NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: S.B. 884 Medical Equipment Sales Tax

SHORT TITLE: Medical Equipment Sales Tax

SPONSOR(S): Senator Cooper

FISCAL IMPACT

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

	($ Millions) FY 1999-00	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04
REVENUES					
General Fund	**(0.45)**	**(0.64)**	**(0.68)**	**(0.73)**	**(0.79)**
Local Governments	**(0.23)**	**(0.32)**	**(0.34)**	**(0.37)**	**(0.39)**

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue, Sales Tax Division, and Local Governments.

EFFECTIVE DATE: October 1, 1999.

BILL SUMMARY: This legislation exempts durable medical equipment and medical sundries, that are eligible for coverage under Medicare or Medicaid, from state and local sales tax. The exemption only applies to items purchased on prescription or by a Certificate of Medical Need. While the item must be eligible under Medicare or Medicaid, it can be purchased by anyone with a prescription. Therefore, the bill exempts Medicare, Medicaid, and some private pay purchases of certain durable medical equipment and medical sundries.

BACKGROUND: Durable Medical Equipment (DME) includes a variety of medical items such as wheelchairs, IV bag holders, and cane stands. Medical sundries are easily and frequently disposed of items like latex gloves, gauze, medical tape, and syringes.

ASSUMPTIONS AND METHODOLOGY: Under current law most drugs and medical equipment items are exempt from sales tax, particularly if they are purchased under a prescription or with a Medicaid Certificate of Medical Need.

According to the Department of Revenue, there are currently 49 items that are covered by Medicare that are taxable under North Carolina law. For the most part, these items are monitors, syringes, urinals, IV poles and hangers, latex gloves, dressings, and other related supplies. The Department determined that these items are taxable because they are not designed to "correct or alleviate a physical aliment" (G.S. 105 – 164.13(12) exempts items that correct or alleviate a physical aliment from sales tax). The tax applies to all 49 DME and sundry items, regardless of the form or type of payment. Therefore, the tax should be applied to all private pay, Medicare, and Medicaid sales.

The Department of Health and Human Services was asked to determine their annual expenditure on each on these 49 items through the Medicaid program. In total, in FY 1997-98 North Carolina's Medicaid program spent $3.6 million on taxable durable medical equipment and sundries. According to the Federal Health Care Finance Administration, Medicaid covered 14.6% of the nation's health expenditures in 1997. Using the 14.6% as a proxy for the proportion of durable medical equipment and supplies covered by Medicaid in North Carolina suggests that approximately $24.7 million is spent annually on these taxable items. (3.6 is 14.6% of 24.7). Assuming the six- percent tax rate applies to these purchases, the 1997 revenue loss would have been $1.47 million.

According to the Federal Health Care Financing Administration's Office of the Actuary, national health spending is expected to grow at a rate of 6.5% annually through 2001. Between 2001 and 2007 national health expenditures are expected to grow at 7.5% per year. In all years the growth in private sector expenditures is expected to outpace public sector growth. (The provisions of the Federal Balanced Budget Act are expected to slow growth in the public sector).

Using the above estimated growth rates, the potential annual revenue losses are as follows:

(Millions)

1997	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**
(1.47)	(1.57)	(1.67)	(1.78)	(1.89)	(2.03)	(2.19)	(2.35)

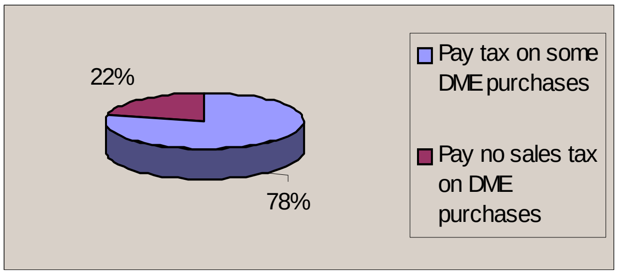
Once adjusted for the fiscal year basis, the state and local potential losses are as follows:

(Millions)

	1999-00	**2000-01**	**2001-02**	**2002-03**	**2003-04**
State	(1.15)	(1.22)	(1.31)	(1.41)	(1.51)
Local	(0.58)	(0.61)	(0.65)	(0.70)	(0.76)
Total	(1.73)	(1.84)	(1.96)	(2.11)	(2.27)

The above estimate assumes all taxpayers are paying the tax on durable medical equipment and supplies.

The Department of Revenue collects and enforces collection of this tax. Industry representatives believe many retailers are not paying the tax. These representatives suggest that many medical equipment and supply retailers may not realize they are liable for sales tax on these items. To determine what proportion of taxes are actually being paid the North Carolina Association of Medical Equipment Suppliers (NCAMES), in conjunction with the North Carolina Retail Merchants Association and Fiscal Research, conducted a survey of NCAMES 110 members. Fifty-eight merchants responded, creating a 52.7% response rate. The survey asked NCAMES members if they remit sales tax on durable medical equipment sales. Of these respondents, 78% (45 respondents) said they remit sales tax on at least some of their DME sales. Assuming all 78% remit all the appropriate tax, the 1999-00 total revenue loss would be $1.35 million ($0.90 state and $0.45 local).



Total Liability	$1.73 million
- 22% not paying	-0.38 million
Total Potential Revenue Loss	$1.35 million
State Loss	$0.90 million
Local Loss	$0.45 million

However, only a small number (12% and 18% respectively) reported remitting sales tax on DME sales through Medicaid or Medicare. Assuming one-half of DME purchases are through Medicaid or Medicare, and a 15% collection rate applies (the mid-point between 12% and 18%), the actual loss associated with these purchases would be approximately $101,000. The actual loss associated with non-Medicare or Medicaid purchases would be $675,000 (1/2 of the 78% loss). As a result, the total potential loss indicated from the survey is $776,00.

Medicaid/Medicare ($1.35 million X 50% of total X 15% collections)	$101,000
Non Medicaid/Medicare ($1.35 million X 50% of total X 100% collections)	$675,000
Total Potential Loss from Survey	$776,000

Because the majority of NCAMES members are small, independent retailers these numbers may not accurately reflect the losses associated with large chain stores with sophisticated computer systems. Fiscal Research assumes these larger groups are complying with the law. A fiscal loss estimate of $900,000 is used to include the impact of large chain stores. Of this amount, 2/3 or $600,000 is the state loss and $300,000 is the local loss. The estimate assumes sales tax revenue from this source would have grown by the 6.5% and 7.5% rate the Federal Health Care Financing Administration's Office of the Actuary set as the expected growth figures for medical expenditures (see above). The fiscal loss associated with the bill is as follows:

	1999-00	**2000-01**	**2001-02**	**2002-03**	**2003-04**
State	0.60	0.64	0.68	0.73	0.79
Local	0.30	0.32	0.34	0.37	0.39
Total	0.90	0.96	1.02	1.10	1.18

The actual amount in the fiscal estimate block reflects the adjustment for the October 1, 1999 effective date.

NOTE: According to the Federal Health Care Finance Administration, the reimbursement Medicare provides to businesses and individual subscribers includes state sales tax. As such, each Medicare reimbursement calculation should include the 6% sales tax. Because most Medicaid reimbursement rates are drawn from the Medicare charts, the 6% sales tax is included in many of those provider reimbursements. However, when the state develops its own reimbursement rate, sales tax is not included. Officials from the state employees' health plan also report that they pay the 6% sales tax, when it is charged to the provider.

TECHNICAL CONSIDERATIONS: While this reflects the potential cost at this time, it is important to note that items are frequently added and removed from the Medicare and Medicaid lists. As such, this estimate provides only a snapshot of potential revenue losses. They are likely to change over time.

FISCAL RESEARCH DIVISION 733-4910
PREPARED BY: Linda Struyk Millsaps

APPROVED BY: Tom Covington

DATE: Friday, April 23, 1999

Official Fiscal Research Division Publication

Signed Copy Located in the NCGA Principal Clerk's Offices