

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2011

Legislative Fiscal Note

BILL NUMBER: House Bill 888 (First Edition)
SHORT TITLE: Sales Tax Fairness Act
SPONSOR(S): Representatives Folwell and Current

FISCAL IMPACT (\$ In Millions)					
	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2011-12</u>	<u>FY 2012-13</u>	<u>FY 2013-14</u>	<u>FY 2014-15</u>	<u>FY 2015-16</u>
REVENUES					
Cap Nonprofit Sales Tax Refund	\$ 81.4	\$ 83.9	\$ 86.4	\$ 88.5	\$ 90.7
End Transfer to Public School Fund	46.8	48.2	50.0	50.9	52.2
LEA State Sales Tax Refund	(38.6)	(39.8)	(40.1)	(42.0)	(43.0)
Net General Fund Impact	\$ 89.6	\$ 92.3	\$ 95.1	\$ 97.5	\$ 99.9
EXPENDITURES					
POSITIONS (cumulative):					
PRINCIPAL DEPARTMENT(S) & North Carolina Department of Revenue,					
PROGRAM(S) AFFECTED: Local Education Administrative Units (LEAs)					
EFFECTIVE DATE: July 1, 2011					

BILL SUMMARY: House Bill 888 amends G.S. 105-164.14(b), the sales tax refunds allowed to nonprofits. The proposal limits the annual sales and use tax refund allowed to a claimant to 100% of the first \$1.0 million requested and 25% of the amount requested that exceeds \$1.0 million. Effective July 1, 2011, the refund cap applies to sales and use tax paid on or after that date.

HB 888 also reinstates the repealed LEA state sales and use tax refund found under G.S. 105-164.14(c)(2b) and (2c). Effective for purchases made on or after July 1, 2011, HB 888, the Sales Tax Fairness Act, provides a sales tax refund for local school administrative units (LEAs) on purchases that meet specified conditions. The bill also repeals a mandatory distribution from the General Fund to the State Public School Fund (SPSF) under G.S. 105-164.44H, a provision enacted in 2005.

S.L. 2005-276 repealed the state portion of LEA sales tax refunds replacing the refund with a recurring transfer of the equivalent amount to the Public School Fund, G.S. 105-164.44H. The result was to direct these state funds for public education through the budgetary process instead of returning the state funds directly to LEAs as refunds.

Lastly, HB 888 modifies G.S. 105-467(b). This change clarifies that a taxing county may not allow an exemption, exclusion, or refund that is not allowed under the state sales tax and deletes various exemptions.

This bill becomes effective July 1, 2011, and applies to purchases made on or after that date.

ASSUMPTIONS AND METHODOLOGY:

HB 888 increases General Fund availability by \$89.6 million in fiscal year 2011-12. Local revenues also increase under HB 888 by \$27.8 million per year. The legislation proposes three changes: 1) capping the annual nonprofit sales and use tax refund at \$1.0 million per institution, 2) repealing the \$46.8 million annual transfer from the General Fund to public schools, and 3) reinstating the state sales tax refunds for LEAs.

Eighty million dollars of the total \$89.6 million increase in General Fund availability results from capping nonprofit sales and use tax refunds. The second change under HB 888—repealing the public school fund transfer increases General Fund availability by \$46.8 million. The third change under HB 888, reinstating the LEA sales tax refund, decreases General Fund availability by \$38.6 million. In the short term, repealing the public school fund transfer, while reinstating the LEA sales tax refund creates a net increase in General Fund availability of \$8.2 million. These two changes over the long-term “cancel each other out” creating a revenue neutral change.

The paragraphs below outline the fiscal impact of all three changes listed above: 1) capping the nonprofit sales and use tax refund at \$1.0 million per institution, 2) repealing the sales tax transfer from the General Fund allocated to public schools, and 3) reinstating the sales tax refund for local education associations.

Capping the nonprofit sales and use tax refund

HB 888 limits the sales and use tax refund for institutions that receive more than \$1.0 million in state and local refunds. The proposal rewards any nonprofit receiving state and local sales tax refunds in excess of \$1.0 million, 25% of the refunds due for amounts above \$1.0 million. Thirty-four nonprofits receive approximately \$144.2 million in annual state sales tax refunds above \$1.0 million. Creating a \$1.0 million cap would affect 34 institutions (28 hospitals and 6 colleges and universities), and increase state and local revenues by \$108 million ($\$144.2 \text{ million} * 75\% = \108 million). The state would receive 74% of the \$108 million in revenues, for a \$78.8 million increase in General Fund availability in fiscal year 2011-12.

Repealing the transfer to the Public School Fund

HB 888 proposes repealing the public school transfer under G.S. 105-164.44H, while reenacting the sales tax refund for LEAs under GS 105-164.14(c), (2b) and (2c). Enacting this portion of HB 888 would increase General Fund availability by \$8.2 million during the 2011-12 fiscal year. Between July 1, 2011 and June 30, 2012, LEAs are expected to qualify for \$38.6 million in state sales and use tax refunds, while Fiscal Research estimates a Public School Fund transfer of \$46.8 million, a difference of \$8.2 million.

Repealing the public school fund transfer under, G.S. 105-164.44H would increase General Fund availability by \$47.0 million to \$52.2 million per fiscal year. In 2005, the General Assembly repealed the state sales and use tax refund for LEAs. In place of a refund, the legislature provided that an equivalent amount be transferred annually to the State Public School Fund (SPSF). HB 888 eliminates this annual transfer, increasing General Fund availability by an equivalent amount.

Reinstating the sales tax refund to local education associations

As mentioned in the section above, the SPSF receives a quarterly transfer from the Department of Revenue in lieu of LEAs receiving a sales tax refund. The transfer was initially based on the amount of sales taxes refunded to LEAs during the 2005-06 fiscal year. LEAs received their final sales and use tax refunds for purchases made during the 2005-06 fiscal year. Since the enactment of the transfer, the allocation has been adjusted annually to reflect increases or decreases in state sales tax collections.

As shown in Table 1, LEA local sales and use tax refunds declined by 11 percent between 2005-06 and 2006-07, coinciding with the repeal of the LEA state sales and use tax refund. There is no complete explanation of why LEA spending declined after the repeal of the state portion of their sales tax refunds, but informal conversations with county finance officers suggest that LEAs began purchasing items through their respective county governments after the repeal.

Table 1. LEA State Sales and Use Tax Refunds, by Fiscal Year (\$ In Millions)	
FY 2005-06	FY 2006-07
\$41.1	\$36.7

Shifting spending to the county allowed the schools to take advantage of the local government sales and use tax exemptions while using the higher, pre 2006-07 spending levels as the basis for the SPSF transfer. Should the state sales and use tax exemption be created in addition to the reinstatement of the refund, LEA spending will increase as schools reallocate expenditures from their county offices back to the LEA. Eliminating the transfer to the SPSF, however, will more than offset the expenditures associated with a tax refund, providing a net surplus to the General Fund.

Reinstating LEA sales tax refunds would reduce General Fund availability by \$38.5 million in fiscal year 2011-12. This loss, however, would be replaced by the influx of revenue associated with repealing the public school transfer. Table 2 illustrates, based on 2008-09 and 2009-10 fiscal year information, how General Fund availability increases under HB 888.

Table 2. Fiscal Impact of HB 888 LEA Sales Tax Refund Changes, FY 2009 and FY 2010, \$ In Millions		
	FY 08-09	FY 09-10
State Public School Fund (SPSF) Transfer	\$ 47.4	\$ 45.3
Local LEA Sales Tax Refund	20.6	17.9
State LEA Sales Tax Refund*	(39.6)	(37.4)
Fiscal Impact of HB 888 LEA refund adjustments**	\$ 7.8	\$ 8.0
* State sales and use tax refunds calculated based on local sales and use tax refunds awarded to LEAs **Represents a gain in General Fund revenue (SPSF Transfer minus Implied State Sales Tax Refund) Sources: Public School Fund Appropriations, 2010 Statistical Abstract, Table 33, Sales and Use Tax Refunds, by Type of Claimant		

SOURCES OF DATA: LEA Sales and Use Tax Refunds—North Carolina Department of Revenue, Amounts Refunded During Designated Fiscal Years under G.S. 105-164.14(2b), (2c), 2010 Statistical Abstract.

Public School Fund Appropriations—BD-701, Public School Fund, Budget Code 13510, Fund 1800, Account 438150.

TECHNICAL CONSIDERATIONS: None

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