NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: House Bill 1548 (First Edition)

SHORT TITLE: Apply Sales Tax to Certain Vehicles

SPONSOR(S): Representative Michaux

FISCAL IMPACT

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

($Million)

	FY 2002-03	**FY 2003-04**	**FY 2004-05**	**FY 2005-06**	**FY 2006-07**
REVENUES					
General Fund					
General Sales Tax	$3.9	$2.8	$2.8	$2.8	$2.8
Repeal of Maximum					
Aircraft	No Estimate Available – See Assumptions and Methodology				
Rail cars	No Estimate Available – See Assumptions and Methodology				
Boats	$3.6	$3.3	$3.3	$3.3	$3.3
Total General Fund:	**$7.5**	**$6.1**	**$6.1**	**$6.1**	**$6.1**
Local Government					
General Sales Tax	$5.3	$7.3	$7.3	$7.3	$7.3
Repeal of Maximum					
Aircraft	No Estimate Available – See Assumptions and Methodology				
Rail cars	No Estimate Available – See Assumptions and Methodology				
Boats	$2.2	$3.1	$3.1	$3.1	$3.1
Total Local Govt.:	**$7.5**	**$10.4**	**$10.4**	**$10.4**	**$10.4**

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

EFFECTIVE DATE: July 1, 2002

BILL SUMMARY: Current law under NC G.S. 105-164.4(a)(1b) levies a 3% sales tax on the purchase of boats, aircraft, railway cars, and locomotives. The maximum tax is $1500 per article. This bill would repeal that section of the statute and apply the general sales and use tax rate to the sale of aircraft, boats, railway cars, and locomotives with no limit. This would include applicable state and local sales and use tax levies.

ASSUMPTIONS AND METHODOLOGY:

Apply General Sales Tax Rate

Gross industry sales growth has been inconsistent over the past four fiscal years. Industry sales of boats, airplanes, and railway cars experienced significant declines over the previous fiscal year starting in October 2001. This could be attributed to the weakened economy and the September 11th tragedy. Retail sales and tax collections data from the NC Department of Revenue are available through March 2002. To estimate the remaining three months for fiscal year 2001, the average from the first three months of the fiscal year was used as opposed to the entire year's data. Sales in the summer months are consistently higher than in fall and winter months.

NC State Sales and Use Tax by Types of Business – Airplanes, Boats, etc. at 3%

Fiscal Year	Gross Retail Sales	Gross Sales Tax Collections	Gross Use Tax
1997-98	$366,303,100	$11,019,295	111,055
1998-99	$340,919,411	$10,652,232	$105,637
1999-00	$356,004,568	$10,737,478	$66,359
2000-01	$354,364,599	$10,716,618	$99,404
2001-02*	$325,546,332	$9,829,268	$50,479**

*Actuals through March 2001 and estimated through June 2002.

**Through November 2001. Effective October 16, 2001, the general state sales and use tax rate increased from 4% to 4.5%. Sales and use taxes were then combined, and taxable sales are computed on the total. Thereafter, gross collections reflect the ½% tax rate increase, and gross retail sales reflect taxable sales computed on the combined total of sales and use taxes.

If the state were to increase the sales and use tax rate for these industries, assuming a July 1, 2002, implementation date and a lag time of one month's collections, the total increase in state and local government revenues would be approximately $10.4 million for fiscal year 2002-03. This was estimated using the current 4.5% state and 2% local sales tax rates. Assuming no industry growth, the total increased revenue would remain at $11.3 million each fiscal year thereafter. This assumes a return to the 4% general state sales tax rate but an increase to 2.5% in the local sales tax rate after fiscal year 2002-03. The chart below shows the breakdown in state and local government sales tax revenues.

Fiscal Year	2002-03	2003-04	2004-05	2005-06	2006-07
State	$4,418,624	$3,192,585	$3,192,585	$3,192,585	$3,192,585
Local	$5,968,349	$8,138,658	$8,138,658	$8,138,658	$8,138,658
Total	$10,386,973	$11,331,243	$11,331,243	$11,331,243	$11,331,243

Changes in consumer buying patterns may result from the increase in NC sales tax. Based on this projection, a reduction of 10% in gross revenues is estimated. This change is reflected in the chart on the first page.

Repeal of the Maximum Sales Tax

The repeal of the $1500 per article limit on sales tax would also contribute to revenue increases, but the impact is more difficult to estimate. The Department of Revenue data on gross retail sales and tax collections does not include the amount of retail sales above the $1500 taxable limit (i.e. a $50,000 purchase or greater). Taxpayers report gross sales up to the $50,000 limit on the tax computation line of their returns, and this value corresponds to the Department's gross tax collections at the 3% tax rate. For those sales greater than $50,000, the difference is reported in an exemption section. The gross exemption amount is not broken down by category due to Department of Revenue processing system functionality. Thus, no estimate about the amount of gross retail sales above $50,000 on boats, aircraft, railway cars, and locomotives can be calculated from the existing revenue data.

Therefore, Fiscal Research attempted to estimate the potential revenue increase based on industry data. The removal of the $1500 per article limit on sales tax on aircraft, railway cars, and locomotives would produce negligible if not slightly negative sales tax revenue. However, the removal of the $1500 per article limit on sales tax on boats would generate increased revenues. Use tax revenues would still apply. Fiscal analysis of the change for industries is noted below.

Aircraft: According to the Federal Aviation Administration (FAA) Registry, there are approximately 7,800 aircraft registered in North Carolina. New registrations by the state are not tracked independent of all registrations that occur each year (transfers, recertifications, etc.). Though annual data on the number and value of aircraft sold in North Carolina are kept by the National Business Aviation Association (NBAA), these data are unavailable to Fiscal Research due to privacy issues. They report that 1006 business aircraft were sold in the United States in 2001. The National Association of State Aviation Officials (NASAO) and the Aircraft Owners and Pilots Association (AOPA) keep records of annual aircraft sales on a national basis, but not by state.

In order to approximate the annual number and value of aircraft sales in North Carolina, Fiscal Research attempted to estimate the average value of aircraft based on depreciation. Aircraft, however, have an unlimited life expectancy due to the level of maintenance they undergo on a yearly basis. As an example, Henry Ogradinsky, director of NASAO pointed out that the majority of the Piper Cubs from the 1947-1949 production period are still in use today. Additionally, aircraft registered in North Carolina as a percentage of registered aircraft in the US is not necessarily a reliable proxy for North Carolina's share of national aircraft sales.

All of the representatives from the previously mentioned aviation organizations have suggested the potential negative fiscal impact of this change due to cross border effects. Sales tax limits exist in both South Carolina ($300) and Virginia ($2000), thus consumers could choose to have delivery of their purchases in a border state to avoid the North Carolina sales tax. This was the case in Wisconsin when they implemented an excise tax on aircraft. Purchasers took delivery in bordering Illinois to avoid the excise tax, resulting in a nominal revenue gain in Wisconsin from the excise tax on aircraft. The NC Department of Revenue has a program in place with the FAA that helps to track new aircraft registrations. Owners are given the opportunity to identify how they acquired the aircraft and show proof of NC sales tax, or be credited for taxes paid to another state and pay the difference. This program would be a means to track down purchasers in North Carolina who attempt to avoid taxes by requesting delivery in a bordering state.

For aircraft used primarily in North Carolina, the use tax liability would still apply. However, the Department of Revenue data for annual gross use tax collections (which includes aircraft and boats) is relatively low. The average for the past four fiscal years is approximately $95,000. Therefore, no exact fiscal impact on sales tax revenues is available at this time.

Railway Cars and Locomotives: According to the Rail Division of the NC Department of Transportation, there are four types of railway users in the state. Class 1 companies are generally large, multistate organizations. The dominant Class 1 companies operating in North Carolina are CSX and Norfolk Southern. Both of these companies operate in approximately 22 states. Organizations of this size generally buy directly from the manufacturer and take delivery at the manufacturing location. There are no locomotive or rail car manufacturers in North Carolina. This means no North Carolina sales tax would be collected on the sale. If the locomotive or rail car was used primarily in North Carolina, these organizations would have a use tax liability equal to the sales tax, less a credit for any taxes paid. However, because these pieces of equipment are used in several states, North Carolina would be unlikely to collect that use tax revenue.

The second category of rail companies is holding companies that own several short lines. These companies generally have ten to twenty operations across the country. Again these organizations generally buy direct from the manufacturer and take delivery at the manufacturing location. Because there are no rail car producers in North Carolina, very little sales tax revenue would be derived from these sales. In these cases a corresponding use tax may apply. Collecting the use tax from these companies would generally be easier, as the equipment would be used primarily on a specific short line. However, neither Fiscal Research nor the Department of Transportation has information on how many rail cars may be sold to these holding companies. Therefore, no exact fiscal estimate is possible. However, the number of rail cars sold to these organizations is expected to be very small.

The third category of rail companies is what the Department terms “mom and pop” short line operators. These companies generally operate on only one short line in a heavy manufacturing area. These companies are generally not very profitable and tend to reply almost exclusively on used and rebuilt machinery. While no data is available on sales to these operators, the Department of Transportation (DOT) believes that very little machinery changes hands each year.

The fourth category of rail car and locomotive purchasers is the NC Department of Transportation Railway Division. Because these items are purchased by DOT, they are exempt from sales tax. This legislation would not change their tax status. Therefore, there is no fiscal impact from these types of purchasers.

Given the above information, it is clear that no exact fiscal estimate is available at this time. However, the data from DOT suggest the impact of this portion of the legislation on the sales tax is likely to be very small.

Boats: North Carolina had a total of 349,631 recreational boat registrations in 2000. This is down 1% from 1999, a trend that is not reflected nationwide (0.4% growth). Boat registrations in the state can be secured for one year or three years at a time. Every boat is required to maintain a current registration, thus this number cannot be used as an indicator of new or used boat purchases in the state. However, the number of new boat registrations is more meaningful. The NC Wildlife Association reports 43,779 new boat registrations for fiscal years 2000 and 2001 combined. NC Wildlife was able to exclude those boats purchased in another state but registered in NC (i.e. a person moves to NC with an existing boat and will not pay NC sales tax). Individual-to-individual sales and transfers of boats are not included as new registrations, because the registration number remains with the boat even when the boat ownership transfers. However, the number of new registrations also does not include those boats purchased but not registered in the state (i.e. a Florida resident who chose to purchase a boat and pay sales tax in NC). Thus, the number of new registrations does not wholly reflect the total number of applicable boat sales in North Carolina.

Fiscal Research then looked to industry providers for detail on NC boating statistics. Data are provided by Info-Link Technologies, Inc. and the National Marine Manufacturers Association (NMMA). Info-Link and NMMA report that 574,000 boats were sold in the US in 2000. North Carolina data reflect $265,942,000 in recreational boat purchases in 2000, which represents 18,500 new boat and 31,000 used boat sales. These figures are slightly less than the already-low NC Wildlife statistics showing an average of at least 21,890 new boat registrations a year for a total of $357,893,325. **For the purposes of this fiscal note, annual new boat sales of 22,800 are assumed.** This number is the average of the three years of data plus 10% to account for the sales not covered in the data.

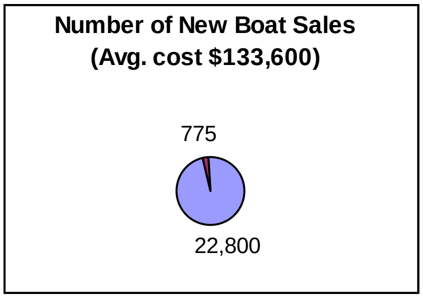
Used boat sales between individuals are more common than used boat sales at dealers, and sales tax will not be levied on a sale between one person and another. **For the purposes of this fiscal note, annual used boat sales of 12,400 are assumed.** This number is 40% of the total based on Department of Revenue used boat sales information.

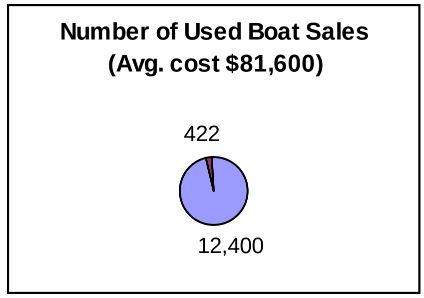
NC Wildlife reports that of these, approximately 3.4% fall above the current $1500 exemption (over $50,000 in value). Thus, 775 new boat and 422 used boat sales were above the maximum and are affected by this section of the bill.

Discrepancies in boat values also exist from different sources. NC Wildlife requests, but does not require, that citizens divulge boat purchase prices when applying for new boat registrations. Their data reflect that approximately 50% of the new boat registration applications give purchase price information. NC Wildlife estimates that of those 3.4% of boats above $50,000 where a purchase price is given, the mean value is $111,200.

Using the industry bluebook values (BUC values) to find the retail prices of these sample vessels, Fiscal Research estimated that the mean price for the 3.4% of new boats over $50,000 is approximately $156,000, which is 40% greater than the NC Wildlife estimate. For the purposes of this fiscal note, the average new boat sales price of $133,600 will be used.

The mean bluebook value price for the 3.4% of used boats over $50,000 is approximately $96,000. Similar to the new boat estimate, this fiscal note also reduces the value by 15% to give an average used boat sales price of $81,600. The two graphs below show the final figures and values used to calculate the sales tax under the proposed legislation.





Using these estimates, the total revenues realized from the sale of new boats would be $103 million ($133,600 x 775). Total revenues from the sale of used boats would be $34 million ($81,600 x 422.) The sales tax revenue generated from these sales at the 3% rate would be approximately $4.1 million. Subtracting out the $1500 per boat ($1.8 million), it can be estimated that the removal of the maximum would have generated an additional $2.3 million annually.

Applying the general sales tax rate (4.5% state and 2% local in fiscal year 2002-03 and 4% state and 2.5% local for each year thereafter), the total additional sales tax revenue from the removal of the maximum can be estimated at $6.5 million for fiscal year 2002-03 and $7.1 million for each year thereafter. This figure includes a lag time of one month's collections for the first fiscal year based on a July 1, 2002, implementation date. The chart below shows the breakdown in state and local government sales tax revenues.

Fiscal Year	2002-03	2003-04	2004-05	2005-06	2006-07
State	$4,045,633	$3,723,571	$3,723,571	$3,723,571	$3,723,571
Local	$2,529,437	$3,449,232	$3,449,232	$3,449,232	$3,449,232
Total	$6,575,070	$7,172,803	$7,172,803	$7,172,803	$7,172,803

This estimate assumes no industry growth; however, the instability of the industry in recent years and its responsiveness to changes in personal income should be taken into account. Thus, the revenue could actually vary from the projections.

The estimate will be reduced by 10% to account for cross border effects that may result from this bill. While it is not possible to predict the revenue loss due to this cross border effect, it is safe to assume that some purchasers will take delivery of boats in bordering states to take advantage of lower tax caps. The Department of Revenue program mentioned in the aircraft section above is also in place with the Wildlife Resource Commission and the Coast Guard. This program would be a means to track down purchasers in North Carolina who attempt to avoid taxes by requesting delivery in a bordering state. The actual fiscal impact could be higher or lower than a 10% reduction depending on consumer activity and the success rate of the tracking project.

SOURCES OF DATA: NC Department of Revenue, NC Wildlife Resource Commission, US Department of Transportation, FAA, Info-Link Technologies, Inc., National Marine Manufacturers Association

TECHNICAL CONSIDERATIONS: An implementation date post July 1, 2002, would result in lower revenue estimates for FY 2002-03 of approximately $1.4 million a month ($692,000 for the state and $695,000 for local governments). This could be higher depending on sales patterns for the summer and fall months.

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