NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 843 (First Edition)

SHORT TITLE: Sales Tax on Certain Electricity

SPONSOR(S): Senators Plyler, Purcell, and Hartsell

FISCAL IMPACT

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

($ Million)

	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06
REVENUES					
General Fund	($1.1)	($1.1)	($1.1)	($1.1)	($1.1)
EXPENDITURES					

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

EFFECTIVE DATE: This act becomes effective July 1, 2001, and applies to sales made on or after that date.

BILL SUMMARY: This bill exempts from the 2.83% state sales tax the electricity used in an electrolytic smelting process to manufacture aluminum.

BACKGROUND: The Secretary of Revenue issued a Directive on February 14, 2000 that ruled electricity is not "an ingredient or component part of the materials being produced by a manufacturer in the operation of an arc furnace or an induction furnace". The Secretary determined that electricity is a form of energy, not a form of matter or tangible property that the Legislature intended to exempt from tax. The Directive overruled previous private letter rulings from the Sales and Use Tax Division of the Department of Revenue that allowed a sales tax exemption for arc furnaces. Effective March 1, 2000, electricity used in arc furnaces once again became subject to the 2.83% sales tax (3% if not separately metered). The Directive clarified that electricity used in induction furnaces is not tax exempt. The state's only aluminum smelter began paying the 2.83% tax in March 2000.

ASSUMPTIONS AND METHODOLOGY: At the present time, this legislation will only provide a sales tax exemption for electricity used in the manufacturing of aluminum at Alcoa's Yadkin/Badin Works. The plant began paying sales tax on its manufacturing electricity in March 2000. The fiscal officer for this plant provided the Fiscal Research Division of the General Assembly with actual tax payments from September 1999 to February 2001. Operating 1.5 of its 2 production lines at 91% capacity and under a new energy contract that began in October 2000, the plant paid an average of $68,779 per month in sales taxes from October 2000 to February 2001. If the current production rate continues, it is expected that the plant will pay $825,357 in sales tax in a 12-month period. Of the sales taxes paid, $4,300 a month is for general plant energy such as plant lighting and auxiliary power to run cranes, furnaces, crushing equipment, etc. Twelve months of tax on general plant energy equals $51,600. By subtracting the general plant energy from the manufacturing energy leaves $773,757 in tax that would be exempt under this bill.

Oct 2000 tax	$ 72,301.04
Nov 2000 tax	$ 71,248.02
Dec 2000 tax	$ 67,648.04
Jan 2001 tax	$ 64,852.56
Feb 2001 tax	$ 67,849.32
Five months of tax payments	$ 343,898.98
Average monthly tax payment	$ 68,779.80
Annualized tax payment	$ 825,357.55
General plant energy use	$ 4,300.00
Annualized tax payment	$ 51,600.00
Manufacturing use only	$ 773,757.55

This fiscal note assumes that the plant will increase operations to utilize 100% of its capacity on the 1.5 lines it has open and will restart the mothballed .5 line at 100% capacity in FY 2001-02. The electrolytic process to make aluminum is done in "pots". The plant is currently running 171 pots that pay an average of $4,525 a year in sales taxes. The plant's fiscal officer states that 2 lines of operation can equal 244 pots. <u>Operating the plant at full capacity at current energy prices can produce state sales tax revenue equal to $1,104,100 per year. (244 pots X $4,525/year).</u> No growth is included in the five-year period of this fiscal note, because the Alcoa plant has a long-term electricity contract. An employee with Duke Energy Corporation said long-term contracts range from 5 to 15 years.

Note: Yadkin, a division of Alcoa Power Generating Inc., supplies much of the electricity used by Badin Works. Yadkin operates four reservoirs, dams, and powerhouses on the Yadkin River to supply hydroelectric power to the Badin Works. Rainfall and stream flow will affect the amount of hydroelectric power produced by Yadkin and thus the amount of electricity purchased by Badin Works from an outside source.

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