NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 1308 – Comm. Sub. Favorable 5-4-99

SHORT TITLE: Government Sales Tax Exemption

SPONSOR(S): Reps. Allen, Luebke, and Miller (G)

FISCAL IMPACT

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

NOTE: BILL HAS NO FISCAL IMPACT FOR THE 1999-00 OR 2000-01 FISCAL YEARS

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES ($Million)					
State General Fund:					
Loss of Interest Income	-1.0	-3.0	-5.6	-5.9	-6.2
Comm. Coll. Exempt.	-4.9	-5.1	-5.4	-5.6	-5.9
Net Impact	**-5.9**	**-8.1**	**-11.0**	**-11.5**	**-12.1**
Local Government:					
Gain In Interest Income	+1.0	+3.0	+5.6	+5.9	+6.2
Comm. Coll. Exempt.	-2.5	-2.6	-2.7	-2.8	-3.0
Net Impact	**-1.5**	**+ .4**	**+2.9**	**+3.1**	**+3.2**

Note: In addition to recurring impact shown, there would be a one-time negative budget impact to the State General Fund, explained in the methodology section, as follows:

2001-02 -$19.0 mill.
2002-03 -$34.4 mill.
2003-04 -$43.5 mill.

Expenditures: Due to the delayed implementation, there should be no additional mailing costs to the Department of Revenue as notice of the proposed change could be included in the normal annual mailing to merchants and other interested parties.

BILL SUMMARY: (1) **Replaces the annual refund of state and local sales taxes allowed counties, cities, and school boards with an exemption**, **phased-in according to the following schedule:**

School Boards	**Purchases made on or after July 1, 2001**
Counties	**Purchases made on or after July 1, 2002**
Cities	**Purchases made on or after July 1, 2003**

To be eligible the local unit must register with the Department of Revenue, make the purchase by the unit's check, credit card, procurement card, or credit account, and provide the seller with the exemption certificate. In addition, the finance officer of the unit shall have the duties of registering for the exemption, signing the exemption certificate, and verifying that all property purchased with the exemption is for use by the unit. In addition, the bill sets out penalties for misuse of a local government exemption certificate.

(2) Exempts community college purchases from state and local sales tax, effective for purchases made on or after July 1, 2001.

ASSUMPTIONS AND METHODOLOGY: **Local Government Tax Refund:**

The shift from a refund to an exemption would reduce interest income for the State and add to investment earnings of local units. The reason has to do with the fact that refunds are paid the year after the purchase is made. A review of the refunds paid by month for a recent fiscal year indicates that the average refund to local units is paid in November of the fiscal year following the purchase of taxable personal property. In analyzing the cost of the exemption, it was assumed that exempt purchases would be made at an even rate through the fiscal year. Thus, the "average purchase" is made around January 1. This meant that a sales tax exemption for local units would accelerate sales tax relief from November back to January, a period of 11 months. The assumed interest rate used for the calculation of the interest income loss to the State (and gain to local units) was 6%, based on a recent estimate by the Office of State Treasurer for the 1999-00 fiscal year. This means that the effective interest loss is equal to 5.5% (6% for 11 months) times the exemption amount.

The actual refunds paid to local units during the 1997-98 fiscal year were $52.4 million, according to the Department of Revenue. This amount was grown by 6% for 1998-99 and by 5% for future years. The refund amount was then moved back one year to obtain an estimate of the exemption dollars.

For public school purchases the 1997 session model developed to cost out the new refund for public school was used. This model separately estimated the refunds for current expense purchases and capital outlay. The capital number was adjusted upward to account for the $1.8 billion state school bond authorization. For capital purchases, it was assumed that 50% of the cost was for taxable purchases of tangible personal property (versus exempt labor charges). In addition, the 1997 analysis assumed that for each of the $450 million installments of the $1.8 billion school bond authorization, 30% of the proceed would be spend in the first year after the bonds were sold, 40% the next year, and 30% the following year.

Community College Exemption. The Department of Community Colleges has indicated that a review of their accounting records shows state and local sales tax of $6.0 million paid on purchases during the 1997-98 fiscal year. This amount was grown by 5% per year to come up with cost estimates for future years.

One Time Impact:
The state general fund budget is prepared on a cash basis and under current law refunds to local units are made in the year after the actual purchases. These two factors mean that for the first year of the change to an exemption, the State General Fund would see reduced sales tax revenue stemming from the combination of an exemption **plus the refunds to local units for purchases made the prior year.** The phased-in implementation of the change means that the one-time revenue loss to the General Fund will occur over a 3-year period. This effects the budget availability for capital improvements and one-time expenditures such as employee bonuses and litigation costs. Since most counties and cities count the potential refund as a "receivable" in the year of the purchase, there should be no one-time gain or loss to local units.

FISCAL RESEARCH DIVISION 733-4910

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