

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** SB 864 – Senate Finance Committee Substitute Lab Testing Facility Sales Tax

**SHORT TITLE:** Lab Testing Facility Sales Tax

**SPONSOR(S):**

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b>(\$ Millions)</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>REVENUES</b>	<b>0</b>	<b>0</b>	<b>(1.2)</b>	<b>(1.7)</b>	<b>(1.8)</b>

**PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED:** North Carolina Department of Revenue, Sales Tax Division.

**EFFECTIVE DATE:** This act becomes effective October 1, 2000 and applies to taxes paid on or after this date. This act is repealed effective for taxes paid on or after October 1, 2005.

**BILL SUMMARY:** The bill maintains the current 6% sales tax on many of the chemicals, test kits, and supplies used in laboratory testing, but makes these purchases eligible for a partial sales tax refund. Under the bill qualifying companies would pay the full 6% sales tax when they purchase supplies and reagents. These companies would then be eligible to receive a reimbursement for 50% of the state portion of the state sales tax charged on certain medical supply purchases. To qualify for the exemption the business must be certified by the federal Health Care Finance Administration (HCFA) as a moderate or highly complex laboratory. The lab must also be “primarily engaged in providing medical, analytic or diagnostic services, including bodily fluid analysis, generally to the medical profession or to employers, or to patients on referral from a medical professional or employer”. The bill defines this type of business as a medical laboratory testing company. The request for a refund is due within six months after the end of the state fiscal year. This sales tax refund sunsets in 2005.

**BACKGROUND:** The legislation authorizes a state sales tax refund for part of the tax charged on the following items that are used or consumed in the clinical laboratory testing business: medical products, medical accessories, reagents, chemicals, test kits, consumable lab supplies, and other similar tangible personal property not including machinery and equipment.

The special tax treatment only applies to companies that met both of two sets of qualifications. First, they must be certified by HCFA as a moderately or highly complex laboratory. Second, laboratory services, as defined in the bill, must be their primary business. Both the bill drafting attorney and industry representatives believe this definition includes only those companies that are laboratory service companies.

According to HCFA, there are 1,506 laboratories in North Carolina that are certified as moderately or highly complex. Most of these laboratories are in hospitals or a doctor's office. Because the primary business of these facilities (hospitals and doctors offices) is not laboratory testing, they would not qualify for the special tax treatment in the bill. Based on a list of all 1506 HCFA certified laboratories, Fiscal Research identified 80 facilities that may be stand alone laboratory testing businesses. These laboratories appear to be operated by approximately 44 companies. Fiscal Research, in conjunction with KPMG Accounting in Greensboro, surveyed these facilities to determine if they met the qualifications listed in the bill. Companies that qualified were asked to supply information about their medical supply and equipment expenditures. Of those surveyed, 15 responded or 34%. Two of these respondents indicated that they did not meet the qualifying criteria in the bill. However, according to the two largest laboratory companies in the state (LabCorp and Spectrum), they represent more than 80% of the total qualifying market. They also indicate that there are two other significantly sized firms, Great Smokey Mountains Laboratory and Triad Laboratories. Three of these four major companies responded to the initial survey. Fiscal Research and industry representatives believe those who responded to the survey, including LabCorp, Spectrum, and Great Smokey Mountains, represent between 85% and 90% of the market. The mid-point of these two points or 87.5% is used in the fiscal note.

One of the responding companies the Laboratory Corporation of America or LabCorp, provided extensive information about their expenditures, purchases, and the company as a whole. According to the organization's filings with the Security and Exchange Commission, LabCorp is the largest independent clinical laboratory company in the United States, based on 1998 net revenue. The company is headquartered in Burlington, NC, and offers more than 2,000 different clinical laboratory tests. LabCorp current maintains 25 regional testing facilities. The company reports 1998 net sales of \$1.6126 billion, with a gross profit of \$563.4 million, and net earnings of \$68.8 million. Because of the level of detail provided by LabCorp, and their dominant market share, much of the analysis is based on their information.

**ASSUMPTIONS AND METHODOLOGY:** Because of the unique structure of laboratory data, the estimates in this note are divided into three parts that reflect the three data segments available. Section 1 reflects the data provided by LabCorp, while Section 2 includes the estimates associated with the 12 other companies that responded to the survey and qualified for the exemption. Section 3 provides total loss estimates, including assumed losses associated with companies who did not respond to the survey. The data included in the note reflects only information provided by laboratory companies directly. No data from the Department of Revenue is used in this analysis.

#### Section 1: LabCorp Information:

According to documents provided by LabCorp, the organization's North Carolina laboratories spent \$50.67 million and \$46.89 million on reagents and other chemicals in 1997 and 1998. This

estimate assumes that 90% of all laboratory supply expenses were associated with reagents and other chemicals. LabCorp officials believe a 5% growth rate in this type of expenditure is appropriate. When questioned about using a 5% growth rate in light of the increased output anticipated by the bill, company representatives stated that “this additional work is not expected to greatly increase lab supply costs.” They cite more favorable contracts with vendors, reducing waste, increased efficiency (by the company manufacturing its own reagents), and the low per unit cost associated with many of the more routine tests which will be handled by the North Carolina facilities.

Assuming the 5% growth rate is appropriate, reagent and chemical purchases by the North Carolina portions of LabCorp will be:

	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Reagents &amp; Other Chemicals</b>	42,733,800	44,870,490	47,114,015	49,469,715	51,943,201	54,540,361

Under current law a 6% sales tax applies to these purchases. The tax liability associated with these estimates, once adjusted for the fiscal year basis are:

	<b>1999-00</b>	<b>2000-01</b>	<b>2001-02</b>	<b>2002-03</b>	<b>2003-04</b>
<b>Reagents &amp; Other Chemicals</b>	43,802,145	45,992,252	48,291,865	50,706,458	53,241,781
<b>Sales Tax (6%)</b>	2,628,129	2,759,535	2,897,512	3,042,387	3,194,507

Because the bill offers a sales tax refund of 2% of the state tax, the potential savings are as follows:

	1999-00	2000-01	2001-02	2002-03	2003-04
Potential Refund from Purchases Made In	876,043	919,845	965,837	1,014,129	1,064,836

Section 2: Other Laboratory Companies:

The 12 non-LabCorp companies that responded to the survey reported annual laboratory supply purchases of \$20,348,831. Assuming the 6% sales tax currently applies, the total revenue associated with these purchases is \$1,220,930. Under the bill, these laboratory companies are eligible for a refund of 2% of the state tax. Assuming supply purchases grow by 5%, the potential revenue impact is as follows:

	1999-00	2000-01	2001-02	2002-03	2003-04
Potential Refund from Purchases Made In	406,977	427,326	448,692	471,126	494,683

Section 3: Total Losses

As mentioned previously, survey respondents are assumed to account for 87.5% of the qualifying market. Assuming the survey results apply to the remaining 12.5%, the fiscal loss associated with the bill is as follows:

Potential Refund from Purchases Made In	1999-00	2000-01	2001-02	2002-03	2003-04
LabCorp	876,043	919,845	965,837	1,014,129	1,064,836
Other Survey Respondents	406,977	427,326	448,692	471,126	494,683
Other Companies	183,289	192,453	202,076	212,179	222,788
<b>TOTAL</b>	<b>1,466,308</b>	<b>1,539,623</b>	<b>1,616,605</b>	<b>1,697,435</b>	<b>1,782,307</b>

Because the bill does not become effective until October 1, 2000 there will be no fiscal impact in FY 1999-00. Under the bill refunds will not be issued until January 1, 2002. Therefore, there will be no fiscal impact until FY 2001-02. The FY 2001-02 estimate is reduced by ¼ to account for the October 1 effective date. The bill sunsets with purchases made on or after October 1, 2005. Therefore the final year of fiscal impact will be 2006-7.

**FISCAL RESEARCH DIVISION 733-4910**

**PREPARED BY:** Linda Struyk Millsaps

**APPROVED BY:** Tom Covington

**DATE:** Thursday, July 08, 1999



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