

# GENERAL ASSEMBLY OF NORTH CAROLINA



Session 2007

## Legislative Fiscal Note

**BILL NUMBER:** House Bill 257 (Second Edition)

**SHORT TITLE:** Streamlined Sales Tax Changes.

**SPONSOR(S):** Representative Hill

| <b>FISCAL IMPACT</b>  |                          |                                  |                          |                          |
|---|--------------------------|----------------------------------|--------------------------|--------------------------|
| <b>Yes (X)</b>  | <b>No ( )</b>            | <b>No Estimate Available ( )</b> |                          |                          |
| <b><u>FY 2007-08</u></b>  | <b><u>FY 2008-09</u></b> | <b><u>FY 2009-10</u></b>         | <b><u>FY 2010-11</u></b> | <b><u>FY 2011-12</u></b> |
| <b>REVENUES:</b> See Assumptions & Methodology                                  |                          |                                  |                          |                          |
| <b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> Department of Revenue |                          |                                  |                          |                          |
| <b>EFFECTIVE DATE:</b> October 1, 2007  |                          |                                  |                          |                          |

**BILL SUMMARY:** In order to comply with the latest amendments to the Streamlined Sales Tax Agreement, North Carolina must make two definitional changes by January 1, 2008. One change is to add a definition of “bundled transaction” and specify how these transactions are to be taxed. The other change is to modify the definition of “sales price” to clarify how third-party discounts, such as a manufacturer’s coupon, affect the sales price of an item. House Bill 257 incorporates those changes and makes several other changes in the sales tax laws, as recommended by the Department of Revenue. The bill:

- Defines “bundled transactions” and modifies the definition of “sales price” to keep North Carolina in compliance with the national Streamlined Sales Tax Agreement (SSTA).
- Changes the definition of “sales price” to conform with SSTA.
- Recognizes for-hire boats as commercial fishing operations eligible for the sales tax exemption for items sold for use in commercial fishing.
- Makes conforming and technical changes.

**ASSUMPTIONS AND METHODOLOGY:** House Bill 257 contains several provisions that may result in a fiscal impact.

### **Bundled Transactions (Sections 1, 2, 3, and 6)**

A “bundled transaction” is the sale of an exempt product and a taxable product for one price.

A bundle of tangible products is taxable on the sales price of the bundle unless it meets either the 50% test or the 10% test.

| <b>Section 2, Bundled Transactions: 50% Test and 10% Test</b> |  |                                     |  |   |
|---|--|-------------------------------------|--|---|
|   | State sales tax  |                                     | Local sales tax  |   |
| Type of Test  | <i>Percent of "bundle" price attributable to <u>exempt food or medical goods</u></i> | <i>Exempt from State sales tax?</i> | <i>Percent of "bundle" price attributable to food items</i>  | <i>Exempt from local sales tax?</i>           |
| 50% Test  | 50% or more  | Yes                                 | More than 10%  | No. Bundled item is taxable at 2% local rate. |
|   |  |                                     | Less than 10%  | Yes   |
|   | 50% or less  | No                                  | N/A  | No  |
| 10% Test  | <i>Percent of "bundle" price attributable to <u>taxable items</u></i>                | <i>Exempt from State sales tax?</i> | <i>Bundles that include services would be subject to the 10% rule and can be subject to tax based on the <u>allocated price</u> of the taxable services in the bundle.<sup>1</sup></i> |   |
|   | 10% or less  | Yes                                 |  |   |
|   | 10% or more  | No                                  |  |   |

Under current law, the sales price of a bundle of tangible products is taxable. Thus, if any item in the bundle is taxable, the entire bundle is taxable. Since this change creates a threshold for exemption, this change may result in a small, negative fiscal impact. Discussions with the Department of Revenue suggest that any impact from this change will be insignificant.

### **Sales Price (Section 1)**

The definition of "sales price" adopted by the SSTA Governing Board is very similar to that in current North Carolina tax law. A small positive fiscal impact is possible from cigarette retailers who reflect a distributor's "buy-down" discount on their invoices. If the discount is shown on the invoice, it is included in the sales price. However, if the discount is not shown separate from the sales price, it is part of the sales price. Due to this technicality, a small increase in revenues may result from the actions of retailers who reflect distributor discounts on their invoices, but it is likely that this practice will become less common over time as retailers realize its tax implications.

### **Other Changes (Sections 1, 4, and 5)**

The remaining changes in this bill are technical and clarifying in nature, and are not expected to result in any significant fiscal impact.

**SOURCES OF DATA:** Department of Revenue

**TECHNICAL CONSIDERATIONS:** None

<sup>1</sup> To be taxed based on part of the sales price, the retailer's accounting records must allocate revenue to the services in the bundle and provide a basis for determining the proportion of the bundle's price that is attributable to each service in the bundle. If the records do not provide for this, the sales price of the bundle is taxable, assuming the taxable services exceed the de minimus threshold.

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