

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2005

Legislative Fiscal Note

BILL NUMBER: House Bill 443 (First Edition)

SHORT TITLE: Efficiency: School Board Sales Tax.

SPONSOR(S): Representative Pate

FISCAL IMPACT					
	Yes (X)	No ()	No Estimate Available ()		
	<u>FY 2005-06</u>	<u>FY 2006-07</u>	<u>FY 2007-08</u>	<u>FY 2008-09</u>	<u>FY 2009-10</u>
REVENUES					
General Fund					
Transition	(35.18)				
Interest Income	(2.69)	(2.85)	(3.02)	(3.20)	(3.39)
TOTAL	(37.87)	(2.85)	(3.02)	(3.20)	(3.39)
Local Governments	(20.66)				
Public Schools					
Transition	55.85				
Interest Income	2.69	2.85	3.02	3.20	3.39
EXPENDITURES					
Public Schools	(44.59)				
More at Four	3.80				
Smart Start	3.80				
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Public Instruction, Department of Revenue, Department of Health and Human Services, North Carolina Public Schools, North Carolina Cities and Counties.					
EFFECTIVE DATE: Section 1 becomes effective July 1, 2005 and applies to sales made on or after that date. Section 3 becomes effective July 1, 2005. The remainder becomes effective January 1, 2005.					

BILL SUMMARY: The legislation moves the school administrative units from a sales tax refund to a sales tax exemption. This shift affects both state and local sales taxes. The bill also outlines the process for certification for an exemption. The bill shifts back by one month the date by which a child must be five years old to enter kindergarten, effective this calendar year.

ASSUMPTIONS AND METHODOLOGY: The legislation creates six fiscal impacts, three related to the sales tax and three related to the change in the kindergarten date.

Sales Tax

In terms of the sales tax issues, the shift from a refund to an exemption would reduce interest income for the State and add to investment earnings of local units. This would be a recurring loss/gain. The shift is because refunds are paid the year after the purchase is made. A review of the refunds paid by month for a recent fiscal year indicates that the average refund to local units is paid in November of the fiscal year following the purchase. In analyzing the cost of the exemption, it was assumed that exempt purchases would be made at an even rate throughout the year. Thus, the “average purchase” is made around January 1. This means that a sales tax exemption, rather than a refund, would accelerate sales tax relief from November back to January, a period of 11 months. The assumed interest rate used for the calculation of the interest income loss to the State (and gain to local units) was 5.25%, based on a recent estimate by the Office of the State Treasurer for the 2001-02 fiscal year. This means that the effective interest loss is equal to 4.8125% (5.25% for 11 months) times the exemption amount.

The actual refunds paid to local schools in recent years are as follows:

Fiscal Year of Purchases	Total Refund Amount
1999-00	33,303,389
2000-01	43,623,309
2001-02	46,735,152
2002-03	48,076,155
2003-04	46,888,586

Analysis of school refund requests filed to date and conversations with school officials suggest that the amount of refunds will continue to rise by approximately 6.0%. Using this 6.0% rate as a proxy for future growth suggests the following refund request stream:

Fiscal Year of Purchases	Total Refund Amount
2004-05	49,701,901
2005-06	52,684,015
2006-07	55,845,056
2007-08	59,195,760
2008-09	62,747,505
2009-10	66,512,355

Because refunds for purchases made in each of fiscal years above are paid in the following fiscal year, the actual cost to the state of these refunds are borne in the next fiscal year. The resulting interest losses to the general fund, taking into account the effective date of the bill, are below.

Fiscal Year	Interest
2005-06	2,687,543
2006-07	2,848,796
2007-08	3,019,724
2008-09	3,200,907
2009-10	3,392,962

This amount is a loss to the state and a gain to school units.

The second sales tax related fiscal impact relates to the one time transition cost. Under the state constitution, the state general fund budget must be prepared on a cash basis. Refunds to local units are made in the year after the actual purchases. The combination of these factors mean that in the first year the exemption is granted the state has to pay both the refund and the exemption amounts (current year exemptions plus refunds for previous year purchases). Because the exemption becomes effective July 1, 2005, the transitional cost will occur in 2005-06. The actual cost is divided between the state and local governments.

Total	55,845,056
State	35,182,385
Local	20,662,671

Kindergarten Date

Moving up by one month the date by which children must have turned five years old in order to enter kindergarten for the 2005-06 school year will render newly ineligible those children whose birthdays fall between September 17 and October 16, 2005.¹ Based on birth rates and other historical data regarding kindergarten enrollment the NC Department of Public Instruction (DPI) predicts that approximately 9,290 children will be affected by the policy. The one-time cost savings to the State associated with this many fewer children attending kindergarten in 2005-06 is calculated using the following assumptions:

- Average State appropriation per pupil in kindergarten is \$5,000 (Source: DPI).
- Four percent of the affected children will in fact enroll in kindergarten under the auspices of the statutory provision for early entry for “gifted” and “mature” children.²
- The State will save money only in the first year the policy is implemented because that is the only year in which fewer children than expected will be eligible for kindergarten entry. The savings derives from serving only eleven months’ worth of children rather than the typical

¹ These children are eligible for kindergarten under current statute (G.S.115C-364).

² G.S. 115C-364(d)

twelve months' worth.³ In 2006-07 and subsequent years, a full twelve months' worth of children will once again be eligible each year.

The policy change will therefore produce a one-time reduction in expenditures from the State Public School Fund of \$44,592,000 (=9,290-371 students) X \$5,000).

More At Four

The More At Four program will be impacted by the change of the enrollment date for kindergarten. The number of students currently enrolled in the More At Four program, whose birthdays fall between September 17 and October 16, 2004, is 1,074 (7.7% of children served). This number is used as a proxy for the same cohort in 2005. The state program costs associated with serving these students for an additional year is \$3,500 per student on average. The total fiscal impact to the state-funded More At Four program is \$3.8 million for FY06.

The More At Four program pays approximately 50% of the cost of the classroom education for the at-risk four-year-olds with other entities (Smart Start, child care subsidies, and other) providing an approximate 50% match; therefore, there is an additional \$3.8 million impact on these other entities providing the required match.

The final impact relates to the childcare subsidy program including Smart Start resources. Because more children will likely remain in daycares that receive funding through the state child care subsidy program and/or Smart Start, there may be additional financial demands on that program and the waiting list for child care subsidy will likely increase. However, Fiscal Research cannot quantify the exact nature of that potential increase in demand. Therefore, no estimate is possible on this portion of the bill.

SOURCES OF DATA: NC Department of Revenue, NC Department of Public Instruction, North Carolina More At Four Program

TECHNICAL CONSIDERATIONS: Potentially the bill could result in the elimination of approximately 525 kindergarten teacher positions, for one year, assuming the state maintains the current ratios. However, the bill does not specifically address how this issue will be handled. Additionally, there may be some inconsistency between the school start date and the effective date of the legislation.

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³ Children who reach the age of five years from September 17-October 16, 2005 will be ineligible for kindergarten in 2005-06, but those who reached that age during that time period in 2004 are still eligible for entry in 2004-05 and are assumed to enter for that school year. The cohort of children entering in 2005-06 therefore have birthdays spread over only eleven rather than twelve months.