimated payments. High-income taxpayers avoid a penalty if estimated payments during the tax year equal at least

90% of actual liability. In the FY 2002-03, taxpayers will pay the remaining 55% of the tax due in tax year 2002 and again pay 45% in estimated payments for tax year 2003. FY 2003-04 is equal to the remaining 55% of tax year 2003.

Eliminate the Marriage Tax Penalty for the Standard Deduction

The term "marriage penalty" refers to the income tax situation where married individuals filing jointly pay more in tax than if the two individuals were unmarried filing as single persons. For example, the North Carolina standard deduction for single filers is $3,000, but for married filing jointly the standard deduction is $5,000. The personal exemption favors single filers, because the exemption is $2,500 until you get to a maximum of $60,000 Adjusted Gross Income (AGI) for single filers and $100,000 AGI for married filing jointly where it drops to $2,000. State tax brackets also favor single filers as shown below:

Single	0 to $12,750	$12,751 to $60,000	$60,000>
Married filing jointly	0 to $21,250	$21,251 o $100,000	$100,000>

Part 7 of this bill reduces the marriage penalty by increasing the standard deduction for married filing jointly taxpayers from $5,000 to $6,000. The standard deduction is increased to $5,500 in tax year 2002 and then to $6,000 in tax year 2003. The FY 2001-02 reduction in General Fund revenue will be $9.7 million due to estimated payments and withholding in the first half of tax year 2002. This change will benefit 762,340 couples in tax year 2002.

FY 2001-02	$9.7 mil.
FY 2002-03	$32.0 mil.
FY 2003-04	$45.0 mil.
FY 2004-05	$45.8 mil.
FY 2005-06	$46.5 mil.

The revenue estimate for the standard deductions was calculated using the North Carolina Individual Income Tax Model. This tax model was created by the Barents Group for the Department of Revenue and the General Assembly to use in estimating tax law changes. The model bases future year estimates on data from 1998 North Carolina individual income tax returns.

Increase Tax Credit for Children

The current $60 child credit was approved by the 1995 General Assembly. Part 8 of the bill increases the child credit from $60 to $75 per child in tax year 2002, and then increases the credit from $75 to $100 in tax year 2003. The first increase will reduce General Fund revenue $19.8 million in FY 2002-03 for taxpayers filing returns in the spring of 2003. The second year increase will boost the revenue loss to $54.8 million in FY 2003-04. This tax change will benefit 18,354 single tax filers, 496,286 married couples, and 411,648 heads of households in tax year 2002. This revenue estimate was calculated using the North Carolina Individual Income Tax Model.

Repeal Children's Health Insurance Credit

Part 9 of the bill repeals the Children's Health Insurance Credit effective for tax year 2001. This credit was effective beginning in tax year 1999. In 1999, 117,972 taxpayers filed for $18,907,846 in Child Health Insurance Tax Credits. Initial data from tax year 2000 returns show a decline in the credit amount to $11.1 million, but the data is inconclusive for determining if this decline is permanent. This fiscal note will assume $18.9 million is the annual tax expenditure for this credit, because it is the amount that is built into the General Fund availability statement.

Equalize Taxation of HMOs & Medical Service Companies

I. HMOs

Under current law, HMOs are not subject to a gross premiums tax but do pay corporate income and franchise taxes and the insurance regulatory fee. Regular insurance carriers pay a 1.9% premiums tax and no corporate income or franchise tax.

According to Department of Revenue reports from HMOs, the historical premium volume that would be subject to the tax is:

Tax Year	Taxable Premiums ($ Billions)
1998	$1.568
1999	1.825
2000	2.180

This data indicates annual growth of 17.9%. For this estimate, an annual growth estimate of 10.0% was used. This yields $2.40 billion of taxable premiums for 2001 and $2.64 billion for 2002. The application of a 1.0% tax rate in Part 10 of the bill produces $26.4 million for the 2002-03 fiscal year.

Part 10 of the bill exempts HMOs from the corporate income and franchise taxes. According to the Tax Research Division of the Department of Revenue, these payments amounted to $3.63 million for the 1999 tax year. This amount was grown by 19% for 2000 and by 10% for 2001 and future years. The resulting corporate liability forecast is $4.63 million for 2002 (2002-03 fiscal year). In this analysis, it is assumed that the companies take their offset through lower final tax payments or higher refunds, not lower estimated tax payments. Thus, the calendar year change converts to fiscal year.

Finally, the fact that HMOs will make installment payments in April and June 2003 in addition to 2002 tax year payments in March 2003 means that in theory the 2002-03 fiscal year could contain a one-time windfall of $17.6 million. However, the statutes do allow an exemption from the required installment payments under certain circumstances. For this reason, the estimate includes only 25% of the potential windfall.

The finalized estimate for the proposal to tax HMOs at 1%, effective beginning with the 2002 tax year, is shown below:

	($ Millions) 2002-03	($ Millions) 2003-04
Premium Tax-Recurring	$26.4	$29.0
Premium Tax-Nonrecurring	4.4	
Less: Repeal of Corporate Taxes	-4.6	-5.1
Net Impact	$26.2	$23.9

II. Medical Service Companies

Blue Cross/Blue Shield and Delta Dental now pay a .5% premiums tax and no corporate income or franchise tax. Regular insurance carriers pay a 1.9% premiums tax and no corporate income or franchise tax. Part 10 of the bill increases the gross premiums tax on medical service companies such as Blue Cross/Blue Shield and Delta Dental to 1%.

The first step in estimating the impact of the rate increase on Blue Cross/Blue Shield and Delta Dental was to review the recent history of taxable premiums for these carriers. This data was provided by the Department of Revenue, the agency that collects the existing .5% tax. The data for recent years is shown below:

Tax Year	($ Billions) Taxable Premiums
1997	$1.082
1998	1.185
1999	1.175
2000	1.256

This data indicates that the average annual growth rate during this period was 3.8%. To be conservative, this fiscal analysis uses a 2.0% rate, yielding an estimate of $1.307 billion for 2002. The application of the .5% rate increase in the bill would mean an additional $6.53 million for the 2002 tax year (2002-03 fiscal year).

In addition, there would be a one-time windfall for the 2002-03 fiscal year due to the fact that in April, June, and October of each calendar year insurance companies must pay installments on their tax liability for that year. Unlike the corporate income tax, the installment payments are not based on a percentage of estimated liability for the year, but are tied to the annual liability for the prior year. The required percentage for each installment payment is 33 1/3% of the prior year's liability. Thus, for the 2002-03 fiscal year the General Fund will receive not only 100% of the 2002 calendar year liability (for which no installment payments have been made) but also two installment payments against the 2003 tax year. These installments would be equivalent to 66 2/3% of the prior year's annual liability, or $4.35 million. However, the statutes do allow an exemption from the required installment payments under certain circumstances. For this reason, the estimate includes only 25% of the potential windfall, or $1.1 million.

Impose State Sales Tax on Spirituous Liquor

Part 11 of the bill imposes a 6% state sales tax on spirituous liquor effective December 1, 2001. The North Carolina Alcoholic Beverage Control Commission reports annually on its retail sales and the volume of bottles sold in its 392 stores. Retail sales have grown from $308.6 million in FY 1994-95 to $367.7 million in FY 1999-00. The average annual growth rate in this five-year period is 3.82%. The five-year projection for the 6% sales tax on retail liquor sales is based on FY 1999-00 actual sales inflated each year by 3.82%. This growth rate appears reasonable based on sales in the first nine months of FY 2000-01 that exceed the annual average. Since there is no readily available data to predict how North Carolinians will react to an increase in liquor prices, no adjustment is made in retail sales based on consumption. Sales tax collections in FY 2001-02 will be for only six months given the December 1 effective date and a month lag in collections. Instead of a full year's collections of $23.8 million as shown in the chart below, the state will collect only $11.89 million.

Liquor Sales

	Retail Sales	6% State Sales Tax
FY 2000-2001	$381,703,699	
FY 2001-2002	$396,284,781	$23,777,087
FY 2002-2003	$411,422,859	$24,685,372
FY 2003-2004	$427,139,213	$25,628,353
FY 2004-2005	$443,455,931	$26,607,356
FY 2005-2006	$460,395,947	$27,623,757

Reduce Liquor Excise Tax

Section 11d of the bill reduces the excise tax on spirituous liquor from 28% to 25% effective February 1, 2002. The estimate for this tax reduction is based on excise tax collections for FY 1999-00. The net General Fund revenue collected from the 28% excise tax on liquor was $88,245,395 in FY 1999-00. The annual growth rate in liquor excise tax revenues has been 4.9% since 1995. Based on this growth pattern, current excise tax collections will increase from $88.2 million in FY 99-00 to $117.6 million in FY 05-06. (see below)

	FY 01-02 Est	FY 02-03 Est	FY 03-04 Est	FY 04-05 Est	FY 05-06 Est
Liquor	$97,105,321	$101,863,482	$106,854,792	$112,090,677	$117,583,120

The estimated tax revenues each year are divided by the current tax rate (see below) to get gross sales. The gross sales are multiplied by the proposed 25% tax rate to produce the estimated revenue for FY 01-02.

	FY 01-02 Est	Gross Sales	Current Rate	Proposed Rate	Proposed Revenue
Liquor	$97,105,321	346,804,718	28%	25%	$86,701,179

Using this method for future fiscal years produces the results in the chart below. No adjustment is made in the five-year projection for the price sensitivity of consumers, since there is uncertainty about the impact of lower prices on alcoholic beverage consumption.

	FY 01-02 Est	FY 02-03 Est	FY 03-04 Est	FY 04-05 Est	FY 05-06 Est
28%	$97,105,321	$101,863,482	$106,854,792	$112,090,677	$117,583,120
25%	$86,701,179	$90,949,537	$95,406,064	$100,080,962	$104,984,929
Difference	($10,404,142)	($10,913,944)	($11,448,728)	($12,009,715)	($12,598,191)

Due to a February 1, 2002 effective date, this fiscal note assumes that 8 months of revenue will be collected from the 28% tax rate (7 months plus 1 month lag) and 4 months from the 25% tax rate. Due to this late effective date, the revenue impact is ($3,468,048) in FY 2001-02.

Repeal Tax Break for Luxury Cars/No Fire & Rescue Vehicle Tax

Part 12 of the bill deletes the $1,500 cap on the 3% Highway Use Tax for non-commercial vehicles and exempt fire trucks and rescue vehicles owned by qualifying volunteer fire departments and volunteer rescue squads from the Highway Use Tax. The additional revenue generated from this section of the bill will go to the General Fund, not the Highway Trust Fund.

According to the Division of Motor Vehicles, approximately 4,800 vehicles were taxed at the maximum rate of $1,500 (corresponding to a vehicle price of $50,000) in FY1999-2000. The tax on these vehicles totaled $7.2 million. The actual average price of these vehicles is not available, but it is reasonable to assume that there is a gradual decline in the number of vehicles in each price bracket as the price moves higher. The number of vehicles in the price bracket from $48,000 to $49,000 was 390. It is assumed that there were 300 vehicles in the price bracket from $49,000 to $50,000 and that there is a constant percentage decline in the number of vehicles as the price bracket changes. Because the number of vehicles in each tax bracket decreases as the tax brackets increase, the average tax paid by vehicles in each bracket is something less than the midpoint of the bracket. That is, in each bracket most of the vehicles are clustered toward the lower end. It is assumed that in each $30 tax bracket the average vehicle will have a tax due of $10 greater than the minimum for that bracket. Using this methodology, the average value of the 4,800 vehicles that paid the maximum tax in FY1999-2000 was $66,350 and the additional tax that would have been paid for the average vehicle was $491 (equal to 3% of the average value in excess of $50,000). In FY1999-00 the fiscal impact would have been the number of vehicles (4,800) multiplied by the additional tax per vehicle ($491), or $2,358,296. This figure is used as the base and the fiscal impact is assumed to grow for the fiscal note forecast period by the same percentage as the Highway Use Tax collections as projected by the Office of State Budget, Planning and Management (see table below).

Forecast Growth Rate in Highway Use Tax

Fiscal Year	Growth Rate
FY2000-01	1.6%
FY2001-02	3.0%
FY2002-03	7.8%
FY2003-04	5.8%
FY2004-05	5.7%
FY2005-06	5.2%

Section 12(d) of the bill exempts vehicles purchased by volunteer fire departments. According to the Department of Insurance, approximately 1,000 volunteer fire departments would qualify for this tax exemption. Each of those departments will have approximately three qualifying vehicles that are replaced on a twenty-year cycle. The result is that approximately 150 vehicles are purchased each year. Based on their high cost and weight (generally over 26,000 pounds), the loss in Highway Use Tax would be 150 vehicles at $1,000 each or about $150,000 per year.

Section 12(d) also exempts vehicles purchased by volunteer rescue squads. According to the North Carolina Association of Rescue and EMS, there are approximately 400 rescue squads that would qualify under the legislation. On average, these rescue squads would have approximately 1.5 emergency service vehicles each and the State total would be about 600 vehicles. Since these vehicles are replaced about every eight years on average, there will be approximately 75 emergency service vehicles purchased each year. These vehicles generally cost over $50,000 but they generally weigh less than 26,000 pounds and would therefore be taxed at $1,500 per vehicle. The loss in Highway Use Taxes would therefore be 75 vehicles at $1,500 each or about $112,500 per year.
The net impact of the Highway Use Tax changes is shown below. The first year revenue is reduced by one fourth ($1.7 million) due to an October 1, 2001 effective date.

	FY 01-02	FY 02-03	FY 03-04	FY 04-05
Highway Use Tax (delete $1500 cap)	**$2,467,910**	**$2,660,407**	**$2,814,710**	**$2,975,149**
Highway Use Tax (exempt vehicles)	**($262,500)**	**($262,500)**	**($262,500)**	**($262,500)**
Net impact	**$2,205,410**	**$2,397,907**	**$2,552,210**	**$2,712,649**

Uniform Telecommunications Tax at 6%

Part 13 of the bill changes the uniform telecommunications tax rate in H.B. 571 from 4.5% to 6.0%. Part 13 will not become effective unless H.B. 571 becomes law before January 1, 2002.

H.B. 571 rewrites the existing telecommunications tax system. That bill attempts to simplify the collection of telecommunications taxes by (1) combining multiple tax rates into one uniform rate equal to 4.5%, (2) broadening the tax base by eliminating exemptions for interstate calls and telephone membership corporations, (3) taxing prepaid phone cards at the point of sale instead of at the point of use, (4) adjusting the tax on the gross receipts from pay phones, (5) setting a call center tax cap of $50,000 a year, and (6) eliminating the current 3.09% franchise tax distribution to municipalities and replacing it with a distribution of 24.4% of the new revenue total (less the previous freeze amount).

At the time H.B. 571 passed the House, the bill was essentially revenue neutral, based on the information available at that time. However, since the bill passed, new information was obtained from another state (Mississippi) that suggests the bill will result in a General Fund loss to the state.
The new revenue estimates, as compared to the existing structure, are as follows:

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
Revenue @ 6% (HB 231)	34.4	87.9	87.9	87.9	87.9
Revenue @ 4.5% (HB 571)	(1.8)	(4.1)	(4.1)	(4.1)	(4.1)
Impact of Bill (change)	36.2	92.0	92.0	92.0	92.0

For simplicity the numbers listed in the fiscal estimate box are those used for “Revenue @ 6%”, which compare a reformed telecommunications tax of 6% with the current multi rate system.

Expenditures

I. Sales Tax Changes

To implement the half cent state sales tax, the Department of Revenue has requested $460,000 in FY 2001-02 for the following: $180,000 for reprinting sales tax booklets, $50,000 for sending notices to taxpayers, and $230,000 for hiring 30 temporary positions for 20 weeks.

The Department of Revenue has projected that the implementation cost of a half cent local sales tax with a 100% hold harmless clause will be $1,470,321 in nonrecurring expenses and $386,357 in recurring expenses in FY 2003-04. The Department requests the following nonrecurring expenses:

Planning, Development & Technology	FY 2003-04
Contractual Services	$750,000
Computers	$23,000
Taxpayer Assistance	
Temporary Wages	$54,000
Social Security Contribution	$4,131
Examination and Collection	
Temporary Wages	$54,000
Social Security Contribution	$4,131
Administrative Services	
Temporary Wages	$9,000
Social Security Contribution	$689
Postage/Forms	$350,000
Furniture/Office Equipment	$27,600
Documents/Payment Processing	
Temporary Wages	$180,000
Social Security Contribution	$13,770
Total Nonrecurring Expenses	$1,470,321

The recurring expenses proposed by the Department are for 5 new positions in the Examination and Collections Division and 1 position in Taxpayer Assistance.

	FY 2003-04
Planning, Development & Technology	
Maintenance Agreements - Equipment/Software	$1,800
Taxpayer Assistance	
Salaries (1 position)	$51,729
Fringe Benefits	$10,356
Examination and Collection	
Salaries (5 positions)	$236,030
Fringe Benefits	$48,242
Travel - In state	$40,000
Administrative Services	
Telephone service/General office supplies	$5,100
Total Recurring Expenses	$393,257

NOTE: Current law allows the Department of Revenue to reduce local sales tax distributions to absorb the cost of collection. While the bill does not explicitly give the Department this authority for the new tax, the data used to calculate revenues includes that administrative expense. Recent reports from the Department indicate that the cost of collection is $0.484 per $100.00 of collections. Applying this ratio to the estimated statewide revenues suggests that $1.11 million has been allocated from the FY 2001-02 revenues for administration. In FY 2002-03 that amount increases to $1.9 million. Out year projections include $2.0 million in FY 2003-04, $2.1 million in FY 2004-05, and $2.2 million in FY 2005-06.

II. Income Tax Withholding Tables

To implement the new 8.25% tax rate and increased standard deduction, the Department of Revenue estimates that it will need a one-time appropriation of $143,228 in FY 2001-02. These funds will be used to print and mail revised withholding tables to employers.

III. Sales Tax on Liquor

The ABC Commission estimates that it will cost each of the 400 ABC stores across the state approximately $350 to $400 per store to upgrade their cash registers. This $140,000 to $160,000 expense will be funded by the operating budgets of the local ABC stores. It will take a minimum of 90 days to complete the upgrade.

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