

NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

**BILL NUMBER:** House Bill 1241, Committee Substitute

**SHORT TITLE:** Bundled Transactions Sales Tax

**SPONSOR(S):** Rep. Shubert

**FISCAL IMPACT:**

<b>Expenditures:</b>	<b>Increase ( )</b>	<b>Decrease ( )</b>
<b>Revenues:</b>	<b>Increase ( )</b>	<b>Decrease (X)</b>
<b>No Impact ( )</b>		
<b>No Estimate Available ( )</b>		

**FUND AFFECTED:**

<b>General Fund (X)</b>	<b>Highway Fund ( )</b>	<b>Local Govt. (X)</b>
<b>Other Funds ( )</b>		

**BILL SUMMARY:** The bill defines a "bundled transaction" as a transaction in which an item is transferred without charge or below the seller's cost for the item on the condition that the purchaser enter into an agreement to purchase services for at least six months and pay a cancellation fee if the purchaser cancels the agreement before the end of the minimum period. Under a bundled transaction, the consumer pays sales tax on the advertised price of the purchased item and may pay a tax on the service agreement. If the services the consumer purchases are not subject to a tax of at least 6%, the tax on the item purchased will be based on the item's normal retail price.

**EFFECTIVE DATE:** The act becomes effective on the first day of the third month following its ratification and applies to sales made on or after that date.

**PRINCIPAL DEPARTMENT(S)/PROGRAM(S) AFFECTED:** Department of Revenue

FISCAL IMPACT

	<u>FY</u> 1996-97	<u>FY</u> 1997-98	<u>FY</u> 1998-99	<u>FY</u> 1999-00	<u>FY</u> 2000-01
<b>REVENUES:</b>					
<b>GENERAL FUND</b>					
<b>LOCAL</b>					
<b>EXPENDITURES:</b>					

**ASSUMPTIONS AND METHODOLOGY:** With the issuance of Sales and Use Tax Bulletin No. 47, the Department of Revenue began collecting use tax on cellular phones sold in a bundled transaction. January 1, 1996 marked the start of the Department's effort to enforce existing sales and use tax law as it relates to products sold below cost in return for other considerations such as a binding service contract. The retail industry disputes the Department's interpretation of the law and at least 32 vendors

have filed claims for refunds of the "new tax" in the first five months of 1996.

Based on the retailers' claims for refunds, the Tax Research Division of the Department of Revenue has estimated the **state and local** revenue gain from the 6% sales tax on bundled transactions to be \$5 to \$10 million per year (\$3.3 to \$6.66 million state / \$1.66 million to \$3.33 local). This data is the most concrete information the Department has on cellular phone sales, because sales tax revenue is collected by business classification and not by item or commodity type.

This estimate is confirmed by national data from the Cellular Telecommunications Industry Association (CTIA). CTIA reported 33.8 million cellular phones in service in the US in 1995; an increase of 9.65 million phones over 1994. CTIA estimates the market penetration of cellular phones is 13% of the population. Using the CTIA estimate, North Carolina's 1995 population of 7,195,000 should have 935,350 phones or 2.7% of the national phone market. If North Carolina had 2.7 % of the national sales in 1995, then 260,550 cellular phone sales were purchased last year. If the price of a cellular phone is \$300, the sales tax due would be \$4,689,900. The \$300 price is an average of several phone models ranging in price from \$189 to \$500, and is the price charged a consumer if a phone service contract is terminated and the phone is kept. If the retailers have been giving cellular phones to customers since the issuance of Revenue's Bulletin No. 47, the state's General Fund has gained revenue from the use tax paid by retailers on the real price of those phones. On an annual basis, the use tax on the \$300 cost of the phone to the retailer versus no sales tax on a "free" phone will generate at least \$4.7 million based on industry data.

The Department's enforcement of the law has produced revenue for the General Fund, thus enactment of this bill will produce a loss to the General Fund in sales tax revenues. However, the revenue gained in 1996 from bundled transactions was not anticipated for the FY 1995-96 budget nor is it budgeted for FY 1996-97.

**SOURCES OF DATA:** Department of Revenue; Cellular Telecommunications Industry Association (CTIA)

**TECHNICAL CONSIDERATIONS:** Concern has been expressed about how the bill may affect other industries such as TV satellite antennas, security alarm systems, fire protection equipment, garbage disposal equipment, home water treatment equipment, cable television, and pagers. The Department of Revenue has not issued any memos on how the proposed law will affect these industries. At the present time, it does not appear that any of these industries have service arrangements similar to the cellular phone industry.

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