NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 231 <1st Edition>

SHORT TITLE: Equalize Sales Tax on Software

SPONSOR(S): Rep. Allen

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund	**$100,000**	**$100,000**	**50,000**	**50,000**	**50,000**
Local Government	**50,000**	**50,000**	**25,000**	**25,000**	**25,000**

PRINCIPAL DEPARTMENT (S) &
PROGRAM (S) AFFECTED: North Carolina Department of Revenue

EFFECTIVE DATE: July 1, 2001.

BILL SUMMARY: Under current law software is considered tangible personal property. As a result, the North Carolina sales and use tax is currently applied to the sale of computer software delivered on a storage medium such as a disk, tape, or CD-ROM. The bill clarifies that tangible personal property includes computer software whether delivered on a storage medium or electronically (via the internet). By including electronic transfers in the definition the bill effectively clarifies that the sales and use tax applies to computer software delivered electronically.

ASSUMPTIONS AND METHODOLOGY:

The International Data Corporation estimated that in 1997 approximately $200 million was spent nationwide on electronically downloaded software, or EDS. The Software Information Industry Association (SIIA) believes that number will increase to just under $1billion nationally in 2001. Using the North Carolina's percent of the U.S. population as a proxy for the state's portion of the EDS market suggests that $28.6 million will be spent in North Carolina in 2001 for EDS. Assuming the 4% state and 2% local sales taxes apply, the maximum potential revenue increase is $1.14 million state and $0.57 million to locals.

Because the sale will be handled electronically, and will often be supplied by a non-North Carolina vendor, the primary collection avenue is the use tax. The North Carolina

Department of Revenue reports that approximately five million dollars in use tax revenue was collected through the use tax line item on the individual income tax form. This represents 4% of the outstanding estimated use tax liability from remote sales. Using the 4% collection rate as a proxy, Fiscal Research estimates that the bill could yield as little as $46,000 for the state and $23,000 for local governments. While the 4% is a good proxy for individual use tax payments, businesses tend to pay a greater portion of their use tax liability. Therefore, a figure of $150,000 ($100,000 state, $50,000 local) is used for the 2001-02 and 2002-03 fiscal years.

Industry analysts believe this market may have peaked as most major software companies are moving towards providing this software on a subscriber or fee for service basis (Building the Net: Trends Report 2000, Trends Shaping the Digital Economy, SIIA). In addition, most of the revenue gain from individual income taxpayers will be lost in 2003-04 as the use tax line item will no longer appear on the individual income tax return for tax years beginning on or after January 1, 2003. Therefore a revenue estimate of $75,000 ($50,000 state, $25,000 local) is used for the remaining fiscal years.

This estimate assumes the Department of Revenue will adjust the table used for estimating use tax liability to include this category of sales.

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