NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 748 (Second Edition) Senate Finance Committee Substitute

SHORT TITLE: Vehicle Transition/ Premiums Tax/ Prepared Food

SPONSOR(S):

FISCAL IMPACT

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

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
Highway Trust Fund	*** See Assumptions and Methodology ***				
General Fund*	*** See Assumptions and Methodology ***				
EXPENDITURES	**No fiscal impact**				

PRINCIPAL DEPARTMENTS AFFECTED: Department of Transportation - Division of Motor Vehicles; N.C. Department of Revenue collects the premiums tax. The enactment of the change will not affect the budget requirements of the Department of Revenue.

EFFECTIVE DATE: Section 1(vehicle transition) is effective when it becomes law. Subsections f and g of Section 2 (premiums tax) are effective for taxable years beginning on or after January 1, 2004. The remainder of Section 2 is effective for taxable years beginning on or after January 1, 2003. Section 3 (prepared food) becomes effective January 1, 2002, and applies to sales made on or after that date.

* Failure to pass the legislation will result in the following minimum revenue loss:

FY 2001-02	($30.26) million
FY 2002-03	($62.84) million
FY 2003-04	($63.34) million
FY 2004-05	($65.72) million
FY 2005-06	($70.26) million

BILL SUMMARY:

I. Vehicle Transition - SB 1005 removed the $1,500 cap on the sale of a motor vehicle, effective for vehicles titled on or after October 1, 2001. That bill also provided that a set amount be transferred annually from the Highway Trust Fund to the General Fund to effectively send the new revenue from this change to the General Fund. This bill provides that the repeal of the $1,500 highway use tax cap effective, October 1, 2001, does not apply to vehicle titles issued pursuant to a sale or a contract entered into before October 1, 2001.

II. Premiums Tax - Concern has been expressed that the 1/1/02 effective date for the premiums tax increase in SB 1005 (.83% rate on 1/1/02, 1.0% for later years) does not provide enough implementation time for the affected taxpayers (HMO's, Blue Cross). After meeting with representatives of the taxpayers and the Department of Insurance, a substitute package was developed that would:

(1) Apply 1.1% tax to premiums of Blues, HMO's for 2003 and 1.0% for all later years.
(2) Use a 1/1/03 effective date
(3) Convert the installment payment system (3 payments during the tax year, each payment equal to 1/3 of **prior year** tax liability) to an estimated tax payment system for the 2003 tax year. Under this proposal, the April and June 2003 payment would be equal to 50% of the expected 2003 tax liability. For 2004 and future tax years, the old installment system would be used.
(4) Corporate income and franchise taxes paid by HMO's would be repealed beginning with the 2003 tax year (repeal was part of original package)

III. Prepared Food - SB 144, Streamlined Sales Tax, made several definitional changes to the state's sales tax statutes. In particular, the legislation revamped the definition of prepared food and exempted at least a portion of that category from state sales tax. Under SB 144, prepared food for home consumption is exempt. This bill returns to a reference to the food stamp eligibility for candy, soft drinks, and prepared food. It also clarifies that dietary supplements and food sold through a vending machine continue to be subject to tax.

ASSUMPTIONS AND METHODOLOGY:

Vehicle Transition

As noted above, the tax cap on motor vehicles was removed effective October 1, 2001. This legislation was passed September 26, 2001. Apparently some motor vehicle dealers, particularly recreational vehicle dealers, sold vehicles on or before October 1, but did not apply for title until after October 1, and did not collect the additional tax for those sales. This provision clarifies that dealers are not liable for the additional tax if the item was sold but not titled by October 1.

Any refunds to be made are based on over collections that were not anticipated in SB 1005. In addition, payments by dealers that have not yet been made were also not anticipated. Therefore, there is no fiscal impact anticipated as a result of HB 748.

Premiums Tax

The original bill (SB 1005) had no impact on the 2001-02 fiscal year and the new proposal does not change that. The specifics of the new plan were designed in such a way that the new revenue produced for 2002-03 would be equal to the General Fund revenue that would have been captured by the SB 1005 plan. Thus, the proposal would be revenue neutral for 2002-03 with regard to the provisions adopted in the budget act.

For future years, it is difficult to determine the exact impact of either the prior change or the new provisions due to the uncertainties in the health insurance marketplace. In general, the new proposal should be revenue-neutral when compared to the budget act provisions. For

2003-04, there might be a revenue loss (compared to budget act) due to the acceleration of estimated tax payments into 2002-03 fiscal year to ensure revenue neutrality for that year.

<u>Prepared Food</u>

Previous to SB 144, food items were exempt from state sales tax if they could be purchased with food stamps. As such, exempted items were limited to particular food items purchased at a grocery or convenience store. SB 144, which becomes effective January 1, 2002, redefined the term prepared food, and removed reference to the federal food stamp program. At the time SB 144 was approved by the legislature, both the Department of Revenue and legislative staff believed the impact of this definitional change would be minimal. This was reflected in the fiscal note for SB 144. Since the passage of SB 144, Fiscal Research became aware that this interpretation of the new law could be challenged on legal grounds. If the challenge is successful, this change would effectively exempt all take-out, drive-thru, and delivery foodstuffs from state sales tax.

The 1997 Economic Census indicates that limited service restaurants whose primary type of foodservice is take-out, drive through, or delivery recorded $995.58 million in sales that year. Applying a 4.5% state sales tax rate to that amount suggests revenue of $44.8 million in 1997 from these facilities alone. While no historical data is available, the National Restaurant Association forecasts a 6.9% growth rate for their industry over the next year. Using this number as a proxy for annual growth suggests the following potential revenue stream. (Adjustments have been made to account for the effective date of both the definitional change and the general sales tax rate).

FY	2001-02	2002-03	2003-04	2004-05	2005-06
$Millions	30.26	62.84	63.34	65.72	70.26

The above amounts could become the <u>**minimum**</u> loss associated with the prepared food portion of SB 144 if a legal challenge is successful. This is only a <u>**minimum**</u> estimate as it does not include take out from a full service restaurant or any other restaurant that is not primarily drive-thru, take out, or delivery. As such, the actual loss could be much larger.

The current legislation would effectively return the definitions of prepared food, candy, and soft drinks to the previous food stamp standard, with some variation at the margins. As such, passage of the legislation will eliminate the above potential revenue loss.

FISCAL RESEARCH DIVISION 733-4910
PREPARED BY: David Crotts, Linda Struyk Millsaps, Bob Weiss, and Richard Bostic.

APPROVED BY: James D. Johnson

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