NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: S.B. 1327 (Second Edition)

SHORT TITLE: No Tax on Gas Cities

SPONSOR(S): Senators Dalton and Phillips

FISCAL IMPACT

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

(Millions)

	FY 1998-99	FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03
REVENUES					
Pre - Directive					
General Fund	**(.3)**	**(.3)**	**(.3)**	**(.3)**	**(.4)**
Cities	**(.5)**	**(.5)**	**(.5)**	**(.5)**	**(.5)**
Post - Directive					
General Fund	**(6.7)**	**(6.8)**	**(6.9)**	**(7.0)**	**(7.2)**
Cities and Counties	**(0.6)**	**(0.6)**	**(0.6)**	**(0.7)**	**(0.7)**

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue, Counties, and Municipalities.

EFFECTIVE DATE: July 1, 1998.

BILL SUMMARY: This bill restructures state excise taxes on natural gas. The bill eliminates the distinction between sales by utilities and sales by others, and applies a uniform excise tax to all piped natural gas consumed in North Carolina. The rate is structured as a "declining block" that decreases as the amount of gas consumed per month increases. The new tax rate is based on the amount of gas consumed, rather than the price paid for the gas. The bill also exempts those cities with their own piped gas systems from the new tax.

BACKGROUND: In the natural gas industry there are three types of sellers: utility companies, gas marketers, and cities that sell their own gas. Several types of tax now apply to piped natural gas, with the rates and type of tax charged determined by the type of seller and buyer. Utility companies are responsible for a sales tax of 3% (2.83% if the customer is a manufacturer) and a gross receipts tax of 3.22% on the commodity price. Under current law the utilities are the only group responsible for sales tax. Gas marketers are responsible for a gross receipts tax on the transportation charge (not the commodity price). However, if the gas is sold to a customer with direct access, no gross receipts tax is payable. Gas cities pay no sales tax, but pay a gross receipts tax only on the gas they purchase for resale from a North Carolina utility. A use tax should be paid by the customers of natural gas marketers. All taxes are based on the price paid for the gas.

On May 5, 1998, the Department of Revenue issued a directive (SD-98-2) concerning the sale of piped natural gas. As of July 1, 1998, piped natural gas will be defined as tangible personal property and its retail sale will be subject to the 6% sales and use tax (4% state and 2% local), unless specifically exempt by statute. Sales of piped natural gas by the producer will continue to be exempt from sales tax. The sale of piped gas by a city is not exempt, and is subject to either a 3% (if utility) or 6% (not a utility) sales tax. A gas marketer is not exempt and would be responsible for the 6% rate. All gas sold to farmers, manufacturers, or laundries will be subject to a 2.83% tax. Utilities will only be responsible for a 3% sales tax rate, or 2.83% if the gas is sold to farmers, manufacturers, or laundries.

ASSUMPTIONS AND METHODOLOGY:

PRE - DOR DIRECTIVE

The first estimate made for SB 1327 is the revenue impact the change in tax rate and tax structure would have on the General Fund and on local governments without the Department of Revenue directive. Actual sales and gross receipts tax collections (related to piped natural gas) in 1997 were estimated to be $58.4 million by the Public Staff of the Utilities Commission. To determine the anticipated revenue for fiscal year 1998-99, this number was increased by 2% each year to reflect future growth. An adjustment was also made to convert the calendar year numbers to a fiscal year basis. After these calculations, the estimate for FY 1998-99 under the current law is $60,164,172.

SB 1327 proposes to tax natural gas on a declining block tax rate system where the tax decreases as the amount of therms of gas consumed increases. The bill has five tax blocks as shown in the chart on the next page. The tax revenue from the proposed tax rates is $59,349,474 or $814,698 less than the projected amount under the current law.

98-99	**98-99**

Rate Block (therms)	Estimated Deliveries (therms)	Rate per therm	Estimated Tax Receipts
Under 200	535,766,523	$0.0470	$25,181,027
201 to 15,000	354,303,606	$0.0350	12,400,626
15,001 to 60,000	272,888,227	$0.0240	6,549,317
60,001 to 500,000	730,938,356	$0.0200	14,618,767
500,001 and over	149,934,084	$0.0040	599,736
Total - SB 1327	2,043,830,796		$59,349,474
FY 1998-99 Revenue Est.(Current Law)			**$60,164,172**
Revenue Loss			**($814,698)**

This revenue loss is shared by the General Fund and cities. The Department of Revenue estimates that the loss will be distributed 60% to cities and 40% to the state based on comparable data from the franchise tax on telephone usage. The General Fund revenue loss will be subtracted from projected General Fund tax revenues for FY 1998-99. The revenue loss in the chart above is estimated to grow by 2% a year for fiscal years 1999-00 to 2002-03.

POST - DOR DIRECTIVE

Without SB 1327, the state, counties and cities will gain revenue from the taxes imposed on gas cities and natural gas marketers due to the DOR directive. In 1997 it is estimated that marketers sold 64,275,492 decatherms of natural gas valued at $160,688,730. Although not taxed at the marketer level, the Department of Revenue attempts to collect the use tax on the gas from the customers. This note assumes the Department collects use tax (2.83% and 6%) on 25% of the volume sold by marketers. The remaining 75% will be taxed according to the directive. The fiscal note assumes 75% of the volume untaxed prior to July 1, 1998 is going to manufacturers and will be taxed at 2.83%. The fiscal note assumes the other 25% of untaxed gas will be taxed at 6% with the revenue split 4% state and 2% local. Future year growth in gas volume is estimated at 2% a year.

	Gas sold by Marketers	Gas Value	use tax paid on 25% of volume	25% of remainder taxed 6%	75% of remainder taxed 2.83%
1997	64,275,492	$160,688,730	$ 1,773,602	$ 1,807,748	$ 2,557,964
1998	65,561,002	$163,902,505	$ 1,809,074	$ 1,843,903	$ 2,609,123
1999	66,872,222	$167,180,555	$ 1,845,255	$ 1,880,781	$ 2,661,305
2000	68,209,666	$170,524,166	$ 1,882,160	$ 1,918,397	$ 2,714,532
2001	69,573,860	$173,934,649	$ 1,919,804	$ 1,956,765	$ 2,768,822
2002	70,965,337	$177,413,342	$ 1,958,200	$ 1,995,900	$ 2,824,199
2003	72,384,644	$180,961,609	$ 1,997,364	$ 2,035,818	$ 2,880,683
2004	73,832,336	$184,580,841	$ 2,037,311	$ 2,076,534	$ 2,938,296

The other new revenue is from a sales tax on the eight municipal gas systems in the state. In 1997, these cities sold natural gas worth $90 million. Since 7 of the 8 municipal gas systems are utilities, this fiscal note assumes the city gas sales will be taxed at the utilities rate of 3%. A 2% growth rate is used for future year revenues.

	Value of Gas sold by cities	3% tax
1997	$ 90,000,000	$2,700,000
1998	$ 91,800,000	$2,754,000
1999	$ 93,636,000	$2,809,080
2000	$ 95,508,720	$2,865,262
2001	$ 97,418,894	$2,922,567
2002	$ 99,367,272	$2,981,018
2003	$101,354,618	$3,040,639
2004	$103,381,710	$3,101,451

Fiscal year cost is derived from the calendar year estimates by taking half of one year plus half of the next year. For example, the FY 1998-99 estimate equals half of 1998 and half of 1999. The state revenue includes 2/3 of the 6% sales on marketers, all of the 2.83% on marketers, and the tax on gas cities. The local revenue equals 1/3 of the 6% tax on marketers.

	State	Local
FY 97-98	$6,527,760	$608,609
FY 98-99	$6,658,316	$620,781
FY 99-00	$6,791,482	$633,196
FY 00-01	$6,927,312	$645,860
FY 01-02	$7,065,858	$658,777
FY 02-03	$7,207,175	$671,953

Although this fiscal note shows a loss of post - directive revenue due to this bill, this income was not built into the consensus General Fund revenue estimate for FY 1998-99.

TECHNICAL CONSIDERATIONS: It should be noted that natural gas prices are highly volatile and very sensitive to changes in climate and market forces. As such, year to year variations in the revenue associated with natural gas taxes, under the current system, can vary dramatically. It should also be noted that an increase in transportation gas directly increases the amount of revenue distributed to cities.

FISCAL RESEARCH DIVISION, 733-4910
PREPARED BY: Linda Struyk Millsaps & Richard Bostic
APPROVED BY: Tom Covington
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