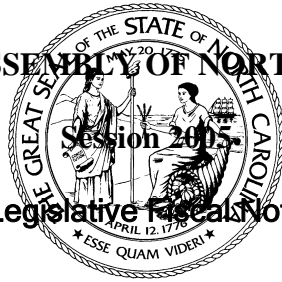


GENERAL ASSEMBLY OF NORTH CAROLINA



Legislative Fiscal Note

**BILL NUMBER:** Senate Bill 1466 (First Edition)

**SHORT TITLE:** Level Field for Baked Goods at 2% Sales Tax.

**SPONSOR(S):** Senator Cowell

<b>FISCAL IMPACT</b>					
	Yes (X)	No ( )	No Estimate Available ( )		
	<u>(in millions)</u>				
	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>	<u>FY 2009-10</u>	<u>FY 2010-11</u>
<b>REVENUES:</b>	(5.4)	(5.5)	(5.6)	(5.6)	(5.7)
<b>POSITIONS</b> (cumulative):					
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> Department of Revenue					
<b>EFFECTIVE DATE:</b> July 1, 2006					

**BILL SUMMARY:** This bill creates a sales tax exemption for bakery items as defined by the Streamlined Sales & Use Tax Agreement (SSTA). The exemption only applies to the state portion of sales tax.

Under current law, “prepared food” is subject to both state and local sales tax, while “food” is subject to only a 2% local tax. Certain bakery items fall within the definition of “prepared food” if they are sold in a heated state, heated by the retailer, or if the item consists of two or more foods mixed or combined by the retailer for sale as a single item. This legislation excludes bakery items from the sales tax base if the bakery item is included in the definition of bakery items and is sold without eating utensils provided by the retailer.

**ASSUMPTIONS AND METHODOLOGY:** In 2001, the General Assembly, in an attempt to conform to the requirements of the Streamlined Sales Tax Project, redefined food and created a new category of food – prepared food. In 2003, the General Assembly determined that all prepared food is taxable by the state. At that time, Fiscal Research assumed, based on the definition in the bill, that much of the bread and other items sold in a bakery or in the bakery portion of a grocery or discount store would be considered food, not prepared food, and would continue to be exempt. However, retailers believe the definition related to this category is unclear. As a result, some

retailers have been applying state tax to these items while others have not. This legislation clarifies that bakery items are exempt when they are sold without utensils.

An exemption for bakery items, as defined under the SSTA, would affect several types of retailers; businesses classified as bakeries by the North Carolina Department of Revenue, and retailers not classified as bakeries by the Department but who derive some portion of their profits from the sale of bakery items, primarily grocery stores, supermarkets, and other retailers who prepare bakery items on-premises for retail sale.

#### Bakeries

The Department of Revenue reported \$4,427,509 in sales tax collections from businesses identifying themselves as bakeries in 2004-05. Under this bill, the majority of those sales would be exempt.

#### Grocery stores and supermarkets

The Department also reported \$226,384,407 in collections from grocery stores, meat markets, and similar retailers. It is almost certain that a portion of gross sales (and therefore gross collections) from grocery stores is due to the sale of bakery items. Currently, many items in grocery stores are not subject to state tax and the Department has indicated that most major grocery stores have been in compliance with the 2003 sales tax change ("prepared food") that brought bakery items under the state sales tax.

The Department of Revenue does not have detailed data on the composition of gross revenues from grocery stores, so an alternative method of estimation was necessary for this fiscal note. To estimate the impact of qualifying bakery items sold by grocery stores and supermarkets, Fiscal Research computed the percent of sales of bakery items made by food and beverage stores at 0.181% of all sales for those types of North Carolina retailers as reported on the 2002 Economic Census.<sup>1</sup> Using this assumption, the amount of sales at North Carolina food and beverage stores attributable to bakery items is approximately \$23.0 million, and the estimated loss in revenue due to the exemption of bakery items is \$1.0 million.<sup>2</sup>

#### Other retailers selling bakery items

Some retailers selling bakery items that would qualify for this exemption do not fit the category of bakery (as defined by the Department of Revenue) or grocery store/supermarket. Since the Streamlined Sales & Use Tax Agreement specifies that bakery items that are sold for home consumption may be exempt but not bakery items intended for on-premises consumption (i.e., the retailer provides eating utensils), there is some question as to whether or not retailers of this sort would qualify for the exemption. Since Fiscal Research has no data on which to base an estimate for this type of retailer, a conservative estimate of the loss due to grocery stores and supermarkets has been used.

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<sup>1</sup> 0.181% is the ratio of total consumer expenditures on bakery items as reported by the 2002 Consumer Expenditure Survey (CEX) performed by the U.S. Bureau of Labor Statistics to total sales made by food and beverage stores in southern region states as reported by the 2002 Economic Census. States included in the CEX-defined "southern region" include: Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

<sup>2</sup> North Carolina food and beverage retailers made approximately \$12.7 billion in sales in 2002.

<b>Estimated 2006-07 Revenue Impact by Type of Retailer</b>				
	Type of retailer (\$ in millions)			
	Bakeries	Grocery stores and supermarkets	Other retailers	Total, all retailers
Estimated change in revenue due to exemption for bakery items	\$ (4.4)	\$ (1.0)	Unknown	\$ (5.4)

The projection assumes 1.3% annual growth in the sale of bakery items.<sup>3</sup>

**SOURCES OF DATA:** North Carolina Department of Revenue, U.S. Bureau of Labor Statistics Consumer Expenditure Survey, U.S. Census Bureau 2002 Economic Census

**TECHNICAL CONSIDERATIONS:** None

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**DATE:** June 14, 2006



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<sup>3</sup> This growth rate is the ten-year average growth in consumer expenditures on bakery items as reported by the CEX.