

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** H.B. 111 <1st Edition>  
**SHORT TITLE:** Government Sales Tax Exemption  
**SPONSOR(S):** Rep. Gordon Allen

**FISCAL IMPACT**

	Yes (X)	No ( )	No Estimate Available ( )		
	<u>FY 2001-02</u>	<u>FY 2002-03</u>	<u>FY 2003-04</u>	<u>FY 2004-05</u>	<u>FY 2005-06</u>
<b>REVENUES</b>					
<b>State General Fund:</b>					
Loss of Interest Income	0	(1.8)	(3.4)	(5.5)	(5.9)
Comm. College Exempt.	0	(4.8)	(5.9)	(6.7)	(7.5)
<b>NET IMPACT</b>	<b>0</b>	<b>(6.6)</b>	<b>(9.3)</b>	<b>(12.2)</b>	<b>(13.4)</b>
<b>Local Government:</b>					
Gain in Interest Income	0	1.8	3.4	5.5	5.9
Comm. College Exempt.	0	(2.4)	(3.0)	(3.4)	(3.7)
<b>NET IMPACT</b>	<b>0</b>	<b>(0.6)</b>	<b>0.4</b>	<b>2.1</b>	<b>2.2</b>

**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:

<b>2002-03</b>	<b>(42.0) million (Schools)</b>
<b>2003-04</b>	<b>(36.0) million (Counties)</b>
<b>2004-05</b>	<b>(43.8) million (Municipalities)</b>

**EXPENDITURES:** Due to the delayed implementation, there should be no additional mailing cost 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. There should be a cost reduction to schools and local governments, as they will no longer have the expenses associated with filing for a refund.

**PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED:** North Carolina Department of Revenue, Local Governments, Community Colleges, Local School Systems.

**EFFECTIVE DATE:** Community College exemption and refund, July 1, 2002. School exemption, July 1, 2002. County exemption, July 1, 2003. City exemption, July 1, 2004.

**BILL SUMMARY:** The bill has two primary parts.

(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, 2002.
Counties	Purchases made on or after July 1, 2003.
Cities	Purchases made on or after July 1, 2004.

To be eligible the local unit must register with the Department of Revenue, made 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 shall register for the exemption, signing the exemption certificate, and verifying that all property purchased with the exemption is for use by the unit. The bill also 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, 2002.

**ASSUMPTIONS AND METHODOLOGY:**

(1). Local Government and School 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. This shift is because 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. In analyzing the cost of the exemption, it was assumed that exempt purchases would be made at an even rate throughout the year. Thus the "average purchase" is made around January 1. This means that a sales tax exemption, rather than a refund, 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 5.25%, based on a recent estimate by the Office of the State Treasurer for the 2001-02 fiscal year. This means that the effective interest loss is equal to 4.8125%. (5.25% for 11 months) times the exemption amount.

The actual refunds paid to local schools and government units during the 1999-00 fiscal year are as follows:

<b>Unit Type</b>	<b>Refund</b>
Schools	33,303,389
Counties	26,975,128
Municipalities	30,977,212
<b>TOTAL</b>	<b>91,255,729</b>

Future estimates were generated by increasing the above amounts by the overall expected North Carolina sales tax revenue growth rates (5.7%, 5.7%, 6.4%, 5.9%, 6.0%, 6.0%). The

refund amount was then moved back one year to obtain an estimate of the exemption dollars. The resulting interest losses to the general fund, taking into account the effective dates of various portions of the bill, are below.

COST	2001-02	2002-03	2003-04	2004-05	2005-06
Schools		1,795,726	1,898,082	2,019,559	2,138,713
Counties		-	1,537,411	1,635,806	1,732,318
Municipalities		-		1,878,497	1,989,328
<b>TOTAL</b>	<b>-</b>	<b>1,795,726</b>	<b>3,435,494</b>	<b>5,533,862</b>	<b>5,860,360</b>

These losses to the general fund result in an equal gain for local governments and schools.

(2). Community College Exemption:

Under current law the community colleges receive neither an exemption nor a refund. The Department of Community Colleges has indicated that a review of their accounting records shows state sales tax payments of \$3,261,851. This suggests a total sales tax liability of \$4,892,777 (\$3.3 million state, \$1.6 million local). These amounts will show as a loss to both the state and local governments. The fiscal impact in the chart includes growth by the standard sales tax amounts listed above.

	2001-02	2002-03	2003-04	2004-05	2005-06
State	0	3,862,958	4,110,187	4,352,688	4,613,849
Local	0	1,931,479	2,055,094	2,176,344	2,306,925
Total	0	5,794,437	6,165,281	6,529,032	6,920,774

The above numbers are based on traditional growth patterns. However, because the state will issue \$600 million in bonds to support construction, which will be matched by approximately \$113 million in local funds, Fiscal Research believes community college purchases will increase sharply. According to the State Treasurer, community college bonds will be sold each March in each of six fiscal years at the following amounts: FY 2000-01 - \$48.4 million, FY 2001-02 - \$58.1 million, FY 2002-03 - \$116.1 million, FY 2003-04 - \$116.1 million, FY 2004-05 - \$135.5 million, and FY 2005-06 - \$125.8 million. Assuming local matches are distributed over the fiscal years in the same proportion as state funds, and that 50% of the investments are in taxable items, the additional losses are as follows:

	State Loss	Local Loss
FY 02-03	0.92	0.46
FY 03-04	1.78	0.89
FY 04-05	2.39	1.20
FY 05-06	2.91	1.46

The combined losses are noted in the fiscal impact chart above.

**NOTE:** In addition to the recurring changes listed above, the bill will also result in a series of one-time losses. Currently the state general fund budget is prepared on a cash basis and refunds to local units are made in the year after the actual purchases. The combination of these factors mean that in the first year the exemption is granted the state has to pay both the

refund and the exemption amounts (current year exemptions plus refunds for previous year purchases). The phased in implementation of the change means that the one-time revenue loss to the general fund will occur over three years.

According to the Local Government Commission, most counties and municipalities list the potential refund as a “receivable” in the purchase year. As a result, there will be no one time gain or loss to local governments and school systems.

**EXPENDITURES:** There will be no expenditure side impact to traditional state agencies. Local governments and schools should see a reduction as the process is greatly simplified.

**FISCAL RESEARCH DIVISION 733-4910**

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